July 1959

Article 8: Investment Securities

Edwin W. Briggs
Professor of Law, Montana State University School of Law

Follow this and additional works at: https://scholarship.law.umt.edu/mlr
Part of the Law Commons

Recommended Citation
Available at: https://scholarship.law.umt.edu/mlr/vol21/iss1/8

This Article is brought to you for free and open access by The Scholarly Forum @ Montana Law. It has been accepted for inclusion in Montana Law Review by an authorized editor of The Scholarly Forum @ Montana Law.
Many years ago a famous legal scholar assured us that "at the present as well as at any other time, the center of gravity of legal development lies not in legislation, nor in juristic science, nor in judicial decision, but in society itself. This sentence, perhaps, contains the substance of every attempt to state the fundamental principles of the sociology of law." Moreover, he insisted that "the statement that the whole law is not contained in the legal propositions [i.e., law propounded by courts and legislatures] applies to a much greater degree to the law that is in force today than to the law of the past." Perhaps no piece of massive legislative drafting more persuasively testifies to the increasing recognition of these facts asserted by Ehrlich, than does the monumental draft Code known popularly as the Uniform Commercial Code. And among its nine articles, dealing with a great variety of commercial subjects, possibly article 8, entitled "Investment Securities," illustrates more dramatically than any of the others the propositions he asserts.

As numerous writers have stated, article 8 is neither a blue-sky law, nor a corporation code, so it does not purport to replace either the statutes regulating the creation, management, and operation of corporations, nor

*Among article 8's many points of interest two are particularly significant, both because of the understanding of the Code which their recognition helps to give and because of their larger implications when considered as part of the doctrine of the modern "science of law." One point involves a recognition of the extent to which this Code has been adapted to already existing commercial practices, which the accompanying modification of general or traditional legal doctrine, which it was found necessary to make in order to achieve that correspondence between "practice" and "theory." The second point of special interest and significance is found in the very considerable modification of "orthodox doctrines" regulating negotiability when applied to the broad field of "investment securities." These two factors are the components of what is often called a "functional treatment" rather than a "conceptual" one. The following analysis is made so as to "point up" these two important factors, in the belief that such analysis is most likely to provide the greatest amount of real understanding of its more enduring implications.

**Professor of Law, Montana State University. B.S. 1927, Oklahoma A. & M. College; LL.B. 1932, University of Oklahoma; LL.M. 1935, Harvard University.

'Foreword to EHRlich, FUNDAMENTAL PRINCIPLES OF THE SOCIOLOGY OF LAW at 34 (Moll Transl. 1936). Two very fine studies based on an institutional analysis, and recognizing the discrepancy between the proper "rules for the inner order" of those institutions and the "legal propositions" offered by traditional doctrine, are found in the following two articles: Douglas and Bates, Stock "Brokers" as Agents and Dealers, 45 YALE L.J. 46 (1933) ; and Taylor, Trading in Commodity Futures—A New Standard of Legality?, 43 YALE L.J. 63 (1933).

"Id. at 487.

'Adapted to the legislative process, Ehrlich's propositions may be currently stated as follows: Legislatures must do the best job possible of recognizing and giving formal expression in statutory law to desirable business practices which have grown up in spite of outmoded legal doctrines and rules, on the one hand, and of modifying other existing rules insofar as they make impossible the development of desirable business practices and the recognition of important social interests.

'See e.g., UNIFORM COMMERCIAL CODE § 8-101, comment (hereinafter cited UCC); CONNECTICUT TEMPORARY COMMISSION, STUDY AND REPORT UPON THE UNIFORM COMMERCIAL CODE 44 (1959) (hereinafter cited CONN. TEMP. COMM., STUDY AND REPORT).
those regulating the issuing of securities. Rather, it focuses its attention on the share certificate itself, as a "chattel" or commodity bought and sold on the open market, in response to a long felt need in the commercial and investment world to give as full effect as possible to the economic fact that a very large part of our wealth today is represented in corporate securities. The operation and practices of the modern exchange and investment markets where these instruments are bought and sold make it almost imperative that these securities be treated as nearly completely negotiable as is possible, in spite of the fact that the special character of economic wealth which they represent has seemed to make the ideal of complete negotiability difficult, if not impossible.

Another badly needed change in the law regulating investment securities concerns the independent though closely related process of registering transfers of ownership, and the duties imposed upon the issuer to guard against "wrongful transfers." The liabilities imposed on the issuer for registering such transfers have become so onerous, that a resultant practice of demanding a mass of documentation supporting the regularity of the transfer has created a serious "clog" in the operations of the entire securities market.

Hence, the two major subjects dealt with in article 8 are: 1. Negotiability—making such instruments fully negotiable to protect good faith purchasers for value thereof; and 2. Registration of title transfer—lessening the prime responsibility of the issuer or its agent for checking against "fraudulent transfers" and simplifying the procedures for satisfying the responsibilities which it continues to have.

The draft of the Code analyzed below is that contained in the 1958 Official Text, which includes both the very extensive revisions of the original 1952 draft made in 1957,' and the further substantial revisions of portions of parts 3 and 4 of article 8, approved in 1958. Almost certainly article 8 was more extensively revised as a result of the intensive studies and hearings carried on by the Law Revision Commission of the State of New York in 1954, 1955, and 1956, than any other article in the Code. Without question, these revisions greatly improved the quality of that article.

General Arrangement

Article 8 is composed of four parts. Part 1 deals with certain general and preliminary matters, and is entitled "Short Title and General Matters." Part 2 is concerned with the status of the "issuer" of investment securities, the issuing process, including restrictions and limitations, and the relationship of the issuer to the various persons who may acquire rights in an "issue." So its subject is "Issue—Issuer." Part 3 is entitled "Purchase" and implements the prime object of article 8 by attributing full negotiability to "investment securities" as defined therein and by setting

5The 1957 official text, approved in that year by the American Law Institute and the National Conference of Commissioners on Uniform State Laws, was based on the 1956 recommendations made by the editorial board for the Uniform Commercial Code. Article 8 was approved as recommended, with little if any further changes.

6The 1958 changes were first presented in U.L.A., 1958 SUPPLEMENT TO UNIFORM COMMERCIAL CODE (1958).
forth the various specialized rules necessary to achieve such "negotiability" in instruments of this particular character. Dealing with the subject of "registration" of such securities, part 4 seeks to simplify and expedite the procedure for registering the transfer of property interests in investment securities in registered form by lessening substantially the responsibility of the "issuer" to determine either the "rightfulness" or the "legality" of such transfer. To the extent that it succeeds, it not only serves a critically felt need in the securities market concerning the transfer process, but it promotes tremendously the object of vesting investment securities with effective negotiability, with the commercial advantages supposed to accrue therefrom.

PART I

Definitions for the purposes of article 8 are set forth in section 8-101. One of the first substantial modifications of traditional thinking and existing law found in this article is in the strictly "functional" (rather than conceptual) definition given to the term "investment securities." The term is defined to include all forms of "investment paper" in bearer or registered form commonly dealt with upon security exchanges, or commonly recognized as a medium of investment in any area, in which the security is issued or dealt with." As thus defined, investment securities include bearer bonds, a form of debt formerly coming under the Uniform Negotiable Instruments Law, as well as the various types of investment paper issued by corporations evidencing "ownership," but they do not include "money."

Unlike ordinary commercial paper, investment securities may be issued subject to liens running in favor of the issuer where they represent a property interest in a corporation rather than a debt. This poses something of a problem at the outset when attributing "negotiability" to such securities. Such liens often arise from the corporation-stockholder relationship, by way of additional security in favor of the corporation for a stockholder obligation. The Uniform Stock Transfer Act dealt in a single section both with these liens and with restrictions imposed by the "issuer" on the free transfer of corporate shares. It provided that neither should be valid against a purchaser "unless the right of such corporation to such lien or the restriction is stated upon the certificate." However, article 8 deals with the two kinds of "limitations" in separate sections, apparently stating slightly different rules. Part 1 provides that an issuer's lien should be valid against a purchaser only if it be noted conspicuously on the security. The italicized

A series of uniform and model acts dealing with this general subject have been approved from time to time, but with indifferent success. They will be discussed at notes 124 to 129 and the applicable text infra.

"UCC § 8-102(1)(a). Some instruments, defined as "securities" under other regulatory legislation, may not meet this definition. See UCC § 8-102, comment.

"UCC § 8-102, comment.

"Uniform Stock Transfer Act § 15 provides in the section title: "There shall be no lien or restriction unless indicated on certificate." (Hereinafter Uniform Stock Transfer Act is cited U.S.T.A.) Compare Revised Codes of Montana, 1947, § 15-642. (Hereinafter Revised Codes of Montana are cited R.C.M.)

word was substituted for "set forth" in the original approved draft, to make clear that the lien does not have to be set forth in full.\textsuperscript{12}

Part 1 also contains the one provision in all of article 8 giving to the rules proscribing abuse of the corporate device a clear and controlling precedence over the interest of the money market in the principle of "negotiability." Here the doctrine that stock issued in excess of the corporation's authorized capitalization is void, is adhered to.\textsuperscript{13} The provisions of the article validating or requiring the issue or reissue of a security are expressly limited so that they do not apply to any issue which would result in an "overissue."\textsuperscript{14} However, if the corporation otherwise would have a duty to issue or reissue such share certificate, the person entitled thereto can compel the corporation to supply the share from the open market "if reasonably available."\textsuperscript{15} Otherwise the corporation must pay damages measured by the price "he or the last purchaser for value paid for it with interest from the date of demand."\textsuperscript{16} A considerable difference of opinion has developed in the various discussions of this section as to what is the most satisfactory measure of damages in such contingency.\textsuperscript{17} Granting that the rule adopted may prejudice the purchaser in some situations, its framers insist that the rule is the most satisfactory one to govern all cases.\textsuperscript{18}

Part 1 also states expressly a rule of "full negotiability" for all securities covered.\textsuperscript{19} It further states certain rules of evidence involving controlling presumptions and burdens of proof in actions on securities, to aid in maintaining the integrity of the negotiability principle. This is done in much the same language as is found set forth in article 3,\textsuperscript{20} regulating other types of negotiable instruments.\textsuperscript{21}

The concluding section in part 1 deals with conflict of laws problems which may arise in applying this Code to the investment securities field.\textsuperscript{22} However, it must be considered with the general section in the Code stating "choice of law" rules for the Code generally.\textsuperscript{23} With certain exceptions, article 1 authorizes the parties to agree on the governing law, chosen from any state bearing a reasonable relation to the transaction.\textsuperscript{24} Failing such agreement, any forum enacting this Code and having "an appropriate rela-

\textsuperscript{12}See comment concerning restraints on alienation in the text at notes 45 and 46 infra.

\textsuperscript{13}UCC § 8-104.

\textsuperscript{14}There was some support for the view that "overissue" should not be a defense against a person otherwise entitled to a security, but that, rather, the issuer should be compelled to amend its articles therefor. But this view did not prevail. See UCC § 8-104, comment 1; Bunn, Article 8—A Law for the Transfer of Investment Securities, 1952 Wis. L. Rev. 338, 343.

\textsuperscript{15}UCC § 8-104(1) (a).

\textsuperscript{16}UCC § 8-104(1) (b).

\textsuperscript{17}2 NEW YORK LAW REVISION COMMISSION, REPORT AND HEARINGS ON THE UNIFORM COMMERCIAL CODE 829, 883, 951 (1964). (Hereinafter cited NYLRC, UCC REPORT.) See also UCC § 8-104, comment 3.

\textsuperscript{18}UCC § 8-104, comment 3.

\textsuperscript{19}UCC § 8-105(1).

\textsuperscript{20}UCC § 3-307.

\textsuperscript{21}The language is modified only to take into account certain intrinsic differences between "investment securities" and other types of negotiable paper.

\textsuperscript{22}UCC § 8-106.

\textsuperscript{23}UCC § 1-106.

\textsuperscript{24}UCC § 1-105(1).
tion” to the transaction will apply the provisions of the Code. However, this same section refers to five articles including article 8 containing provisions specifying the “applicable law” for each article, recognizes them as controlling for each respective article, and states that any contrary agreement will be effective “only to the extent permitted by the law (including the conflict of laws rules) so specified.” The relevant section for article 8 selects the “law (including the conflict of laws rules) of the jurisdiction of organization of the issuer” to determine “the validity of a security and the rights and duties of the issuer with respect to registration of transfer,” though general contract rights arising from a contract for the sale of securities still appear to be governed by the rule governing commercial contracts generally, under article 1. Although this is not the place to explain in detail the implications of this formulation of the conflicts rule, it reflects a principle which the present writer has been expounding for quite some years now, i.e., that the most satisfactory solution for some conflicts questions, in some fields and for some issues, is to select some one law as controlling the question, wherever general agreement thereon is possible, and then to apply the whole of that law, including its applicable “choice-of-law” rule.

PART 2 — ISSUE-ISSUER

For the “principle of negotiability” better to serve modern investment practices there is a need for growth, flexibility, and adaptability in that concept, as becomes strikingly apparent in the next three parts. Although the Uniform Stock Transfer Act sought to give to “subsequent purchasers” of stock the protection afforded by “negotiability,” as against prior holders, it did not attempt to modify the rights and duties existing between the

---

2Ibid. Comment 3 to this section recognizes that the phrase “appropriate relation” may broaden the forum’s “choice of law” rule considerably, leading the forum to apply its UCC, though it would not so apply its own law in other types of transactions, justifying its application on the grounds of its “comprehensiveness,” desire for uniformity, and the fact that it is a reformulation of the “law merchant” and of business community practices transcending political boundaries.

2UCC § 1-105(2).
2UCC § 8-106.
2Ibid. But see discussion at notes 182 to 188 infra.
2UCC § 1-105(1).
3This is consistent with what we may call an “organic-institutional approach.” See Briggs, The Jurisdictional—Choice-of-law Relation in Conflicts Rules, 61 Harv. L. Rev. 1165 (1948); Briggs, The Utility of the Jurisdictional Principle in a Policy Centered Conflict of Laws, 6 Vand. L. Rev. 667 (1953); Briggs, The Need for the “Legislative Jurisdictional Principle” in a Policy Centered Conflict of Laws, published concurrently in 30 Minn. L. Rev. 517 (1955) and 4 Int'l. & Comparative L.Q. 329 (1955); Briggs, Excerpts from Utility for Solving the “Remot,” SELECTED READINGS ON CONFLICT OF LAWS 189 (1956). The following statement made in 1953 is especially relevant to the present issue: “The domicil’s governmental interest in the permanent corporate-stockholder relation, in maintaining the power to regulate and supervise and limit those rights, with a general recognition that these legal relations must generally be determined by a single law, makes it almost as natural to state a jurisdictional rule looking to the corporate domicil, as it is to look to the situs to control land. The shape of the future points to more governmental regulation of these matters rather than less, calling for a delimitation of legislative power thereover to minimize conflict. So if that domicil chose to utilize the law of a third state to determine these rights, certainly it should be included in any reference from F, foreign court, to the domiciliary law.” Briggs, 6 Vand. L. Rev. supra, at 883.
issuing corporation and the transferee of its stock, measured by constitutional and statutory regulations governing stock issues, even though its editorial comment states that that act extends full negotiability to certificates of stock. Article 8 deals with both questions. As suggested by its title, "Issue—Issuer," part 2 tries to give effect to the special character of corporate shares and bonds at the same time that it frames rules of negotiability between the issuer and all subsequent holders of its stock. "Issuer" is described generally as any legal person who sells shares in his property or enterprise or acknowledges a duty to perform an obligation, represented and evidenced by an appropriate security, and includes any guarantor on such instrument to the extent of his obligation. As between the issuer and all "purchasers" (which includes the original "subscriber" to the security), part 2 narrows the concept of "negotiability" in one important respect, and broadens it in another.

On the one hand, recognizing the common practice of "incorporating" in securities by reference relevant statutory, charter, and bylaw provisions, it narrows the protection which negotiability gives to even a purchaser for value and without notice by charging him with notice of those provisions to the extent that such "terms" do not conflict with the stated terms of the security. However, part 2 does not subject such purchaser, even with notice, to defects affecting "validity." Compliance with the law limiting issue is the primary responsibility of the issuer. A purchaser for value without notice of the particular defect, even though it goes to validity, is protected if the issue is not unconstitutional. The defenses of a private issuer are narrower than those of a government issuer. To be enforceable against the latter, an issue must substantially comply with legal requirements or the issuer must have received value, and a purpose of the issue must be one for which the issuer can legally borrow. Generally, lack of genuineness of a security is a complete defense for the alleged issuer. Other issuer's defenses generally are ineffective against a purchaser for value without notice of the particular defense.

On the other hand negotiability is broadened by the rule that the fact that the security has "matured," in the sense of being either "collectible" or "salable" or "exchangeable" to the issuer, does not prevent the holder from being a "bona fide purchaser," as defined by the act. Some types

---

U.S.T.A. § 5, editorial comment.
UCC § 8-201 (1).
UCC § 8-201 (2).
UCC § 1-201 (32) defines "purchase" to include "taking by issue," and UCC § 1-201 (33) defines "purchaser" to include any person taking by "purchase."
UCC § 8-202 (1).
Ibid.
UCC § 8-202 (2) (a). Although this section expressly makes even an unconstitutional issue valid in the hands of a subsequent purchaser for value and without notice, comment 3, thereto, makes it clear that the rights of the original purchaser under an unconstitutional issue are left to the law of the particular state. Further, as against the "issuer," to be charged with notice a purchaser must have notice of the particular defect involved, not merely notice of "adverse claims generally," the rule which controls between different purchasers. This broadens the protection against the issuer given by "negotiability." See note 68 infra and the applicable text.
UCC § 8-202 (2) (b).
UCC § 8-202 (3).
UCC § 8-202 (4).
UCC § 8-302.
of securities continue to be negotiable against the issuer for one year after "maturity" while others retain that quality for two years." Of course, this varies much from the effect of such "maturity" on ordinary commercial paper. This is in recognition of the fact that the latter normally will be "enforced" if not paid when "due," while the many kinds of securities with "maturity provisions" in them, whether bonds or some form of stock, continue to be dealt in for a considerable period thereafter. Effect is thus given to the demands of the market.

Another characteristic of securities not present in other negotiable paper is that in modern times, at least, the issuer frequently wishes to impose some limitations on the transfer thereof. Free assignability has been considered as essential to the principle of "negotiability." The Code resolves this apparent conflict by providing that "unless noted conspicuously on the security a restriction on transfer imposed by the issuer even though otherwise lawful is ineffective except against a person with actual knowledge of it." But this exception recognizes and states the prevailing interpretation of section 15 of the Uniform Stock Transfer Act, that it did not protect "purchasers with notice." However, as observed earlier in dealing separately with "liens," part 1 of this article does not contain this exception. Though editorial comment does not help here, the long history of careful consideration given to the drafting of these sections may support the conclusion that the variation was intentional.

The sections in part 2 providing that even unauthorized signatures placed on securities by certain classes of persons entrusted by the issuer with the securities and with authority to sign or prepare them for signing preliminary to their issue, will create an enforceable instrument in the hands of a bona fide purchaser, and that, if an incomplete security is wrongly altered, it is enforceable according to its original terms, do not vary markedly from corresponding sections governing commercial paper. Though the basis for liability of the maker is stated primarily in terms of negligence under the latter sections, and in terms of "inherent authority of an agent" under the former, the scope of the rights of a good faith holder seem to be substantially the same under each, and the comments expressly state that both are framed on the idea that the issuer or maker should stand the primary loss, both because he is in the best position to guard against

-UCC § 8-203(1)(a) and (b). Comment 1 notes that the effect of "maturity" is stated in terms of "issuer’s defenses," rather than "negotiability." The fact is that one can be a "good faith purchaser" of "matured" investment securities, while he cannot be a "holder in due course" of matured "commercial paper" under either the Uniform Negotiable Instruments Law or article 3 of the Code.

-UCC § 8-204.

-Supra note 11.

-See text at notes 10, 11, and 12 supra.

-2 NYLRC, UCC REPORT 862, 864, 974 (1954). Since the question of whether actual notice should so charge was discussed at length by various groups studying this Code, and since that proviso was added to UCC § 8-204, but not to § 8-103, presumably the distinction was intentional, but query whether justified.

-UCC § 8-205(a) and (b).

-UCC § 8-206(2). UCC § 8-206(1) also provides that the blanks in a security containing the necessary endorsements may be filled in by anyone, and enforced as completed by a good faith purchaser.

-UCC §§ 3-403 to 406.
such wrong-doing, in the first place, and also to protect himself by bonding his employees and agents.\textsuperscript{a}

To make clear, however, that the "negotiability" concept has not run so rampant as to overturn all traditional corporate law regulating the relation of issuer and shareholder, part 2 preserves the traditional right of the issuer to treat the record owner of shares as the person entitled to exercise those rights and powers normally incident to ownership, such as receiving notice and participating in meetings, voting, and receiving dividends.\textsuperscript{a} Likewise the issuer can charge the owner with all the duties incident to ownership until formal demand for registering a transfer is made.\textsuperscript{a} Continuing the change made by the Uniform Stock Transfer Act,\textsuperscript{a} registration becomes similar to the recording of a deed under a registry system, and is not essential to the completing of title transfer as it was at common law. The corporation's right to look only to the record owner is required both by business necessity and by custom and usage.\textsuperscript{a}

The concluding section in part 2 states the scope of the warranties given by a person "authenticating security" to a bona fide purchaser as limited to the following: 1. the security is genuine and in proper form; 2. he acts with capacity and authority; and 3. he reasonably believes it is within the authorized capitalization of the issuer.\textsuperscript{a} He does not warrant validity of the issue unless specially agreed.\textsuperscript{a} It is believed that this section states the current understanding of the prevailing case law as to the effect of such signature.\textsuperscript{a}

\textbf{PART 3 — PURCHASE}

Understandably, we find part 3 on "Purchase" containing the bulk of those rules implementing the principle of "negotiability." Although a comment to the original Uniform Stock Transfer Act declares that "this section [5] gives full negotiability to certificates of stock," it has since been realized that it is not at all accurate to talk about full negotiability so long as the defenses traditionally existing in favor of the issuer, and arising out of the various "irregularities" in the issuing process, continue to operate with full force against all holders. Consequently, the comment to part 3 states:\textsuperscript{a} "This Article views the concept of negotiability from two aspects: issuer's defenses and adverse claims. . . ." (i.e., claims of third persons as "purchasers").

Although the traditional law of corporations regulating the transfer of stock ownership always has been influenced by the idea that "record title" as shown by the corporation's "stock books" should control and limit ownership, that idea has been progressively modified over the years in the direc-

\textsuperscript{a}UCC § 8-205, comment 1.
\textsuperscript{a}UCC § 8-207(1).
\textsuperscript{a}UCC § 8-207(2).
\textsuperscript{a}U.S.T.A. § 3.
\textsuperscript{a}It is important to note that the language of UCC § 8-207(1) is permissive only, saying that "the issuer may treat the registered owner as the person exclusively entitled to vote. . . ." (emphasis added), permitting the issuer to recognize the right of transfer before "presentment"; however, informal notice of transfer is not enough to impose a duty. See also UCC § 8-207, comments 2 and 3.
\textsuperscript{a}UCC § 8-208(1).
\textsuperscript{a}UCC § 8-208(2).
\textsuperscript{a}UCC § 8-208, comment 1.
\textsuperscript{a}UCC § 8-301, comment 1.
tion of looking to the delivery of a properly assigned or indorsed certificate, as controlling the transfer of "title" thereto. Gradually it was realized that although the corporation must be permitted to rely on its own records to determine whom it should treat as owner, this principle need not limit title transfer. Earlier statutes went far in this direction, and the Uniform Stock Transfer Act adopted it without qualification. Article 8 reaffirms the principle, applied to corporate stock, and extends it to all "investment securities." So, on delivery of the certificate, the "purchaser" acquires all the rights which his transferor had authority to convey. This is true even though the certificate lacks a necessary indorsement, because the purchaser can compel such indorsement. However, he is a bona fide purchaser only from the time of indorsement, because such holder is defined as a "purchaser for value in good faith without notice of any adverse claim who takes delivery of a security in bearer form or of one in registered form issued to him or indorsed to him or in blank." (Emphasis added.) As such, he acquires the security free of all adverse claims. Conversely, indorsement, whether special or in blank, does not effect a transfer until delivery, which means delivery of both documents if the "assignment" is on a separate document.

At this point, it may be well to note that to preserve the principle of "negotiability," as against the issuer, the "purchaser" does not have to be a strict bona fide purchaser; it is only necessary that he take for value without notice of the particular defect claimed, while to be free of all adverse claims by third persons, he must not have had notice of any adverse claim. However the issuer has a defense against all parties, when the defect is that the shares are part of an excess issue.

Although on most issues of notice it is for the trier of fact to determine such notice, part 3 stipulates that either a special indorsement on a bearer or registered instrument, or a clear statement of ownership in a third person on the face of a bearer instrument, is notice by operation of law. But the mere fact that an instrument is held by a fiduciary, or for a third person, is not notice of an adverse claim, though if the purchaser knows that the fiduciary is applying proceeds to his own use, he is chargeable with such notice.

The original draft of the Code provided that any purchaser of a certificate within six months after he had received notice that it was lost or stolen was charged with notice of adverse claim by operation of law. Criticism made in the hearings before the New York Law Revision Com-

See R.C.M. 1947, § 15-504(2), making the stockholder record conclusive of ownership rights, and also R.C.M. 1947, § 15-603, making a transfer of a certificate conclusive against subsequent purchasers and creditors, though recognizing the issuer's right to look only to the record owner as the true owner.

U.S.T.A. §§ 3 and 5.

U.C.C. §§ 8-301(1).


Ibid.

U.C.C. § 8-302.

U.C.C. § 8-301(2).

U.C.C. § 8-309.

Compare U.C.C. §§ 8-202(2), (4), -206(1)(b), -208(1), requiring notice of the particular "defect" as against the issuer, with U.C.C. § 8-302, defining "bona fide purchaser."

U.C.C. § 8-304(1).

U.C.C. § 8-304(2).
mission was that this limitation would impose too great a burden on banking and brokerage houses just because of the great volume of shares involved. The restriction was omitted in the 1957 revision, thus converting into an ordinary fact issue for the jury the question whether it is a "notice" forgotten in good faith. If so, it will not be effective notice.  

A closely related question on "notice" is the effect "staleness" or "maturity" has on the relative rights of different purchasers. The section dealing with that subject, already discussed, stated a special rule with regard to notice of defenses as between a purchaser and the issuer. The problem still has to be resolved as between different purchasers, and is dealt with in part 3. The "maturity" of the security does not automatically serve as notice of adverse claims between different purchasers any more than it does of defects giving defenses between the issuer and a purchaser. However, the "allowable" periods for dealing in securities after "maturity" are shorter, between different purchasers, than between issuer and purchaser. For the latter it will be recalled that the periods are one year, if the maturing event calls for the payment of money which is available, and two years otherwise. For different purchasers part 3 sets a six month and a one year period for the two classes respectively. The editorial reason given for this difference is that "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 his security rather than transfer it at such a time." The same comment also observes that "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."  

With registered securities traditionally treated as simple contracts, they naturally were transferred by the same kind of formal assignments as other "chooses-in action," and a formal assignment form commonly appears on the back of stock certificates. However, these methods of transfer are inapt for negotiable instruments. So, with its attempt to make corporate stock generally negotiable, the Uniform Stock Transfer Act simplified the indorsement required for transfer, utilizing the various kinds of "indorsements" regularly associated with the principle of "negotiability." That "simplified method" is preserved in this Code. So the simple signature of an "appropriate" person on the back of the instrument will suffice as an indorsement. Such indorsement may be either "special" or in blank.

72 NYLRC, UCC REPORT 831, 869, 925, 936 (1954).  
73 Compare UCC § 8-301(1) in the 1952 draft of the UCC with that in the 1958 official text.  
74 UCC § 8-202.  
75 UCC § 8-203(1) (a), (b).  
76 UCC § 8-305. Comment 1 provides if payment is in default, the six months period is not applicable.  
77 UCC § 8-305, comment 1.  
78 Ibid. It is well to remember that "defaulted" securities may be traded indefinitely on the open market, so long as funds for repayment are not available. The rules regarding staleness clearly are trying to make formal law correspond to the "needs of the inner order," in Ehrlich's phrase.  
80 UCC § 8-308.  
81 UCC § 8-308(1).  
82 UCC § 8-308(2).
and although not specified in the general section on indorsements, apparently also restrictive, as "for collection" or "for surrender." The traditional assignment form still may be useful therefor, because when properly filled in to a named person, either as an assignment or as a power of attorney, it will serve as a "special indorsement." Of course, any of various persons, in addition to the registered owner, may be an "appropriate person" to indorse. These include all classes of fiduciaries with such "power," such as agents, trustees, administrators, guardians, survivors of joint owners, or those possessing special statutory powers. Consistently with the principle that transfers require two distinct steps, i.e., indorsement and delivery, the question whether the indorser is an "appropriate person" is determined as of the time of the indorsement, so his subsequent "incapacity" does not effect the indorsement.

Although a bearer instrument needs no indorsement, it may be indorsed restrictively, which, as noted above, may serve as "notice of adverse claims." Another rather important respect in which the incidents arising from the negotiability of "investment securities" differ from those of the negotiability of "commercial paper" under article 3 of the Code, is that "an indorsement purporting to be only of part of a security representing units intended by the issuer to be separately transferable is effective to the extent of the indorsement," while partial transfer of an instrument defined as commercial paper under article 3 is not possible—though apparently it may operate as a "partial assignment."

Two of the more important changes in the law regulating the character of "investment securities" involve the question of what "warranties" a transferor thereof gives and, secondly, the exact status the various parties participating in transactions in the securities markets have to each other and to the subject matter of the transaction. As to the first question, the framers of article 8 decided that because of the special character of investment securities, the social limitations regulating the issue of many securities contrasted with "commercial paper," and the differing purposes creating the demand for them in the investment markets, the liabilities of transferees of securities must be substantially more limited than those of transferees of "commercial paper" generally. So, although under article 3 an indorser of commercial paper warrants both to his transferee and subsequent holders in good faith that "no defense of any party [which includes the maker or drawer] is good against him" (emphasis added), an indorser of an investment security assumes no obligation that the security will be honored by the issuer "unless otherwise agreed." As provided in article 1 of the Code, the parties may alter the rights normally existing

---

\(^{a}\)UCC § 8-304(1) (a).
\(^{b}\)UCC § 8-308, comment 2.
\(^{c}\)UCC § 8-308(3). The definition of an "appropriate person," given here, also is controlling in UCC § 8-312, concerning what is covered by a "signature guarantee."
\(^{d}\)UCC § 8-308(6).
\(^{e}\)UCC § 8-304(1) (a) and note 82 supra.
\(^{f}\)UCC § 8-308(5).
\(^{g}\)Cf. UCC § 3-202(3).
\(^{h}\)UCC § 3-417(2) (d).
\(^{i}\)UCC § 8-308(4).
under it, by agreement," and this section expressly re-affirms that proposition with regard to an indorser's warranty of performance by the issuer.

One of the most debatable legal questions relating to indorsements has to do with just what is covered by a "guarantee of a signature" and a "guarantee of an indorsement," and whether these two guarantees involve basically different matters, and if so, in precisely what way they differ. With the existing law generally imposing very strict duties on the issuer or its agent, to determine both the validity and rightfulness of transfers when registration of transfer is demanded, their very common practice is to require full signature and indorsement guarantees. Not only does the inquiry necessary to support such warranties become very burdensome, especially when the record owner holds in a fiduciary capacity, but a recent special study shows considerable disagreement and uncertainty as to what is included under each. So part 3 spells out the coverage of each guarantee. The "signature guarantee" warrants (1) the "genuineness" of the signature, (2) of an "appropriate person," (3) with full legal capacity to indorse." The "indorsement guarantee" includes these three, and also warrants the rightfulness of the particular transfer, i.e., that it conforms with all conditions which may exist determining whether such transfer is "proper." This last warranty may be particularly important when the "appropriate person" is transferring in a fiduciary capacity, covered by a trust instrument or a possible court order, or even under a "power of attorney" with conditions. Either warranty runs in favor of all subsequent "purchasers" taking in reliance thereon.

Section 8-313 considers the "relationship of the parties in a securities transaction," and is one of the most interesting in article 8. It deals with a problem which, on analysis, starkly reveals how inadequate traditional legal concepts and doctrines may be when a real attempt is made to make them correspond with the customs and practices of the "market place." The problem involved is that of adequately dealing with the "stock-broker's" relationship to the process of buying and selling investment securities on the open market and in the exchanges. All too often, transactions on the securities markets have been analyzed as involving a simple sales-purchase agreement between seller and buyer. Agreeably with this analysis, any broker or brokers involved are considered simply agents of the respective parties, with their rights and duties measured accordingly. Even the Uniform Stock Transfer Act frames the rights and duties arising reciprocally from these transactions on that analysis." The fact is, however, that a vast and complicated apparatus (i.e., body of practices and procedures) constituting the institution known as the securities exchanges and markets, has grown up, which requires a set of rules and concepts to govern its

[UCC § 1-102(3).]
[UCC § 8-312(1).] Remember that UCC § 8-308(3) defines who is "an appropriate person" under UCC § 8-312(1)(b).
[UCC § 8-312(2).]
[UCC § 8-312(3).]
[UCC § 8-303 defines "broker," for this article only, broadly and functionally to include all persons buying and selling securities for all or part of their time on behalf of "purchasers."
[U.S.T.A. §§ 1, 4 to 7; Bunn, Article 8—A Law for the Transfer of Investment Securities, 1952 Wis. L. Rev. 339, 344.]
"inner order" quite different from those traditionally applied. To make the "law" of this Code correspond functionally with the custom and usage of the market, part 3 recognizes the common fact that instead of being a simple purchase-sale transaction generally, securities sales are very apt to be a multi-stage affair, in which the seller may deliver to broker A, who has a new certificate issued and delivers to broker B, who has still another certificate issued to himself or possibly to his purchasing customer. Once this is recognized as an operative fact, the statement in the comments to section 8-313 that "the relationship between broker and customer is unique, partaking of various aspects of an agency, bailment, trust and pledge," becomes quite understandable. The problem is to frame rules which are comprehensive and flexible enough to give full effect to such complex relationships with their varying practices.

As an ordinary agent, under the traditional analysis, the broker quite generally was not subject to the incidents of being a "party" to the transaction, though he might be guilty of "conversion." The architects of article 8, however, found two quite different primary types of transactions, and they determined to establish a clear basis for distinguishing between the two. In the first major class, as described in section 8-313 of the Code, a delivery to the ultimate "buyer," is found to have been completed by any of the following four variations in the handling of the security: (1) when such buyer, or a person designated by him acquires actual possession thereof; (2) when his broker so acquires a security specially indorsed or issued in the buyer's name; (3) when his broker confirms the purchase and also sets aside the specific security and positively identifies the same as belonging to buyer; and (4) when an identified security is held by a third person, who acknowledges that he holds for the buyer—as where such securities are pledged by the broker for the balance due for a purchase on margin trading.

The second major class includes all securities held for customers by the broker as part of a "fungible bulk," with a confirmation of purchase and appropriate book entry. In the first class the buyer is deemed to be the holder, so as to give a defense to all adverse interests coming to his notice thereafter. As to this second class, however, the buyer is said not to be such holder, even though he have a "proportionate property interest" in the fungible bulk. A very important policy consideration enters into the framing of these rules on when "delivery to the purchaser" occurs. An earlier New York decision had ruled that a broker could compel his customer to take securities ordered, even where notice of adverse interests came to the purchaser before receiving physical delivery, though after the broker became "custodian" (acting as an agent). This either makes it impossible for the buyer to avoid being subjected to such adverse interests, or at the very least requires him to assume the burden of establishing his

---

80 NYLRC, UCC REPORT 999-1005 (1954); Bunn, op. cit. supra note 97, at 344.
81 UCC § 8-313, comment 1.
82 See UCC § 8-313, comment 4.
83 The large volume of securities which must be treated as a fungible mass is emphasized by the introduction of "clearing house" practices whereby brokerage houses merely settle on the basis of "balances" due, rather than for specific purchases and sales. See UCC § 8-313, comment 3.
84 Isham v. Post, 141 N.Y. 100, 35 N.E. 1084 (1894).
priorities—perhaps to defend a lawsuit. The drafting committee is very sure that the burden of any resulting lawsuits should be on the broker rather on the customer, who "hires the broker" and pays him for "clean securities." To make it easier to place responsibility on the broker, the concept of a series of "purchases" without corresponding "sales" in any multi-step transaction is introduced. Brokers are treated as "purchasers," even bona fide purchasers, though the only "sale" is to the ultimate buyer. Though novel sounding at the outset, there may be any number of transfers of "legal title" from fiduciary to fiduciary, with only a single beneficial ownership being involved. The purchases may be said to involve legal title transfer, but the "sale" is an attribute or an incident of the beneficial ownership. The practical or "functional" purpose of this analysis is simply to support the attributing of some incidents of "ownership" to the broker, rejecting pro tanto the incidents of mere agency ordinarily attributed to him. And this is done to place the primary responsibility for defending lawsuits over ownership on the broker in certain circumstances, providing him, however, with the protection granted to a bona fide purchaser, if he is otherwise entitled to claim as such.

The special status of a broker as "purchaser" also is used to determine when "delivery" of a security is deemed completed when effected through brokers. In transactions on exchanges or through brokers generally the seller satisfies the duty to "deliver" by placing "qualifying" securities in the possession of the selling broker or one designated by him, and the selling broker completes "delivery" by taking the same action in favor of the "buying" broker. But in other sales not using a broker the seller's duty to deliver is completed only by placing the security, in negotiable form, to the broker introducing it into the market, seemingly approving a rule imposing liability for such "adverse interests." 2 NYLRC, UCC REPORT 887, 897. This objection is not actually answered by Israels, who justifies requiring the broker to resist adverse claims on the very practical ground that he is the one in the best position to take or defend legal action, and that, "I am paying him my good money to get me clean stuff, and I don't want to be required to take anything else from him under any conditions whatever." 2 id. at 1004. So, the basic issue is one of policy, whether these "implications" should be considered part of the normal security-purchase agreement. The Code answers affirmatively, and probably correctly, on these policy considerations.

In comment 3 to UCC § 8-313, the Code's editors attempt to support the rule that the buyer rather than the broker should have to resist "adverse claims" if there has not been actual delivery to the buyer and if notice of such claims comes to the buyer before that delivery, though after "delivery" to the broker. Their argument is that the buyer could not possibly be a bona fide purchaser in such case, so it would be unjust to make him accept delivery. However, this rationale is criticized (correctly, it seems) on the ground that if the broker holds as a bona fide purchaser he can and will convey all of his rights to the buyer, under UCC § 8-301(1), known as the "shelter provision." 2 NYLRC, UCC REPORT 897, 1005 (1954). This objection is not actually answered by Israels, who justifies requiring the broker to resist adverse claims on the very practical ground that he is the one in the best position to take or defend legal action, and that, "I am paying him [broker] my good money to get me clean stuff, and I don't want to be required to take anything else from him under any conditions whatever." 2 id. at 1004. So, the basic issue is one of policy, whether these "implications" should be considered part of the normal security-purchase agreement. The Code answers affirmatively, and probably correctly, on these policy considerations.

2 NYLRC, UCC REPORT 1004 (1954). There is a difference of opinion whether a selling broker is or should be treated as a "purchaser" under the Code, but in any case this rule on "completed delivery" so treats him, rather than as a simple agent of the seller. Cf. 2 NYLRC, UCC REPORT 999 (1954).
in the hands of the purchaser, or at his direction. A sale to a broker for his own account, not on an exchange, is included under this last rule.

The general right of an owner to reclaim possession of a security wrongfully transferred, except as against bona fide purchasers, is continued, and if based on a forged or unauthorized indorsement, even a bona fide purchaser is subject to a recovery action if he has not yet secured a new security upon registering of transfer. The rules stated elsewhere protecting such bona fide purchaser in all events control the latter event. This right of recovery is in addition to a possible damage action for conversion.

Further stressing the negotiable character of investment securities, part 3 requires generally that the certificate itself be seized as a condition to attachment, and all available process for the levying on property "not readily attachable" is made available to creditors. Hence, in spite of an outstanding order for attachment, the security still may be negotiated until actual seizure. This is the rule for negotiable instruments generally, in contrast to simple contract obligations which are only "garnishable" by serving the debtor, himself. The exception to this rule, that securities surrendered to the issuer may be levied on "at the source," is consistent with the general rule. This is the orthodox manner for "levying" on stock. But when in the hands of the issuer, the record title becomes controlling again. And, with the certificate withdrawn from circulation its "negotiable" quality is suspended, making it similar to a simple contract, leviable against its ultimate "obligor," the issuer.

Part 3 concludes with a standard statute of frauds provision, alternatively requiring (1) a writing signed by the party to be charged, adequately describing the subject matter and the terms, or (2) delivery or payment, or (3) a written confirmation with adequate description, received by the person chargeable, with no written objection from him within 10 days, or (4) the party charged admits in judicial proceedings a contract for such sale. The editorial comment points out that the third alternative, authorizing a written confirmation, is particularly significant on the securities market because a large portion of the total volume of transactions is consummated by phone, followed by a confirming statement, generally, on a
standard form more than meeting the minimal descriptions and terms re-

PART 4 — REGISTRATION

Although the registration of transfers of investment securities dealt with in part 4 involves questions which are quite independent of the law of negotiability, to secure the maximum benefit from extending that principle to such securities, it is vitally important that the “registration” procedure be simplified in every way possible, and that the duties and responsibilities imposed on the issuer or its agent for guarding against the registration of “wrongful transfers” be minimized as much as possible, consistent with the requirements of honesty and “fair dealing” among all the parties concerned. But the drafting of satisfactory legislation regulating this matter always has caused special difficulty. That difficulty lies in one of the important differences between “investment securities” and other “commercial paper,” generally, a difference which always has complicated seriously earlier attempts to extend the principle of “negotiability” to the former. Commercial paper represents “single” obligations to pay—simple “chooses-in-action.” In contrast, instruments representing shareholder interests and composing a large part of investment securities represent two very divergent interests: 1. proportional ownership in a business or industry, representing substantial proprietary interests for the indefinite future, and certainly embodying a large bundle of reciprocal rights, privileges, powers and immunities between issuer and holder; 2. The share certificate itself, valued as a “chattel” or “commodity.” Of course, it is the latter only which is made “negotiable.” Historically, the issuer’s primary concern has been with the first aspect of “shareholdership”; so it has thought it quite necessary to keep a formal record, not only of all initial issues, but also of subsequent transfers thereof. And, of course, to identify the persons entitled to exercise these proprietary rights, the law of business organizations generally has both approved and even required the keeping of such records. The difficulty and complexity involved in framing fully satisfactory legislation regulating the registration process which will do violence to neither of the above interests is strikingly demonstrated by the history of such legislation, including particularly the forerunners of part 4 in article 8.

The Uniform Stock Transfer Act did not attempt to regulate the registration of security transfers; nor did it apply the attributes of nego-

111 UCC § 8-319, comment 2.
112 As has been said, the definition of “investment securities” used in this act is “functional” rather than “conceptual,” in the sense that it includes all instruments in that class which serve the “investment needs” of the community. But, in a larger sense, the whole of article 8 is designed to serve as an “apparatus of function.” It may be instructive to think of the investment market processes and instrumentalities organically, in institutionalized form, with the apparatus formalized in article 8 as doing its best to give expression to a body of already highly developed norms for its “inner order,” though finding it necessary every now and then to “rectify” some traditional conceptual rules which heretofore have hindered the smooth and trouble free operation of that institution.
113 The only sections dealing directly and especially with the rights and duties between the issuer and a purchaser are two: (1) U.S.T.A. § 3 authorizes the issuer to treat the record holder as the true owner; (2) U.S.T.A. § 17 gives the owner of a lost or stolen security the remedy of “specific performance” to compel the issuer by court order to issue a replacement certificate, upon proper proof and bond.
tliability to the "issuer-stockholder" relation. However, a uniform act approved in 1922 by the commissioners, entitled "Uniform Fiduciaries Act," and attempting to regulate all forms of transactions transferring interests to and from fiduciaries, contains a section dealing with fiduciary transfers of securities which is intended to relieve the agency registering such transfer of all duty to check whether such fiduciary may be violating any of his fiduciary obligations. However, this section has failed to simplify and facilitate registration, as had been hoped. Those drafting part 4 of article 8 undoubtedly gave a great deal of thought to the problem of stating the controlling rules so as to expedite registration and give relief from the excessive burden of documentation which continued to be required under the Uniform Fiduciaries Act. Notwithstanding this, part 4, as approved for adoption in 1952, probably was justly criticized on the ground that it largely failed in this objective. The heart of this part of the article is found in section 8-402, permitting the issuer to require assurances of the indorsing signatures' effectiveness, and section 8-403, delimiting the duty to inquire into the "rightfulness of the transfer." Of the former, one critic has said:

Apparently the purpose of sec. 8-402 was to simplify the transfer requirements, but it would appear that all it has done is to shift the responsibility from the transfer agent to the signature guarantor. So long as the signature guarantor is compelled to warrant the capacity and the authority of the fiduciary the guarantor will have to require the same documents now required by the transfer agents.

Probably a more substantial criticism of section 8-403 in its original form is put thus:

The apparent purpose of the Code, to accelerate the transfer of securities, is achieved only in a limited number of situations and could have been best carried out by providing the transfer agent with a clear procedure to follow when faced with an adverse claim. Instead of providing such a procedure, which would have relieved a transfer agent of the unwarranted investigatory burden imposed upon it, the Code merely attempts to limit its liability.

In the 1957 revision the demand for a "clear procedure to follow when faced

18 Uniform Fiduciaries Act § 3. Still another attempt to deal with this problem is found in the Model Fiduciaries Securities Transfer Act, sponsored by a special committee of the American Bar Association and the Illinois Bar Association. See discussion in 1 Christy, Transfer of Stock § 225b, at p. 17:10 (3d ed. 1958). A number of states adopted this act in 1957, but upon adoption of the UCC by those states it will be superseded.

19 Ironically, the Montana legislature enacted § 3 of the Uniform Fiduciaries Act as a self-contained, independent piece of legislation in 1959, although it had long since been shown that it largely failed in its original purpose to simplify registration of transfers by fiduciaries and to lessen substantially the supporting documentation required by the issuer. Laws of Montana 1959, ch. 136, at 245.

20 NYLRC, UCC Report 872 (1964). Israels seems to answer this criticism in 2 id. at 983.

with an adverse claim" was amply provided for, at this point only tardily recognizing the necessity for a genuinely "functional" treatment in its regulations.

Concurrently with the studies of article 8, itself, going on continuously by those sponsoring the Code, and possibly based on the informed conclusion that section 3 of the original Uniform Fiduciaries Act had proved altogether inadequate, and because the "where and when" of the Code's adoption as a whole was very uncertain, influential representatives of the investment markets pushed to completion and approval in 1958 an independent uniform act, entitled "Uniform Act for Simplification of Fiduciary Security Transfers." This act deals in great detail with the very limited and single subject of the regulation of the registration of transfers of investment securities by fiduciaries, amplifying on section 3 of the Uniform Fiduciaries Act. Although article 8 had been extensively revised in 1957, along with the entire Code, to avoid the charge that the Commissioners on Uniform State Laws recommended inconsistent measures to govern a single subject, article 8 was further revised in 1958 to achieve complete agreement with the act on "simplification." The following discussion is based on the 1958 revision, which surely goes far in achieving the objectives sought.

Part 4 imposes on the issuer a general duty to register the transfers of all securities in registered form upon presentment and demand, subject, however, to the provisos that (1) they are properly indorsed (the issuer also may require assurances of the genuiness and effectiveness of the indorsements); (2) there is no notice of adverse claim, or the issuer has made the investigation required; (3) the transfer is in fact "rightful or is to a bona fide purchaser." On refusal to register, if right exists, the issuer may become liable both for specific performance and for damages.

As mentioned above, determined to protect themselves against possible liability, issuers and their agents have developed a firmly entrenched practice and procedure requiring a great amount of "proof" as to the legality and rightfulness of transfers. Though especially acute where the transferor is a fiduciary, a penetrating analysis of market practices in a memorandum presented in the New York hearings on the Code shows that the practice is almost as common in other kinds of transaction. The memorandum approves the intention of article 8 to limit such "clogs" on all

186Compare the 1952 and 1957 versions of UCC § 8-403 as set forth in 1956 Recommendations of the Editorial Board for the Uniform Commercial Code 247-249. The editors observe: "The section is completely revised. . . . Subsection (2), modelled on the New York statute dealing with adverse claims to bank deposits, provides a procedure which in a large majority of cases should be effective to protect the rights of all interested parties and relieve the issuer of further responsibility." Id. at 249.

187Israels, Article 8—Investment Securities, 16 LAW & CONTEMP. PROB. 249, 262 (1951); 2 NYLRC, UCC REPORT 848-852 (1954); Bunn, Article 8—A Law for the Transfer of Investment Securities, 1952 WIS. L. REV. 339, 346 n.35.

188UCC § 8-402(1).

189UCC § 8-401(1).

190UCC § 8-401(1) (e). This "condition" makes it clear that, even though other conditions for imposing the duty to register exist, the duty does not arise unless the transfer was in fact rightful—wrongfulness of transfer always will be a defense, except against a bona fide purchaser.

191UCC § 8-401(2).

1922 NYLRC, UCC REPORT 839-841 (1954).
transfers generally. So, part 4 both limits the issuer's duty to investigate adverse claims, and stipulates the "assurances" that indorsements are effective which it may require, in the light of its newly limited liabilities for "improper" registration. As to the latter, it always may require (1) a guarantee of signature, by a person reasonably believed to be responsible, (2) assurance of authority of an indorsing agent, (3) an appropriate certificate of appointment or incumbency of such fiduciary or fiduciaries, and (4) if there are several fiduciaries, assurance that all have signed who are required to do so.

Implementing the expressed policy to discourage excessive documentation, although permitting additional reasonable assurances, part 4 penalizes the issuer for demanding documentation for purposes other than to establish the effectiveness of the indorsements by charging it with notice of anything affecting the transfer contained in the instruments so required. Furthermore, frequently there will be no reason for demanding the assurances expressly authorized. For example, though the issuer can require evidence of the incumbency of an indorsing trustee, the next section expressly authorizes the issuer to accept the signature of a registered fiduciary at its face value, until it receives written notice of the revocation of that fiduciary's power over the particular security. This rule implements the Code's policy of limiting the issuer's duty to inquire about adverse claims.

The duty to inquire into adverse claims also is limited generally by the condition that either the issuer receive a written notice thereof in time to permit it to delay the registration, or it be charged with notice from a controlling instrument which it has elected to require. Furthermore, the notification must identify the claimant, the registered owner, and the issue of which the security is a part, and give the claimant's mailing address. Unless the written notice meets these formal requirements it is no legal notice at all. If not charged in one of the two ways just given the issuer has no duty at all to inquire. In particular, it is not so charged by the fact that the registered holder is a fiduciary, as stated above; neither is it bound to check whether the transfer is "rightful" under any instrument limiting the fiduciary's authority, nor to examine the law of the state controlling the fiduciary relationship to determine whether it has been complied with.

Two sections of part 4 reveal how directly the granting of full negotiability to investment securities bears on the consequences of "registering the transfer," and in doing so how it enlarges those consequences be-
yond all traditional principles of negotiability. These two sections, first, measure the limits of the liability of the issuer for a "wrongful" transfer, and secondly, provide that in certain circumstances the issuer can be compelled to make two securities grow, where only one has grown theretofore, solely because of the enlarged scope given to the negotiable principle. While in the past it has been thought impracticable, if not impossible, to give as broad a scope to the negotiability of securities as to other forms of commercial instruments, we now discover that it is appropriate and desirable to give it a broader scope because of the peculiar nature of the instruments involved.

The first of these sections affirms the basic policy of the article against any liability of the issuer for any loss sustained by any person as a result of the registration of a security transfer, provided only that it was "appropriately indorsed" as required in part 3, and the issuer had no further duty to inquire into adverse claims, as limited by part 4. This general exoneration is then followed by a statement affirmatively imposing the duty on the issuer to issue a "like security" upon demand, where it has registered a transfer to a person not entitled to it unless it is entitled to the above exoneration or the true owner has failed to notify the issuer of loss of the security within a reasonable time thereafter or such delivery would result in an over-issue. Under the first two contingencies mentioned the issuer has no liability. Under the last one the issuer's liability is governed by section 8-104. Although neither section expressly states that receipt of a new certificate is the only relief available to the person suffering a loss from an improper registration of a security transfer if no over-issue results, editorial comment indicates that it is the intention of these two sections to eliminate the option which the owner generally has under common law rulings to demand another security or damages, though language in the first paragraph of section 8-405 might be interpreted as suggesting an optional remedy in some cases.

After denying any liability under the preceding section to an owner who fails to notify the issuer that his security has disappeared, and also any claim of that owner to a new security, section 8-405 continues by incorporating into the Code the general practice of issuing a new security

147 UCC §§ 8-404, 405.
148 UCC §§ 8-308(1), (3).
149 UCC § 8-404(1).
150 UCC § 8-404(2).
151 UCC § 8-404(2) (a).
152 UCC §§ 8-404(2) (b), 8-405(1).
153 UCC §§ 8-404(2) (c).
154 It will be recalled that UCC § 8-104 provides for remedies in cases where a further issue, normally required, would result in "overissue." The issuer must then supply from the market if reasonably available. If not, then he pays the purchaser's cost plus interest running from demand.
155 UCC § 8-404, comment 2. Casper v. Kalt-Zimmers Mfg. Co., 159 Wis. 517, 149 N.W. 754 (1914), approves the common law rule. An early section in the original approved draft stated that editorial comment should be taken as a guide in interpreting the Code, but that in the case of conflict the language of the Code sections should control. UCC § 1-102(3) (f) (1952). Actually, in the hearings before the New York Law Revision Commission witnesses frequently referred to asserted conflicts. 2 NYLRC, UCC Reporter 967, 973-974 (1954). Although UCC § 1-102 (3) (f) was omitted in the 1888 revision, the editorial comments remain persuasive.
156 UCC § 8-405(1).
157 Ibid.
to replace lost, destroyed, or stolen ones, upon demand with a "sufficient bond."\textsuperscript{159} The issuers' common practice of issuing a new certificate without requiring litigation, on posting of a bond, thus is made legally mandatory, provided the owner so requests before the issuer has notice of purchase by a bona fide purchaser.\textsuperscript{159} Then subdivision 3 of this section introduces the most novel feature of the entire article. It provides further that if a bona fide purchaser later requests the registration of the transfer of the original security, the issuer must likewise register that security, unless that would result in an over-issue,\textsuperscript{160} in which case the party's rights are again governed by section 8-104, authorizing damages in such case. Standing alone, this does not yet result in the "growing of two securities where only one is supposed to grow," because the issuer normally has two remedies, if needed, against the original owner; he not only can recover the replacement security issued that owner, but likewise he can recover on any rights arising under the indemnity bond. However, if the replacement security has passed into the hands of a bona fide purchaser, the issuer no longer can recover it,\textsuperscript{161} and must thereafter treat both holders as owners of shares for all purposes, if no over-issue results,\textsuperscript{162} solely because of the controlling effect given the principle of "negotiability.

However, a rule of law requiring the issuer to issue "duplicate" securities for the one original issue may seem to violate other desirable policies governing the financing and operation of corporate issuers generally, which require them to issue stock only for a stipulated consideration, and prohibit them from making "gifts or donations" or otherwise "watering" their stock.\textsuperscript{163} Moreover, it may be objected to on the assumption that there are the same reasons against this practice as there are against requiring the maker of a promissory note to issue a second note merely because the first one was stolen from the holder. But the analogy is very misleading. A dual issue of securities is permissible only because of one of the fundamental differences between investment securities and commercial paper. The latter is supported by a single, simple chose-in-action, which will not support multiple "issues" of notes. In contrast, the share certificate represents a designated number of share units of "ownership," which not only are fungible, but are identical with every other unit of the same class and issue; so additional share units may be "charged" against the second certificate, so long as the supply is not exhausted, even though corporate securities generally continue to be subject to constitutional and/or statutory duties on the corporation to receive consideration therefor as a condition.

\textsuperscript{159}UCC § 8-405(2). UCC § 8-403(2) also provides that upon notification of an "adverse claim" the issuer discharges his duty to inquire by notifying the claimant that he has thirty days either to secure a proper court order compelling registration, or to post an indemnity bond "sufficient in the issuer's judgment."

\textsuperscript{160}UCC § 8-405 (2) (a).

\textsuperscript{161}UCC § 8-405(3).

\textsuperscript{162}Ibid.

\textsuperscript{163}UCC § 8-405, comment 3, considers the question which holder should be required to surrender if overissue does result. It interprets this section as relegating the purchaser of the original security to an action for damages. Otherwise, if both certificates are held by bona fide purchasers, both remain outstanding.

\textsuperscript{164}Montana has an explicit constitutional provision so regulating. Mont. Const. art. XV, § 10. As will be recalled, some sentiment developed while drafting progressed for the view that, even if an additional issue would result in an "overissue," the issuer still should be required to so issue, with a duty imposed to increase its authorized capitalization by amendment. This view did not prevail, however.
to their issue, and not to overissue. The prohibition against "overissue" stipulated by section 8-104 prevents violation of the last named duty. Further, the requirement of "consideration" for any "issue" is cared for by the assumption that the issuer will be able to receive full compensation for the second outstanding security by means of the indemnity bond which the corporation should require.\footnote{UCC § 8-405(2) (b) and comment 3.}

The last statement suggests a question, however, which has been raised concerning what should be deemed a "sufficient indemnity bond" under section 8-405.\footnote{See 2 NYLRC, UCC REPORT 857 (1954), where the question is raised whether the indemnity bond called for should be deemed for the benefit of the issuer or of the transfer agent. It would seem clear that "to be sufficient" the bond required should be enough to indemnify all parties fully who may suffer injury for having to comply with the security owner's demand for a new certificate.} Without exhausting the subject, it may be suggested that the least that should be required under the bond is the amount for which the issuer could be required to ask as the "issuing" price for such security, plus any incidental costs arising from the transaction which may accrue against the issuer and/or its transfer agent.

A more serious problem of construction, arising both from a latent ambiguity in the term "original security" and from uncertainty of what classes of "lost or stolen securities" a subsequent holder may be a bona fide purchaser, is found in the language used in section 8-405(3). It is stated there that "if, after the issue of the new security, a bona fide purchaser of the original security presents it for registration of transfer, the issuer must register the transfer unless registration would result in overissue." (Emphasis supplied.) Although the question was raised in hearings whether the holder of a stolen security with a forged indorsement could ever be such bona fide purchaser "of the original security,"\footnote{Bunn, Article 8—A Law for the Transfer of Investment Securities, 1952 Wis. L. REV. 339, 344; 3 NYLRC, UCC REPORT 1956 (1955).} there does not appear to be any satisfactory editorial commentary on it. An adviser for article 8 points out that very often the holder presenting a security for registration will not be holding the certificate with the forged indorsement on it, even though it may be based on an unindorsed stolen certificate. This will be true generally if purchased on an exchange, because a new certificate normally will have been issued, warranted by the issuer itself. Nevertheless, even though it be possible for such holder to be a bona fide purchaser in all other cases, in any instance in which the holder presents the original stolen certificate, with a forged indorsement, it would seem that he could not claim as a bona fide purchaser under sections 8-302 and 8-308(1) which exclude a forgery as an "indorsement." On this construction the term "original security" cannot ever mean the "original certificate" unless it is indorsed before its theft.

Part 4 concludes with the requirement that transfer agents of all kinds exercise "good faith and due diligence" on behalf of the issuer, and subjects such agent to the same obligations, rights, and privileges with regard to the holder or owner of securities as has the "issuer," thus imposing substantially greater duties and rights on him than would ordinary agency law.\footnote{UCC § 8-406(1).} At the same time, as under ordinary agency rules, notice to
such agent is deemed notice to the issuer, with respect to matters pertaining to that agent's authority. 183

CHANGES IN EXISTING LAW

The foregoing analysis of article 8 has indicated a great many of the changes which the framers of that article intended to make in existing law generally. For the most part, the adoption of article 8 in Montana would effect those same changes here. Space limitations preclude an exhaustive examination of all possible changes, statutory and otherwise, which might result from its adoption. However, the most obvious changes, calling for the repeal or amendment of certain existing statutes, may be considered briefly. Upon the Code's adoption, 182 Montana's laws incorporating the Uniform Negotiable Instruments Law and the Uniform Stock Transfer Act should be formally repealed, as should Laws of Montana, 1959, ch. 136, dealing with the registration of security transfers by fiduciaries. In addition, R.C.M. 1947, sections 15-603 (providing for transfer of shares by "effective delivery" of the certificate) and 15-605 (authorizing issuer to require certain "guarantees" before transfer) should be repealed as superseded, and the statutes relating to "assessible" shares (sections 15-701 through 15-721) should be re-examined in the light of Code sections 8-103 (restricting issuers' liens) and 8-202 (authorizing the incorporation by reference of statutory regulations and restrictions). However, this last problem already exists in part under R.C.M. 1947, section 15-642, similarly restricting issuers' liens.183 Further, R.C.M. 1947, sections 93-4307(4), and 93-4308 through 93-4311, providing for the attachment of corporate shares, must be examined in the light of Code section 8-317, requiring seizure of the certificates themselves for that purpose.

Article 3 of the Code is drafted as a complete substitute for the Uniform Negotiable Instruments Law.184 Although negotiable bonds were covered by the Uniform Negotiable Instruments Law, they are expressly covered by article 8 in the definition of investment securities, 185 and expressly excluded from article 3 of the Code.186

Of course, the principal legislation which is supplanted by article 8 is the Uniform Stock Transfer Act, 187 even though the provisions thereof

183UCC § 8-406(2).
184It is here assumed that article 8 would be approved as part of the Code or not at all. Separate adoption would require further drafting, because of the general provisions in other articles applying to article 8, and because of the interrelationship between it and article 3, Commercial Paper. Recognizing the practical impossibility of discovering in one study, however intensive, all the relevant state law which may be affected by the adoption of the Code, the Connecticut Commission, in addition to recommending its adoption, also recommends the appointment of a special commission to carry on a continuous study of the interrelationship between the Code and other parts of the Connecticut Code. CONN. TEMP. COMM., STUDY AND REPORT 5 (1959).
185The legislature should seriously consider whether R.C.M. 1947, §§ 15-608 to -614, authorizing the issuing of "bearer certificates of stock" in mining corporations should be continued. Assuming they once served a useful purpose in facilitating the financing of mining ventures, query whether, with all stock fully negotiable, their special characteristics are needed.
186UCC § 3-101, comment.
187UCC § 8-102(1)(b).
188UCC § 3-103(1).
ARTICLE 8: INVESTMENT SECURITIES

are preserved in large part in article 8. The changes in the existing law under the Uniform Stock Transfer Act which the sponsors of the Code intend to make in it by the enactment of article 8 have been indicated above. However, a few Montana decisions adjudicating that act remain to be considered. A leading Montana case on what is required to constitute an ‘‘effective delivery’’ under the act would not be changed by the adoption of article 8 since the definition of ‘‘delivery’’ under the former is almost exactly that found in the controlling definition of the term under the Code. On the other hand, a Montana federal court decision, concurred in by a leading decision from another state, would be changed by the adoption of article 8, under section 8-207. It held that in spite of R.C.M. 1947, section 15-630, authorizing the issuer to treat the record owner as the true owner for determining rights under the share contract, if the issuer has actual knowledge of equitable rights in a third person, including the right to receive dividends as a pledgee of the stock, the issuer has a duty to recognize that right. At the same time, the law holding the record owner subject to certain liabilities is left unchanged. Also, R.C.M. 1947, section 15-504, providing for the closing of the stock record books prior to an election, is left unaffected.

The one section in the Montana Code which substantially changed the wording of the comparable section in the original Uniform Stock Transfer Act would itself be materially changed, with much improvement therein. Originally, the last substantive section in the Uniform Stock Transfer Act limited the application of that act to securities issued after the act’s adoption. Although many states changed this rule to apply the act to both subsequent and prior issues of all securities otherwise subject to the act, Montana retained that portion of the section. However, although the Uniform Stock Transfer Act had no section formally providing a choice-of-law rule for the act, Montana saw fit to include one in R.C.M. 1947, section 15-649, stating that the act also should be applicable to all ‘‘transfers made in this state, whether of certificates for shares of domestic or foreign corporations.’’ In so doing the statute treated the sale as the controlling contract for choice-of-law purposes, and Montana placed itself practically in a minority of one in this regard. In contrast, the Uniform Stock Transfer Act quite generally is interpreted as giving effect to the same choice-of-law principle as is found in section 8-106 of the Code. The law of the corporate domicile is held to govern share negotiability, so wherever a certificate transfer occurs, it would be governed by the Uniform Stock Transfer Act if that act

117 R.C.M. 1947, §§ 15-623, -649; Lyons v. Freshman, 124 Mont. 485, 226 P.2d 775 (1951), ruling that a share certificate with separate assignment found in a joint deposit box had not been “delivered” by a wife to her husband at their death.
118 R.C.M. 1947, § 15-649, and UCC § 1-201(14).
119 Homestake Oil Co. v. Rigler, 39 F.2d 40, 41 (9th Cir. 1930).
120 Morrison v. Gulf Oil Corporation, 189 Miss. 212, 196 So. 247 (1940).
121 UCC § 8-207, comment 1.
122 UCC § 8-207 (2).
123 UCC § 8-207, comment 5.
125 U.S.T.A. § 23.
126 The California statute is illustrative, providing: “This article applies to certificates for shares, whether issued before or after the taking effect of this article. . . .” See 6 U.L.A., STOCK TRANSFER, 1958 Pocket Part 118.
were adopted by the corporate domicile.\textsuperscript{165} The 1952 version of the Code adopted a basis for selecting the controlling law similar to Montana's, but it was precisely that rationale of "territoriality of the transaction" which was most vigorously attacked in the hearings before the New York Commission.\textsuperscript{166} Those criticisms led to the inclusion of section 8-106, which deals with the matter.

Unfortunately, however, though the rationale adopted and the craftsmanship shown in its drafting are a great improvement over the 1952 version, section 8-106 of the Code, correlated with section 1-105, still is no model of drafting. It seems reasonably clear, as stated above, that while the "validity" of the security and the "issuer's obligations" as the registrar of security transfers are governed by the issuer's domicile under section 8-106, the law governing the "sales" contract itself is subject to the agreement of the parties under section 1-105. But, whether the negotiability of a security should be governed by the one section or the other is not altogether clear. The question is, are the elements of "negotiability" to be treated as essential characteristics of the share certificate itself, issued according to and subject to the law controlling the issue generally, or are they to be treated as incident to the "sale"—the transfer as a transaction? The provisions of section 1-105, found in the 1952 version of the Code, which were rejected in the 1957-58 revisions, were based on the latter premise. Furthermore, the nearly uniform interpretation given the Uniform Stock Transfer Act, that it is the issuer's domicile which controls "negotiability," would tend to support the conclusion that the issuer's domicile governs the question of what rules regulate the transfer of title under the wording of section 8-106, clearly approving that general principle. At least one state legislative commission has so interpreted that section. The Legislative Commission for Kentucky assumes that the issuer's domicile continues to regulate both the questions of "title and transfer," leaving the rule under the Uniform Stock Transfer Act unchanged in this respect.\textsuperscript{167} Moreover, the same practical and functional reasons dictate the selection of a single controlling law for any given security to determine the requirements for its "transfer of title," as well as for the matters dealt with in section 8-106.

Nevertheless, there remains a latent ambiguity in its language on this point, since it expressly so provides only with respect to "validity of a security and the rights and duties of the issuer with respect to registration of transfer." Of the three principal aspects involved in the subject matter of article 8 (i.e., 1. the relation of the issuer to the purchaser; 2. the requirements for effective transfer of title itself, i.e., negotiability; and 3. the issuer's status as the registrar of those transfers), section 8-106 formally considers only the first and the third. Since these various phases of the problem generally are treated distributively, distinctively, and in-

\textsuperscript{165}\textsc{Restatement, Conflict of Laws} § 53, comment d, provides: "[S]hares created in a State in which such an Act [U.S.T.A.] is in force may be transferred by delivery of the certificate as provided by the Act even though such delivery takes place in another state where such Act is not in force." See Annot., 131 A.L.R. 192 (1941).
\textsuperscript{166}\textsc{NYLRC, UCC Report} 33-35 (1956).
\textsuperscript{167}\textsc{Kentucky Legislative Research Commission, Uniform Commercial Code—Analysis of Effects on Existing Kentucky Law} 301 (1967).
ARTICLE 8: INVESTMENT SECURITIES

dependently in the Code otherwise, it would seem desirable to continue to so treat them for "choice of law" purposes, expressly stating the "governing law" for each phase—especially so for negotiability, because that concept is most ambiguous with respect to the question whether it should be assimilated "to the law of the transaction" or "to the law of property." It must be admitted also that the only section in the Code dealing with the question to what "things" the Code applies, which provides that "it applies to transactions entered into and events occurring after" the act goes into operation,\(^ {106}\) does not particularly strengthen the construction favored above, since it talks only in terms of "transactions" and "events." Neither term appears to be defined anywhere in the Code.

At least one group of decisions, based on common law principles, seems to be unaffected by article 8. These cases involve the question of what remedies a subsequent purchaser has against the issuer for wrongful refusal to register the transfer to him.\(^ {109}\) They establish that in Montana such purchaser has an election to sue either in "trover" as for conversion, or to compel the issuer to register. These optional remedies apparently would continue to be available under the Code, which does not propose to change existing law on this matter.\(^ {105}\)

CONCLUSION

Although there has been general approval of article 8 as revised in 1957 and 1958, it has not been quite unanimous. One early critic has persisted in his objections to portions of article 8. Mr. Francis T. Christy has wielded such influence on the stock brokerage business over many years through his famous work, entitled The Transfer of Stock, that some of his criticisms, found in his latest edition,\(^ {1} \) call for direct comment. Though his introductory discussion of part 4 of article 8 easily leads the reader to understand that his critique is directed at the 1958 revision,\(^ {109}\) the fact is that most of it was made against the 1952 act and as such may have had some merit. But, in nearly every instance, the difficulties as charged have been corrected, so that those criticisms have no merit whatever against the 1958 act. For example, he quotes a serious criticism made of the 1952 act, that it had failed to "provide the transfer agent with a clear procedure

\(^{106}\) UCC § 10-101.

\(^{106}\) Fitzpatrick v. O'Neill, 43 Mont. 552, 118 Pac. 273 (1911), rules that the purchaser is entitled to sue the corporate officers in equity to compel recording of the transfer and the issuance of a new certificate. Gillies v. Robert E. Lee Mining Co., 78 Mont. 402, 254 Pac. 422 (1927), holds that wrongful refusal to transfer by a corporation amounts to a conversion of the stock sufficient to support an action for its value. Although not noted by the Montana court, this latter rule should be subject to the limits on the power of the corporation to purchase its own stock under R.C.M. 1947, § 15-801(9).

\(^{106}\) These optional remedies for "refusal to register," must not be confused with those given the "record" owner for a "wrongful registration," under the common law, whereby he could either demand a new security or sue for damages. Under UCC § 8-404, as interpreted by comment 2, the record owner is limited to a new security, except when one is not available. In that case only is he entitled to damages under 8-104, thus extinguishing this general common law option.

\(^{106}\) Christy, Transfer of Stock (3d ed. 1958).

\(^{106}\) 1 Christy, Transfer of Stock § 225a (3d ed. 1958).
to follow when faced with an adverse claim," as though it still were a justified criticism of the 1958 revision, when actually the defect has been completely cured. In another paragraph he severely criticises section 8-403(2), as it appears in the 1952 act, for proposing to charge the issuer with a duty to make inquiry in any case in which it has notice that a fiduciary transfer is to the fiduciary, or the proceeds placed in his individual account. Though he does not note it, the criticized language is omitted completely in the 1958 revision.

A criticism which he makes of section 8-405(2), however, cannot be explained in this way, because it remains unchanged in substance in both drafts. He objects to its requirement that the issuer register the transfer of a lost certificate on demand of a bona fide purchaser, even though a replacement certificate is already outstanding, so that if the latter is now in the hands of another bona fide purchaser the issuer must recognize both. His comment on this is "this is not only unsound in theory, but unrealistic in practice." Though he says nothing to explain this dictum, it would appear that Christy is unwilling to admit that section 8-405 works out a reasonably acceptable "resolution" or compromise of the very divergent interests represented in the security markets, on the one hand, and the responsible use of the corporate device for cumulating capital, on the other. There is a plausible and rational basis for explaining the validation of both certificates in the interest of "negotiability," as given above.

If both intensive and extensive study and criticism of a piece of legislation ever justifies careful consideration by the legislature, this Code more than qualifies in that respect. Almost certainly there has not been a uniform act yet submitted to the state legislatures which was subjected to more critical consideration and analysis than was this act, both before and after its initial approval by the Code Commissioners and the American Law Institute. And even though the hearings held by New York's Law Revision Commission brought out much valid criticism of provisions, considered in detail, there was little criticism in terms of the overall theory, objectives, and organization of the Code. The defects pointed out merely attest to the extreme difficulty inherent in any large piece of legislative drafting, and to the infinitely greater difficulty found in any such work which attempts a genuinely functional (institutional) treatment, rather than one guided by the ideal of "logical symmetry." Certainly no other proposed statute has ever had the benefit of the additional thousands of man hours going into the continued intensive study following its proposal that this act has had. Those studies resulted in the greatly improved revisions of 1957-58. Furthermore, since the 1957 revision particularly, those state legislative committees who have made a report on the Code quite generally strongly recommend adoption.