Michigan
Law Revision Commission

NINETEENTH ANNUAL REPORT
1984

MICHIGAN
LAW REVISION COMMISSION

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MICHIGAN LAW REVISION COMMISSION

Nineteenth Annual Report to the Legislature

To the Members of the Michigan Legislature:

The Law Revision Commission hereby presents its nineteenth annual report pursuant to Section 14(e) of Act No. 412 of the Public Acts of 1965.

The Commission, created by Section 12 of that Act, consists of the chairperson and ranking minority members of the Committees on Judiciary of the Senate and House of Representatives, the Director of the Legislative Service Bureau, being the five ex-officio members, and four members appointed by the Legislative Council. Terms of appointed Commissioners are staggered. The Legislative Council designates the Chairman of the Commission.

Membership

The ex-officio members of the Commission during 1984 were Senator Alan Cropsey of DeWitt, Senator Basil W. Brown of Highland Park, Representative Perry Bullard of Ann Arbor, Representative Ernest W. Nash of Dimondale, and Elliott Smith, Director of the Legislative Service Bureau. The appointed members of the Commission were Tom Downs, David Lebenbom, Theodore W. Swift, and Richard C. Van Dusen. Mr. Tom Downs served as Chairman; Professor Jerold Israel of the University of Michigan Law School served as Executive Secretary.

The Commission's Work in 1984

The Commission is charged by statute with the following duties:

1. To examine the common law and statutes of the state and current judicial decisions for the purpose of discovering defects and anachronisms in the law and recommending needed reform.

2. To receive and consider proposed changes in law recommended by the American Law Institute, the National

Conference of Commissioners on Uniform State Laws, any bar association, and other learned bodies.

3. To receive and consider suggestions from justices, judges, legislators and other public officials, lawyers and the public generally as to the defects and anachronisms in the law.

4. To recommend, from time to time, such changes in the law as it deems necessary in order to modify or eliminate antiquated and inequitable rules of law, and to bring the law of this state, civil and criminal, into harmony with modern conditions.

The problems to which the Commission directs it studies are largely identified by a study of statute and case law of Michigan and legal literature by the Commission members and the Executive Secretary. Other subjects are brought to the attention of the Commission by various organizations and individuals, including members of the Legislature.

The Commission's efforts during the past year have been devoted primarily to three areas. First, Commission members met with legislative committees to secure disposition of various proposals previously recommended by the Commission. Second, the Commission examined suggested legislation proposed by various groups involved in law revision activity. These proposals included legislation advanced by the Council of State Governments, the National Conference of Commissioners on Uniform State Laws, and the Law Revision Commissions of various jurisdictions within and without the United States (e.g, California, New York, and British Columbia).

Finally, the Commission considered various problems relating to special aspects of current Michigan law suggested by its own review of Michigan decisions and the recommendations of others.

As in previous years, the Commission studied various proposals that did not lead to legislative recommendations. In the case of certain Uniform or Model Acts (e.g., The Uniform Conservation Easement Act), we found that the subjects treated had been considered by the Michigan legislature in recent legislation. In other instances, Uniform or Model Acts were not pursued as formal recommendations because similar or identical legislation was currently before the legislature upon the initiation of legislators having a special interest in the particular subject. In the case of the Uniform Marital Property Act, the Commission simply furnished its research on the subject to the legislative committee considering the proposal.

Four of the topics studies by the Commission over the past year have resulted in legislative recommendations. Those are:

(1) Amendment of Assumed Names Statute (limited partnership)

(2) Uniform Transfer to Minors Act

(3) Uniform Transboundary Pollution Reciprocal Access Act

(4) Amendments to Article 8 of the Uniform Commercial Code

Recommendations and proposed statutes on these topics accompany this Report.

Proposals for Legislative Consideration in 1984

In addition to the recommendation submitted in 1984, the Commission recommends favorable consideration of the following recommendations of past years upon which no final action was taken in 1984.

(1) Amendments to the Uniform Limited Partnership Act. See Recommendations of 1983 Annual Report, page 9.

(2) Appeals to the Tax Tribunal -- Former H.B. 4304. See Recommendations of 1978 Annual Report, page 9.

(3) In Rem Jurisdiction by Attachment or Garnishment Before Judgment -- Former H.B. 4303. See Recommendations of 1978 Annual Report, page 22.

(4) Repeal of M.C.L. Section 764.9 -- Former H.B. 4903, passed by the House. See Recommendations of the 1982 Annual Report, page 9.

(5) Disclosure in the Sale of Visual Art Objects Produced in Multiples -- former H.B. 4300, 4301, and 4302, passed by the House. See Recommendations of the 1981 Annual Report, page 57.

Current Study Agenda

Topics on the current study agenda of the Commission are:

(1) Eliminating Statutory References to Justice of the Peace and Other Abolished Courts
(2) Inconsistent References to "Police Officer" and "Peace Officer"
(3) Transfer of A Business Having Liquor Sales As A Minor Portion of Its Activities
(4) Registration of Assumed Names
(5) Granting and Withdrawal of Medical Practice Privileges in Hospitals
(6) Uniform Law on Notarial Acts
(7) Uniform Unclaimed Property Act
(8) Responsibilities of Finders of Lost Property

The Commission continues to operate with its sole staff member, the part-time Executive Secretary, whose offices are in the University of Michigan Law School, Ann Arbor, Michigan 48109-1215. By using faculty members at the several law schools as consultants and law students as researchers, the Commission has been able to operate at a budget substantially lower than that of similar commissions in other jurisdictions.

The Legislative Service Bureau has generously assisted the Commission in the development of its legislative program. The Director of the Legislative Service Bureau, who acts as Secretary to the Commission, continues to handle the fiscal operations of the Commission under procedures established by the Legislative Council.

Prior Enactments

The following Acts have been adopted to date pursuant to recommendations of the Commission and in some cases amendments thereto by the Legislature:

1967 Legislative Session

Subject	Commission Report	Act No.
Original Jurisdiction of Court of Appeals	1966, p. 43	65
Corporation Use of Assumed Names	1966, p. 36	138
Interstate and International Judicial Procedures	1966, p. 25	178
Stockholder Action Without Meetings	1966, p. 41	201
Powers of Appointment	1966, p. 11	224
Dead Man's Statute	1966, p. 29	263

1968 Legislative Session

Subject	Commission Report	Act No.
Possibilities of Reverter and Right of Entry	1966, p. 22	13
Stockholder Approval of Mortgaging Assets	1966, p. 39	287
Corporations as Partners	1966, p. 34	288
Guardian Ad Litem	1967, p. 53	292
Emancipation of Minors	1967, p. 50	293
Jury Selection	1967, p. 23	326

1969 Legislative Session

Subject	Commission Report	Act No.
Access to Adjoining Property	1968, p. 21	55
Recognition of Acknowledgments	1968, p. 61	57
Dead Man's Statute Amendment	1969, p. 29	63
Notice of Tax Assessments	1968, p. 30	115
Antenuptial Agreements	1968, p. 27	139
Anatomical Gifts	1968, p. 39	189
Administrative Procedures Act	1967, p. 11	306
Venue Act	1968, p. 19	333

1970 Legislative Session

Subject	Commission Report	Act No.
Land Contract Foreclosures	1967, p. 55	86
Artist-Art Dealer Relationships Act	1969, p. 44	90
Minor Students Capacity to Borrow Act	1969, p. 51	107
Warranties in Sales of Art Act	1969, p. 47	121
Appeals from Probate Court Act	1968, p. 32	143
Circuit Court Commission Power of Magistrates Act	1969, p. 62	238

1971 Legislative Session

Subject	Commission Report	Act No.
Revision of Grounds for Divorce	1970, p. 7	75
Civil Verdicts by 5 of 6 Jurors In Retained Municipal Courts	1970, p. 40	158
Amendment of Uniform Anatomical Gift Act	1970, p. 45	186

1972 Legislative Session

Subject	Commission Report	Act No.
Summary Proceeding for Possession of Premises	1970, p. 16	120
Interest on Judgments Act	1969, p. 64	135
Business Corporation Act	1970, Supp.	284
Constitutional Amendment re Juries of 12	1969, p. 65	HJR "M"

1973 Legislative Session

Subject	Commission Report	Act No.
Execution and Levy in Proceedings	1970, p. 51	96
Technical Amendments to Business Corporation Act	1973, p. 8	98

1974 Legislative Session

Subject	Commission Report	Act No.
Venue in Civil Actions Against Non-Resident Corporations	1971, p. 63	52
Model Choice of Forum Act	1972, p. 60	88
Extension of Personal Jurisdiction in Domestic Relations Cases	1972, p. 53	90
Technical Amendments to the General Corporations Act	1973, p. 38	140
Technical Amendments to the Revised Judicature Act	1971, p. 7	297
1974 Technical Amendments to the Business Corporation Act	1974, p. 30	303
Amendment to "Dead Man's" Statute	1972, p. 70	305
Attachment Fees Act	1968, p. 23	306
Contribution Among Joint Tortfeasors Act	1967, p. 57	318
District Court Venue in Civil Actions	1970, p. 42	319
Elimination of Pre-judgment Garnishment	1972, p. 7	371

1975 Legislative Session

Subject	Commission Report	Act No.
Amendment of Hit-Run Provisions to Provide Specific Penalty	1973, p. 54	170
Equalization of Income Rights of Husband and Wife in Entirety Property	1974, p. 30	288
Uniform Disposition of Community Property Rights at Death Act	1973, p. 50	289
Insurance Policy in Lieu of Bond Act	1969, p. 54	290
Uniform Child Custody Jurisdiction Act	1969, p. 22	297

1976 Legislative Session

Subject	Commission Report	Act No.
Due Process in Replevin Actions	1972, p. 7	79
Qualifications of Fiduciaries	1966, p. 32	262
Revision of Revised Judicature Act Venue Provisions	1975, p. 20	375
Durable Family Power of Attorney	1975, p. 18	376

1978 Legislative Session

Subject	Commission Report	Act No.
Study Report on Juvenile Obscenity Law	1975, p. 133	33
Multiple Party Deposits	1966, p. 18	53
Amendment of Telephone and Messenger Service Act Amendments	1973, p. 48	63
Elimination of References to Abolished Courts		
a. Township By-Laws	1976, p. 74	103
b. Public Recreation Hall Licenses	1976, p. 74	138
c. Village Ordinances	1976, p. 74	189
d. Home Rule Village Ordinances	1976, p. 74	190
e. Home Rule Cities	1976, p. 74	191
f. Preservation of Property Act	1976, p. 74	237
g. Bureau of Criminal Identification	1976, p. 74	538
h. Fourth Class Cities	1976, p. 74	539
i. Election Law Amendments	1976, p. 74	540
j. Charter Townships	1976, p. 74	553
Amendments of the Plat Act	1976, p. 58	367
Amendments to Article 9 of the Uniform Commercial Code	1975, Supp.	369

1980 Legislative Session

Subject	Commission Report	Act No.
Condemnation Procedures Act	1968, p. 11	87
Technical Revision of the Code of Criminal Procedure	1978, p. 37	506

1981 Legislative Session

Subject	Commission Report	Act No.
Elimination of Reference to the Justice of the Peace: Provision on the Sheriff's Service of Process	1976, p. 74	148
Amendment of R.J.A. Section 308 (Court of Appeals Jurisdiction) in accord with R.J.A. Section 861	1980, p. 34	206

1982 Legislative Session

Subject	Commission Report	Act No.
Revised Uniform Limited Partnership Act	1980, p. 40	213
Technical Amendments to the Business Corporation Act	1980, p. 8	407
Amendment of Probate Code as to Interest on Judgments	1980, p. 37	412

1983 Legislative Session

Subject	Commission Report	Act No.
Elimination of Various Statutory References to Abolished Courts	1979, p. 9	87
Uniform Federal Lien Registration Act	1979, p. 26	102

1984 Legislative Session

Subject	Commission Report	Act No.
Study Report on Legislative Privilege		
a. Immunity in Civil Actions	1983, p. 14	27
b. Limits of Immunity in Contested Cases	1983, p. 14	28
c. Amendments to R.J.A. for Legislative Immunity	1983, p. 14	29
Disclosure of Treatment Under the Psychologist/ Psychiatrist-Patient Privilege	1978. p. 28	362

The Commission continues to welcome suggestions for improvement of its program and proposals.

Respectfully submitted,

Tom Downs, Chairman
David Lebenbom
Theodore W. Swift
Richard C. Van Dusen

Ex-Office Members

Sen. Alan Cropsey
Sen. Basil W. Brown
Rep. Perry Bullard
Rep. Ernest W. Nash
Elliott Smith, Secretary

Date: January 30, 1985

AMENDMENT OF THE ASSUMED NAMES ACT

(LIMITED PARTNERSHIP)

In the 15th Annual Report, the Commission recommendation on the Uniform Limited Partnership Act proposed inclusion within that Act of a central registration procedure for assumed names similar to the registration procedure utilized for corporations. It was further noted that, if this proposal were adopted, the general Assumed Names Act should be amended to delete its coverage of limited partnerships. The Uniform Limited Partnership Act, including the central registration provision, was adopted in Public Act No. 213 of 1982 (see M.C.L. 449.1104), and there is now need for the recommended amendment of the Assumed Names Act.

The Assumed Names Act -- M.C.L. 445.1 to 445.5 -- provides for county registration of assumed names (i.e., business names other than the "real name of the person owning, conducting, or transacting" the business). As adopted in 1907, Section 4 of the Act provided:

> This Act shall in no way affect or apply to any corporation, partnership, association, limited or special partnership duly organized under the laws of this State, or to any corporation organized under the laws of any other State and lawfully doing business in this State.

In 1966, the Michigan Law Revision Commission recommended the inclusion of corporations and partnerships under the Act. Michigan Law Revision Commission, First Annual Report, 1966, p. 36. The Commission noted that

> Corporations and partnerships both have occasions to engage in operating businesses under assumed names. To do so, they must either organize paper corporations or register in the name of an individual with a separate acknowledgment of trust for the real party in interest. Where this occurs, creditors are not afforded the protections

intended by the assumed name statute.

The Commission recommended that Section 1 be amended to refer to partnerships and corporations, that Section 4 be deleted, and that a new Section 4 be added specifying the filing requirements for an entity. This was accomplished in Public Act No. 138 of 1967. That Act eliminated the original Section 4 language and added to Section 1 the following sentence.

> As used in this Act, "person" means any one or more individuals, corporations, partnerships, limited partnerships, trusts, fiduciaries, or any other entities capable of contracting.

This provision was short-lived, however, as the legislature found that county-by-county registration unduly burdened corporations. Public Act No. 165 of 1968 amended the definition of "person" to excluding corporations and modified Section 4 to add a new sentence similar to that found in the original Section 4 except that it was limited to corporations. The new sentence stated

> This Act shall in no way affect or apply to any corporation organized under the laws of this State, or to any corporation organized under the laws of any other State and lawfully doing business in the state, except as otherwise provided by Act No. 192 of the Public Acts of 1962, as amended.

The exception noted for Act No. 192 of 1962 applies to professional service corporations, who are allowed to drop the "PA" from their name provided they register "in the manner required for the registration of fictitious names." See M.C.L. 450.231.

In 1972, the Business Corporation Act was adopted (P.A. 1972, No. 284). Section 217 of that act (M.C.L. 450.1217) created a central certification scheme for corporate assumed names. This met the concern of the Law Revision Commission expressed in its 1966 Report, but avoided the burden of county-by-county registration. No amendment of the Assumed Names Act was required since the 1968 Amendment had excluded corporations.

In 1982, the Limited Partnership Act was adopted (P.A. 1982, No. 213; M.C.L. 449.1101 et. seq.). Sections 102 and 104 (M.C.L. 449.1102, 449.1104) set out the guidelines for naming limited partnerships and using assumed names. Those provisions adopt a central certification procedure similar to that used for

corporations. As noted at the time, adoption of this procedure should be followed by amendment of the Assumed Names Act to exclude coverage of limited partnerships. See 15th Annual Report, pages 79, 165. Without such an amendment, limited partnerships would be required to obtain certificates for assumed names both centrally and on the county level, creating a double burden for limited partnerships which does not apply to any other entity.

The proposed bill follows:

ASSUMED NAMES -- LIMITED PARTNERSHIPS

An Act to amend sections 1 and 4 of Act No. 101 of the Public Acts of 1907, entitled "An Act to regulate the carrying on of business under an assumed or fictitious name," as amended, being Sections 445.1 to 445.5 of the Compiled Laws of 1970, by amending Sections 1 and 4 thereof and adding a new Section 4a.

THE PEOPLE OF THE STATE OF MICHIGAN ENACT

Sections 1, and 4 of Act No. 101 of the Public Acts of 1907, as amended, being Sections 445.1, and 445.4 of the Compiled Laws of 1970, are amended, and a new Section 4a is added, to read as follows:

Section 1. (1) A person shall not carry on or conduct or transact business in this state under an assumed name, or under a designation, name, or style other than the real name of the person owning, conducting, or transacting that business, unless the person files in duplicate in the office of the clerk of the county or counties in which the person owns, conducts, or transacts, or intends to own, conduct, or transact business, or maintains an office or place of business, a certificate on a form furnished by the county clerk setting forth the name under which the business owned is, or is to be conducted or transacted, and

the true or real full name of the person owning, conducting, or transacting the same, with the address of the person, at which time the person shall pay the clerk a filing fee of $6.00. The certificate shall be excuted and duly acknowledged by the person owning, conducting, or intending to conduct the business.

(2) The selling of goods by sample or through a traveling agent or traveling salesperson or by means of orders forwarded by the purchaser through the mails, shall not be construed for the purpose of this act as conducting or transacting business so as to require the filing of the certificates.

(3) The county clerk shall certify the duplicate and return it to the applicant.

(4) As used in this act:

(a) "Person" means 1 or more individuals, partnerships, ~~limited partnerships,~~ trusts, fiduciaries, or other entities capable of contracting, EXCEPT AS PROVIDED IN SECTION 4a.

(b) "Address" means the residence or principal business address of the person.

Section 4. The certificate referred to in section 1, in the case of any person named therein other than an individual, shall state the nature of the entity; the statutory law, if any, pursuant to which it was organized; the place and the date of

filing with any governmental authority, identifying it, of any documents, describing them, required to be filed in order to accomplish or complete the organization of the entity and to entitle it to operate or transact business under the laws of this state and; if organized elsewhere, of the state or county where organized; and, if a fiduciary, the date of the last will and testament or trust agreement and the court, place and date of admission to probate of the will or the names and addresses of the parties to the trust agreement, and the name and address of each fiduciary; and, if a partnership ~~or limited partnership;~~ the name and address of each partner. ~~This act shall in no way affect or apply to any corporation organized under the laws of this state; or to any corporation organized under the laws of any other state and lawfully doing business in the state; except as otherwise provided by Act No. 192 of the Public Acts of 1962, as amended.~~

Section 4a. THIS ACT SHALL IN NO WAY AFFECT OR APPLY TO ANY CORPORATION OR LIMITED PARTNERSHIP ORGANIZED UNDER THE LAWS OF THIS STATE, OR TO ANY CORPORATION OR LIMITED PARTNERSHIP ORGANIZED UNDER THE LAWS OF ANY OTHER STATE AND LAWFULLY DOING BUSINESS IN THE STATE, EXCEPT AS OTHERWISE PROVIDED BY ACT NO. 192 OF THE PUBLIC ACTS OF 1962, AS AMENDED.

UNIFORM TRANSFERS TO MINORS ACT

INTRODUCTION

The Uniform Transfers to Minors Act (UTMA) (App. A) expands the scope of the Uniform Gifts to Minors Act (UGMA), which was enacted in Michigan in 1959 (M.C.L. 554.451, et seq., App. B). The UGMA provides for gifts of money, securities and insurance policy proceeds to minor donees under the protection of a custodian. The primary advantages of this custodial mechanism, as compared with trusts, conservatorships and the like, are its economy and informality. The proposed UTMA has a twofold purpose: (1) to expand the UGMA's custodial mechanism so that it is available for a wider range of property interests and transactions; and (2) to address an increasing lack of uniformity, and resulting conflicts problems, produced by piecemeal modifications of the UGMA by various states in recent years.

The UTMA achieves its first objective by including under the Act all kinds of property, whether real or personal, tangible or intangible. It encompasses not only gifts, but transfers made by persons obligated to a minor. It also encompasses transfers based on the occurrence of a future event, and thus may be used for transfers to be made by a personal representative or trustee pursuant to the authorization of a will or trust instrument.

The second objective of the UTMA is to be achieved (1) by proposing a provision sufficiently broad so that all jurisdictions will find it adequate and thereby produce uniformity through adoptions without modifications, and (2) by a specific provision on choice of laws. That provision (section 2 of the Act) states that a transfer made under the Act of the particular state will be governed by the law of that state, provided a sufficient nexus existed at the time of the transfer. A subsequent change in residence of the relevant parties or removal of the property from the state does not alter the applicable law.

EXPANSION OF PROPERTY: ABUSE AND LIABILITY ISSUES

The UTMA's inclusion of a broader range of property interests raises basically two questions: (1) is the degree of supervision provided by the Act approriate for the added types of

property interests and (2) does the Act deal adequately with the assessment of liability arising from the use of that property?

Abuses. The problem of abuse arises from the possibility that persons will seek to take advantage of the UTMA as a tax shelter without actually parting with dominion and control. Such a concern was discussed in Newman, The Uniform Gifts to Minors Act in New York and Other Jurisdictions, Tax Consequences, Possible Abuses, and Recommendations, 49 Cornell L.Quart. 12 (1963), with respect to the UGMA. The author noted that surveys had shown some tendency toward abuse by custodians who attempted to transfer custodial property into their own accounts, and that donor-custodians seemed to often not understand the legal limits on their use of the property. The author also concluded, however, that adoption of special restraints designed to preclude such abuse was not desirable. Restrictions on withdrawals from custodial bank accounts, for example, would place fiduciary responsibility on the bank without compensating them therefor, and such restrictions would discourage many legitimate gifts to minors. The UTMA presents the question as to whether the same conclusion should be reached where the custodial property is something other than money or securities.

In the case of money and securities, the ability of the donor-custodian to abuse the custodianship device is tempered by the requirement that, to obtain a benefit, the custodian must make some open transfer of title, thereby creating a record of any dilution of custodial property. The UTMA however, encompasses property interests that can be utilized to the benefit of the custodian without a transfer of title. Thus, a donor-custodian of real property can retain the beneficial use of that property by a token transfer to the minor and continued use of realty without payment of compensation. Similar concerns are applicable to various items of personal property, such as an aircraft, where a diversion of the beneficial use of the property to the custodian-donor can readily occur without a clear paper record.

Any increased potential for abuse without detection must be weighed against the value of the UTMA in providing an affordable custodianship for the benefit of the minor. The popularity of trust mechanisms indicates how frequently a genuine desire to transfer property is accompanied by misgivings about proper management and control of the property when given to a minor. For many persons, trusts are economically out of reach (or thought to be out of reach). Many persons of modest means may be discouraged from proceeding with non-cash gifts to minors because of fears that legal expenses would be excessive. They could, of course, convert the property to cash or securities, and give the receipts to the minor, but that may be a costly process in itself, particularly where the property is expected to grow in value in the future. In the end, considering that any potential for abuse also would exist in many trust arrangements, there

seems to be no reason to penalize persons who are likely to make such transfers only if the UTMA is available. Certainly, the legal obligations of the custodian are fully stated (see e.g., Section 12) and third parties dealing with the custodian are adequately protected (see Section 16).[1]

Liability. Unlike cash or securities, many types of property transferable under the UTMA bear substantial liability risks. Not all of the risks are insurable. See Comment to Section 17, UTMA. There is a substantial possibility, under the UTMA's broader scope, that an ill-informed custodianship could transfer large risks to the custodian or the minor (as owner). Section 17 seeks to respond to this concern. It basically limits personal liability to instances of personal fault. Of course, some questions may arise in applying this standard. For example, where the minor acts irresponsibly, a question may arise as to the custodian's liability, just as questions have arisen, for example, as to whether parents are "at fault" for actions of their children based on a theory of insufficient supervision. The possible uncertainties in assessing fault have not precluded the adoption of similar standards in analogous areas dealing with trust and conservatorship mechanisms. See e.g., M.C.L. 700.489, 700.818 (both based on Uniform Probate Act provisions that also served as the model for Section 17).

EFFECT OF THE UTMA ON CHOICE OF LAWS AND JURISDICTION

Section 2(a) provides that the state's Act applies to all custodianships made under the Act if a minimal nexus criteria is satisfied. Acceptable connections for utilizing a particular state's Act include the residence of the minor, the custodian, or the grantor/donor within the state, or the location of the property in-state.

Under current law, a gift of money, securities or insurance may be made under the Michigan Act if the gift is made pursuant to the terms of the UGMA, which requires an instrument naming the

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1. While the expansion of the encompassed property does create more situations in which custodian's authority might be put in question (e.g., in the passage of title to real property), Section 16 allows third parties to rely on that authority without undertaking any significant inquiry into the custodian's capacity. It should work as effectively with the new range of property as Section 6 of the UGMA did with the old, and jurisdictions that have added real property, etc., to their versions of the UGMA experienced no difficulties in this regard.

custodian and invoking the UGMA to transfer the property. See M.C.L. 554.452. The current Act does not specify what contact the various interested parties must have in Michigan. It appears to be assumed that one of nexuses noted in Section 2 of the UTMA will be present. Thus, a donor located out-state may utilize the Michigan Act by giving a gift of cash, deposited in a Michigan bank, to an out-state minor donee, with the custodian being an out-state adult. The unspoken premise of the UGMA appears to be that subject matter authority exists, and a custodianship under the law of this state therefore can be created, with a nexus based on the location of the property or the residency of the parties. Thus, Section 2 of the UTMA probably does no more than make specific what is curently assumed.

The current Act authorizes the court to take certain actions enforcing or defining the obligations of the custodian. See e.g., M.C.L. 554.457. Section 554.451(d) apparently assumes that such actions ordinarily will be brought in this state; it notes that the reference to "the court" ordinarily is to the probate court of the county in which the minor resides. The UTMA similarly provides for the bringing of an action in the state in which the custodianship is created. Section 2(b) provides that the custodian is subject to personal jurisdiction in that state "with respect to any matter relating to the custodianship." This does not, of course, preclude suit against the custodian in another state where jurisdiction is lawfully obtained. Section 2(c) ensures, however, that the law of the designated state of the custodianship will govern in any such action. This provision would commit Michigan to apply the law of another state to a suit seeking to enforce the custodian's obligations under a custodianship created in that other state, and it would require other states to apply Michigan law to a similar suit brought against a custodian under a Michigan custodianship.

The combination of the various provisions of Section 2 could produce some difficulties in special situations. Consider, for example, a case in which the donor was a Michigan resident and used the Michigan Act to transfer Ohio property to an Ohio custodian for the benefit of a minor living in Ohio. Under Section 2, any litigation "relating to the custodianship" could be brought in Michigan and resolved under Michigan law. A broad reading of that phrase could have Michigan exercise jurisdiction in a dispute that may resolve title to Ohio property, producing enforcement uncertainties under the doctrine of Fall v. Eastin, 215 U.S. 1 (1909). It is assumed, however, that the Michigan courts would readily avoid that difficulty -- and any similar difficulties produced by a tenuous nexus to this state (though sufficient under Section 2) -- by use of the forum non conveniens doctrine. See Anderson v. Great Lakes Dredge and Docking Co., 411 Mich. 619, 309 N.W.2d 539 (1981) (trial court abused its discretion in failing to dismiss, on forum non conveniens grounds, a Jones Act action brought by Florida resident for injuries received in Florida on dredge owned by Delaware

Corporation, with principle place of business in Illinois, which was engaged in only unrelated business in Michigan). The use of that doctrine will not alter the law governing the custodianship, since Section (c) would also require the Ohio courts to apply Michigan law.

OTHER ASPECTS OF THE UTMA

Taxes. One of the primary purposes for the original enactment of the UGMA was to create a reliable standard for making gifts to minors that would qualify for the Federal gift tax exlusion. See Newman, supra. The UGMA has been ruled to create qualifying gifts for the purposes of the Federal gift tax exclusion, but in order to do so was compelled to include a provision whereby custodial property could be used for the benefit of the donee before his attaining the age of majority. See M.C.L. 554.454(2),(3). This provision in turn gave rise to income-attribution problems for income tax purposes. Where a legal obligation of the donor existed to support the donee, regardless of the donee's ability to support himself with separate funds, the I.R.S. determined that, under Section 61 of the 1954 Internal Revenue Code, any income from the custodial property that was used for the support and maintenance of the minor was attributable to the donor who had a duty of support. This ruling (Rev. Rul:484, 1956-2 C.B. 23) treated the UGMA transfer as a trust-like arrangement rather than an outright gift. The UTMA attempts to deal with this problem of satisfying the requirements for both gift and and income tax benefits by the addition of a subsection (c) to Section 14. This new subsection states: "A delivery, payment, or expenditure under this section is in addition to, not in substitution for, and does not affect any obligation of a person to support the minor." Whether the I.R.S. will consider this declaration to make any substantive difference in cases where custodial income is used for purposes normally considered to be "support" is debatable. Even if this provision is unsuccessful, the UTMA will still expand upon the tax advantages of the UGMA by expanding the range of encompassed property.

Section 3. Another notable change in the UTMA is the inclusion of a provision for prospective custodians. Section 3 permits a custodian to be presently nominated for a custodianship to take effect only upon the occurence of a future event, generally the death of the prospective transferor. Essentially, this provision is identical to testamentary appointment of a conservator. However, it had broader application, such as for beneficiaries of insurance policies and other accounts. Under current law a payor like an insurance company would in all likelihood petition for appointment of a conservator where a minor beneficiary was to receive substantial benefits. This

provision simply makes the more economical custodianship device readily available even when the policy holder has died, and together with Section 16, assures obligors that their obligation will be legally discharged.

Age Limit. Since the tax law draws the line at 21, the UTMA continues to use that age limit, and urges the states to do so also, even though the age of majority in the state may be 18. (See Prefatory Note). Since Michigan, refused to heed this advice as to the UGMA, it is assumed that the same will be done under the UTMA.

Continuity. The UTMA ensures continuity by validating gifts made previously under the enacting state's UGMA (see Section 22). It also validates transfers that mistakenly refer to the UGMA after the effective date of the new act (see Section 21).

* * * *

Overall, the Uniform Transfers to Minors Act offers an updated and more complete application of the goals of the UGMA, an Act that was well received in Michigan and elsewhere. Accordingly, the Commission recommends its adoption. The proposed bill follows:

UNIFORM TRANSFERS TO MINORS ACT

A bill to regulate certain transfers of property to minors; to make uniform the law regulating certain transfers of property to minors; and to repeal certain acts and parts of acts.

THE PEOPLE OF THE STATE OF MICHIGAN ENACT:

Section 1. As used in this Act:

(a) "Adult" means an individual who is 18 years of age or older.

(b) "Benefit plan" means an employer's plan for the benefit of an employee or partner.

(c) "Broker" means a person lawfully engaged in the business of effecting transactions in securities or commodities for the person's own account or for the account of others.

(d) "Conservator" means a person appointed or qualified by a court to act as a guardian, limited guardian, or temporary guardian of a minor's property or a person legally authorized to perform substantially the same functions.

(e) "Court" means the probate court for the county in which a minor resides.

(f) "Custodial property" means any interest in property transferred to a custodian under this act and the income from, and proceeds of, the interest in property.

(g) "Custodian" means a person so designated pursuant to section 9 or a successor or substitute custodian designated under section 18.

(h) "Financial institution" means a bank, trust company, savings and loan association, or credit union chartered and supervised under state or federal law.

(i) "Legal representative" means an individual's personal representative or conservator.

(j) "Member of the minor's family" means the minor's parent, stepparent, spouse, grandparent, brother, sister, uncle, or aunt, whether of the whole or half blood or by adoption.

(k) "Minor" means an individual who is less than 18 years of age.

(l) "Person" means an individual, partnership, corporation, association, or other legal entity.

(m) "Personal representative" means an executor, administrator, successor personal representative, or special administrator of a decedent's estate or a person legally authorized to perform substantially the same functions.

(n) "State" includes any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession subject to the legislative authority of the United States.

(o) "Transfer" means a transaction that creates custodial property under section 9.

(p) "Transferor" means a person who makes a transfer under this act.

(q) "Trust company" means a financial institution, corporation, or other legal entity, authorized to exercise general trust powers.

Section 2. (1) This Act applies to a transfer that refers to this act in the designation, under section 9(1), by which the transfer is made if, at the time of the transfer, the transferor, the minor, or the custodian is a resident of this state or the custodial property is located in this state. The custodianship so created remains subject to this act despite a subsequent change in residence of a transferor, the minor, or the custodian, or the removal of custodial property from this state.

(2) A person designated as custodian under this act is subject to personal jurisdiction in this state with respect to any matter relating to the custodianship.

(3) A transfer that purports to be made and which is valid

under the Uniform Transfers to Minors Act, the Uniform Gifts to Minors Act, or a substantially similar act, of another state is governed by the law of the designated state and may be executed and is enforceable in this state if, at the time of the transfer, the transferor, the minor, or the custodian is a resident of the designated state or the custodial property is located in the designated state.

Section 3. (1) A person having the right to designate the recipient of property transferable upon the occurrence of a future event may revocably nominate a custodian to receive the property for a minor beneficiary upon the occurrence of the future event by naming the custodian followed in substance by the words: "as custodian for _____ (name of minor) under the Michigan Uniform Transfers to Minors Act." The nomination may name 1 or more persons as substitute custodians to whom the property must be transferred, in the order named, if the first nominated custodian dies before the transfer or is unable, declines, or is ineligible to serve. The nomination may be made in a will, a trust, a deed, an instrument exercising a power of appointment, or in a writing designating a beneficiary of contractual rights that is registered with or delivered to the payor, issuer, or other obligor of the contractual rights.

(2) A custodian nominated under this section shall be a person to whom a transfer of property of that kind may be made under section 9(1).

(3) The nomination of a custodian under this section does not create custodial property until the nominating instrument becomes irrevocable or a transfer to the nominated custodian is completed under section 9. Unless the nomination of a custodian has been revoked, upon the occurrence of the future event the custodianship becomes effective and the custodian shall enforce a transfer of the custodial property pursuant to section 9.

Section 4. A person may make a transfer by irrevocable gift to, or the irrevocable exercise of a power of appointment in favor of, a custodian for the benefit of a minor pursuant to section 9.

Section 5. (1) A personal representative or trustee may make an irrevocable transfer pursuant to section 9 to a custodian for the benefit of a minor as authorized in the governing will or trust.

(2) If the testator or settlor has nominated a custodian under section 3 to receive the custodial property, the transfer shall be made to the custodian.

(3) If the testator or settlor has not nominated a custodian under section 3, or all persons so nominated as custodian die before the transfer or are unable, decline, or are ineligible to serve, the personal representative or the trustee, as the case may be, shall designate the custodian from among those eligible to serve as custodian for property of that kind under section

9(1).

Section 6. (1) Subject to subsection (3), a personal representative or trustee may make an irrevocable transfer to another adult or trust company as custodian for the benefit of a minor pursuant to section 9, in the absence of a will or under a will or trust that does not contain an authorization to make the irrevocable transfer.

(2) Subject to subsection (3), a conservator may make an irrevocable transfer to another adult or trust company as custodian for the benefit of the minor pursuant to section 9.

(3) A transfer under subsection (1) or (2) may be made only if the personal representative, trustee, or conservator considers the transfer to be in the best interest of the minor; the transfer is not prohibited by or inconsistent with provisions of the applicable will, trust agreement, or other governing instrument; and, if the transfer exceeds $10,000.00 in value, the transfer is authorized by the court.

Section 7. (1) Subject to subsections (2) and (3), a person not subject to section 5 or 6 who holds property of, or owes a liquidated debt to, a minor not having a conservator may make an irrevocable transfer to a custodian for the benefit of the minor pursuant to section 9.

(2) If a person having the right to do so under section 3 has nominated a custodian under that section to receive the

custodial property, the transfer shall be made to that person.

(3) If no custodian has been nominated under section 3, or all persons so nominated as custodian die before the transfer or are unable, ineligible, or decline to serve, a transfer under this section may be made to an adult member of the minor's family or to a trust company unless the value of the property exceeds $10,000.00.

Section 8. A written acknowledgment of delivery by a custodian constitutes a sufficient receipt and discharge for custodial property transferred to the custodian pursuant to this act.

Section 9. (1) Custodial property is created and a transfer is made whenever any of the following occurs:

(a) An uncertificated security or a certificated security in registered form is either of the following:

(i) Registered in the name of the transferor, an adult other than the transferor, or a trust company, followed in substance by the words: "as custodian for _____ (name of minor) under the Michigan Uniform Transfers to Minors Act."

(ii) Delivered if in certificated form, or any document necessary for the transfer of an uncertificated security is delivered, together with any necessary endorsement to an adult other than the transferor or to a trust company as custodian,

accompanied by an instrument in substantially the form set forth in subsection (2).

(b) Money is paid or delivered to a broker or financial institution for credit to an account in the name of the transferor, an adult other than the transferor, or a trust company, followed in substance by the words: "as custodian for _____ (name of minor) under the Michigan Uniform Transfers to Minors Act."

(c) The ownership of a life or endowment insurance policy or annuity contract is either of the following:

(i) Registered with the issuer in the name of the transferor, an adult other than the transferor, or a trust company, followed in substance by the words: "as custodian for _____ (name of minor) under the Michigan Uniform Transfers to Minors Act."

(ii) Assigned in a writing delivered to an adult other than the transferor or to a trust company whose name in the assignment is followed in substance by the words: "as custodian for _____ (name of minor) under the Michigan Uniform Transfers to Minors Act."

(d) An irrevocable exercise of a power of appointment or an irrevocable present right to future payment under a contract is the subject of a written notification delivered to the payor, issuer, or other obligor that the right is transferred to the

transferor, an adult other than the transferor, or a trust company, whose name in the notification is followed in substance by the words: "as custodian for _____ (name of minor) under the Michigan Uniform Transfers to Minors Act."

(e) An interest in real property is recorded in the name of the transferor, an adult other than the transferor, or a trust company, followed in substance by the words: "as custodian for _____ (name of minor) under the Michigan Uniform Transfers to Minors Act."

(f) A certificate of title issued by a department or agency of a state or of the United States which evidences title to tangible personal property is either of the following:

(i) Issued in the name of the transferor, an adult other than the transferor, or a trust company, followed in substance by the words: "as custodian for _____(name of minor) under the Michigan Uniform Transfers to Minors Act."

(ii) Delivered to an adult other than the transferor or to a trust company, endorsed to that person followed in substance by the words: "as custodian for _____(name of minor) under the Michigan Uniform Transfers to Minors Act."

(g) An interest in any property not described in subdivisions (a) through (f) is transferred to an adult other than the transferor or to a trust company by a written instrument in substantially the form set forth in subsection (2).

(2) An instrument in the following form satisfies the requirements of subsection (1)(a)(ii) and (1)(g).

"TRANSFER UNDER THE MICHIGAN UNIFORM TRANSFERS TO MINORS ACT

I, _____ (name of transferor or name and representative capacity, if a fiduciary) hereby transfer to _____ (name of custodian), as custodian for _____ (name of minor) under the Michigan Uniform Transfers to Minors Act, the following:

(insert a description of the custodial property sufficient to identify it).

Dated: _____

_____

(Signature)

_____ (name of custodian) acknowledges receipt of the property described above as custodian for the minor named above under the state uniform transfers to minors act.

Dated: _____

_____"

(Signature of Custodian)

(3) A transferor shall place the custodian in control of the custodial property as soon as practicable.

Section 10. A transfer may be made only for 1 minor, and only 1 person may be the custodian. All custodial property held under this act by the same custodian for the benefit of the same minor constitutes a single custodianship.

Section 11. (1) The validity of a transfer made in a manner prescribed in this act is not affected by any of the following:

(a) Failure of the transferor to comply with section 9(3) concerning control.

(b) Designation of an ineligible custodian, except designation of the transferor in the case of property for which the transferor is ineligible to serve as custodian under section 9(1).

(c) Death or incapacity of a person nominated under section 3 or designated under section 9 as custodian or the disclaimer of the office by that person.

(2) A transfer made pursuant to section 9 is irrevocable, and the custodial property is indefeasibly vested in the minor, but the custodian has all the rights, powers, duties, and authority provided in this act, and neither the minor nor the minor's legal representative has any right, power, duty, or authority with respect to the custodial property except as provided in this Act.

(3) By making a transfer, the transferor incorporates in the

disposition all the provisions of this act and grants to the custodian, and to any third person dealing with a person designated as custodian, the respective powers, rights, and immunities provided in this Act.

Section 12. (1) A custodian shall do all of the following:

(a) Take control of custodial property.

(b) Register or record title to custodial property if appropriate.

(c) Collect, hold, manage, invest, and reinvest custodial property.

(2) In dealing with custodial property, a custodian shall observe the standard of care that would be observed by a prudent person dealing with property of another. If a custodian has a special skill or expertise or is named custodian on the basis of representations of a special skill or expertise, the custodian shall use that skill or expertise. However, a custodian, in the custodian's discretion and without liability to the minor or the minor's estate, may retain any custodial property received from a transferor.

(3) A custodian may invest in or pay premiums on life insurance or endowment policies on the life of the minor only if the minor or the minor's estate is the sole beneficiary, or the life of another person in whom the minor has an insurable

interest only to the extent that the minor, the minor's estate, or the custodian in the capacity of custodian is the irrevocable beneficiary.

(4) A custodian at all times shall keep custodial property separate and distinct from all other property in a manner sufficient to identify it clearly as custodial property of the minor. Custodial property consisting of an undivided interest is so identified if the minor's interest is held as a tenant in common and is fixed. Custodial property subject to recordation is so identified if it is recorded, and custodial property subject to registration is so identified if it is either registered, or held in an account designated, in the name of the custodian, followed in substance by the words: "as custodian for _____ (name of minor) under the Michigan Uniform Transfers to Minors Act."

(5) A custodian shall keep records of all transactions with respect to custodial property, including information necessary for the preparation of the minor's tax returns, and shall make them available for inspection at reasonable intervals by a parent or legal representative of the minor or by the minor if the minor is at least 14 years of age.

Section 13. (1) A custodian, acting in a custodial capacity, has all the rights, powers, and authority over custodial property that an unmarried adult owner has over his or her own property, but a custodian may exercise those rights, powers, and authority

in that capacity only.

(2) This section does not relieve a custodian from liability for breach of section 12.

Section 14. (1) A custodian may deliver or pay to the minor or expend for the minor's benefit so much of the custodial property as the custodian considers advisable for the use and benefit of the minor, without court order and without regard to the duty or ability of the custodian personally or of any other person to support the minor, or any other income or property of the minor which may be applicable or available for that purpose.

(2) On petition of an interested person or the minor if the minor is at least 14 years of age, the court may order the custodian to deliver or pay to the minor or expend for the minor's benefit so much of the custodial property as the court considers advisable for the use and benefit of the minor.

(3) A delivery, payment, or expenditure under this section is in addition to, not in substitution for, and does not affect any obligation of, a person to support the minor.

Section 15. (1) A custodian is entitled to reimbursement from custodial property for reasonable expenses incurred in the performance of the custodian's duties.

(2) Except for a person who is a transferor under section 4, a custodian has a noncumulative election during each calendar

year to charge reasonable compensation for services performed during that year.

(3) Except as provided in section 18(6), a custodian need not give a bond.

Section 16. A third person in good faith and without court order may act on the instructions of or otherwise deal with any person purporting to make a transfer or purporting to act in the capacity of a custodian and, in the absence of knowledge, is not responsible for determining any of the following:

(a) The validity of the purported custodian's designation.

(b) The propriety of, or the authority under this Act for, any act of the purported custodian.

(c) The validity or propriety under this Act of any instrument or instructions executed or given either by the person purporting to make a transfer or by the purported custodian.

(d) The propriety of the application of any property of the minor delivered to the purported custodian.

Section 17. (1) A claim based on a contract entered into by a custodian acting in a custodial capacity, an obligation arising from the ownership or control of custodial property, or a tort committed during the custodianship, may be asserted against the custodial property by proceeding against the custodian in the custodial capacity, whether or not the custodian or the minor is

personally liable therefor.

(2) A custodian is not personally liable in any of the following situations:

(a) On a contract properly entered into in the custodial capacity unless the custodian fails to reveal that capacity and fails to identify the custodianship in the contract.

(b) For an obligation arising from control of custodial property or for a tort committed during the custodianship unless the custodian is personally at fault.

(3) A minor is not personally liable for an obligation arising from ownership of custodial property or for a tort committed during the custodianship unless the minor is personally at fault.

Section 18. (1) A person nominated under section 3 or designated pursuant to section 9 as custodian may decline to serve by delivering a written disclaimer to the person who made the nomination or to the transferor or the transferor's legal representative. The disclaimer shall describe the custodianship being declined and shall be signed by the disclaimant. If the event giving rise to a transfer has not occurred and no substitute custodian able, willing, and eligible to serve was nominated under section 3, the person who made the nomination may nominate a substitute custodian under section 3. If a substitute custodian is not nominated, the transferor or the transferor's

legal representative shall designate a substitute custodian at the time of the transfer. A substitute custodian shall be nominated or designated from among the persons eligible to serve as custodian for that kind of property under section 9(1). The custodian so designated has the rights of a successor custodian.

(2) A custodian at any time may designate a trust company or an adult other than a transferor under section 4 as successor custodian by executing and dating an instrument of designation before a subscribing witness other than the successor. If the instrument of designation does not contain, or is not accompanied by, the resignation of the custodian, the designation of the successor does not take effect until the custodian resigns, dies, becomes incapacitated, or is removed.

(3) A custodian may resign at any time by delivering written notice to the minor if the minor has attained the age of 14 years and to the successor custodian and by delivering the custodial property to the successor custodian.

(4) If a custodian is ineligible, dies, or becomes incapacitated without having effectively designated a successor and the minor is at least 14 years of age, the minor may designate as successor custodian, in the manner prescribed in subsection (2), an adult member of the minor's family, a conservator of the minor, or a trust company. If the minor is less than 14 years of age or fails to act within 60 days after the ineligibility, death, or incapacity, the conservator of the

minor becomes successor custodian. If the minor has no conservator or the conservator declines to act, the transferor, the legal representative of the transferor or of the custodian, an adult member of the minor's family, or any other interested person may petition the court to designate a successor custodian.

(5) A custodian who declines to serve under subsection (1) or resigns under subsection (3), or the legal representative of a deceased or incapacitated custodian, as soon as practicable, shall put the custodial property and records in the possession and control of the successor custodian. The successor custodian by action may enforce the obligation to deliver custodial property and records and becomes responsible for each item as received.

(6) A transferor, the legal representative of a transferor, an adult member of the minor's family, a guardian of the person of the minor, the conservator of the minor, or the minor if the minor is at least 14 years of age, may petition the court to remove the custodian for cause and designate a successor custodian other than a transferor under section 4, or to require the custodian to give appropriate bond.

Section 19. (1) A minor who is at least 14 years of age, the minor's guardian of the person or legal representative, an adult member of the minor's family, a transferor, or a transferor's legal representative may petition the court for either of the

following:

(a) An accounting by the custodian or the custodian's legal representative.

(b) A determination of responsibility, as between the custodial property and the custodian personally, for claims against the custodial property, unless the responsibility has been adjudicated in an action under section 17 to which the minor or the minor's legal representative was a party.

(2) A successor custodian may petition the court for an accounting by the predecessor custodian.

(3) The court, in a proceeding under this act or in any other proceeding, may require or permit the custodian or the custodian's legal representative to account.

(4) If a custodian is removed under section 18(6), the court shall require an accounting and order delivery of the custodial property and records to the successor custodian and the execution of all instruments required for transfer of the custodial property.

Section 20. The custodian shall transfer in an appropriate manner the custodial property to the minor or to the minor's estate upon the earlier of the following:

(a) The minor becoming 18 years of age with respect to custodial property transferred under section 4, 5, 6, or 7.

(b) The minor's death.

Section 21. This act applies to a transfer within the scope of section 2 made after its effective date if either of the following is true:

(a) The transfer purports to have been made under former Act No. 172 of the Public Acts of 1959.

(b) The instrument by which the transfer purports to have been made uses in substance the designation "as custodian under the Uniform Gifts to Minors Act" or "as custodian under the Uniform Transfers to Minors Act" of any other state, and the application of this act is necessary to validate the transfer.

Section 22. (1) Any transfer of custodial property made before the effective date of this act is validated notwithstanding that there was no specific authority in former Act No. 172 of the Public Acts of 1959 for the coverage of custodial property of that kind or for a transfer from that source at the time the transfer was made.

(2) This Act applies to all transfers made before the effective date of this Act in a manner and form prescribed in former Act No. 172 of the Public Acts of 1959, except insofar as the application impairs constitutionally vested rights or extends the duration of custodianships in existence on the effective date of this act. To the extent that this Act does not apply due to the impairment of constitutionally vested rights, the powers,

duties and immunities conferred upon custodians and persons dealing with custodians by transfers made before the effective date of this Act in a manner and form prescribed in former Act No. 172 of the Public Acts of 1959 shall not be affected by the repeal of that Act.

Section 23. This Act shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this act among states enacting it.

Section 24. This Act may be cited as the "Michigan Uniform Transfers to Minors Act."

Section 25. Act No. 172 of the Public Acts of 1959, being sections 554.451 to 554.461 of the Michigan Compiled Laws, is repealed.

APPENDIX A

UNIFORM TRANSFERS TO MINORS ACT

PREFATORY NOTE

This Act revises and restates the Uniform Gifts to Minors Act (UGMA), one of the Conference's most successful products, some version of which has been enacted in every American jurisdiction.

The original version of UGMA was adopted by the Conference in 1956 and closely followed a model "Act concerning Gifts of Securities to Minors" which was sponsored by the New York Stock Exchange and the Association of Stock Exchange Firms and which had been adopted in 14 states. The 1956 version of UGMA broadened the model act to cover gifts of money as well as securities but made few other changes.

In 1965 and 1966 the Conference revised UGMA to expand the types of financial institutions which could serve as depositories of custodial funds, to facilitate the designation of successor custodians, and to add life insurance policies and annuity contracts to the types of property (cash and securities) that could be made the subject of a gift under the Act.

Not all states adopted the 1966 revisions; some 11 jurisdictions retained their versions of the 1956 Act. More importantly, however, many states since 1966 have substantially revised their versions of UGMA to expand the kinds of property that may be made the subject of a gift under the Act, and a few states permit transfers to custodians from other sources, such as trusts and estates, as well as lifetime gifts. As a result, a great deal of non-uniformity has arisen among the states. Uniformity in this area is important, for the Conference has cited UGMA as an example of an act designed to avoid conflicts of law when the laws of more than one state may apply to a transaction or a series of transactions.

This Act follows the expansive approach taken by several states and allows any kind of property, real or personal, tangible or intangible, to be made the subject of a transfer to a custodian for the benefit of a minor (SECTION 1(6)). In addition, it permits such transfers not only by lifetime outright gifts (SECTION 4), but also from trusts, estates and guardianships, whether or not specifically authorized in the governing instrument (SECTIONS 5 and 6), and from other third parties indebted to a minor who does not have a conservator, such as parties against whom a minor has a tort claim or judgment, and depository institutions holding deposits or insurance companies issuing policies payable on death to a minor (SECTION 7). For this reason, and to distinguish the enactment of this statute from the 1956 and 1966 versions of UGMA, the title of the Act has been changed to refer to "Transfers" rather than to "Gifts," a much narrower term.

As so expanded, the Act might be considered a statutory form of trust or guardianship that continues until the minor reaches 21. Note, however, that unlike a trust, a custodianship is not a separate legal entity or taxpayer. Under SECTION 11(b) of this Act, the custodial property is indefeasibly vested in the minor, not the custodian, and thus any income received is attributable to and reportable by the minor, whether or not actually distributed to the minor.

The expansion of the Act to permit transfers of any kind of property to a custodian creates a significant problem of potential personal liability for the minor or the custodian arising from the ownership of property such as real estate, automobiles, general partnership interests, and business proprietorships. This problem did not exist under UGMA under which custodial property was limited to bank deposits, securities and insurance. In response, SECTION 17 of this Act generally limits the claims of third parties to recourse against the custodial property, with the minor insulated against personal liability unless he is personally at fault. The custodian is similarly insulated unless he is personally at fault or fails to disclose his custodial capacity in entering into a contract.

Nevertheless, the Act should be used with caution with respect to property such as real estate or general partnership interests from which liabilities as well as benefits may arise. Many of the possible risks can and should be insured against, and the custodian has the power under SECTION 13(a) to purchase such insurance, at least when other custodial assets are sufficient to do so. If the assets are not sufficient, there is doubt that a custodian will act, or there are significant uninsurable risks, a transferor should consider a trust with spendthrift provisions, such as a minority trust under Section 2503(c), IRC, rather than a custodianship, to make a gift of such property to a minor.

The Act retains (or reverts to) 21 as the age of majority or, more accurately, the age at which the custodianship terminates and the property is distributed. Since tax law permits duration of Section 2503(c) trusts to 21, even though the statutory age of majority is 18 in most states, this age should be retained since most donors and other transferors wish to preserve a custodianship as long as possible.

Finally, the Act restates and rearranges, rather than amends, the 1966 Act. The addition of other forms of property and other forms of dispositions made adherence to the format and language of the prior act very unwieldy. In addition, the 1966 and 1956 Acts closely followed the language of the earlier model act, which had already been adopted in several states, even though it did not conform to Conference style. It is hoped that this rewriting and revision of UGMA will improve its clarity while also expanding its coverage.

UNIFORM TRANSFERS TO MINORS ACT

Sec.
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5. Transfer Authorized by Will or Trust.
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11. Validity and Effect of Transfer.
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21. Applicability.
22. Effect on Existing Custodianships.
23. Uniformity of Application and Construction.
24. Short Title.
25. Severability.
26. Effective Date.
27. Repeals.

§ 1. Definitions

In this [Act]:

(1) "Adult" means an individual who has attained the age of 21 years.

(2) "Benefit plan" means an employer's plan for the benefit of an employee or partner.

(3) "Broker" means a person lawfully engaged in the business of effecting transactions in securities or commodities for the person's own account or for the account of others.

(4) "Conservator" means a person appointed or qualified by a court to act as general, limited, or temporary guardian of a minor's property or a person legally authorized to perform substantially the same functions.

(5) "Court" means [_____ court].

(6) "Custodial property" means (i) any interest in property transferred to a custodian under this [Act] and (ii) the income from and proceeds of that interest in property.

(7) "Custodian" means a person so designated under Section 9 or a successor or substitute custodian designated under Section 18.

(8) "Financial institution" means a bank, trust company, savings institution, or credit union, chartered and supervised under state or federal law.

(9) "Legal representative" means an individual's personal representative or conservator.

(10) "Member of the minor's family" means the minor's parent, stepparent, spouse, grandparent, brother, sister, uncle, or aunt, whether of the whole or half blood or by adoption.

(11) "Minor" means an individual who has not attained the age of 21 years.

(12) "Person" means an individual, corporation, organization, or other legal entity.

(13) "Personal representative" means an executor, administrator, successor personal representative, or special administrator of a decedent's estate or a person legally authorized to perform substantially the same functions.

(14) "State" includes any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession subject to the legislative authority of the United States.

(15) "Transfer" means a transaction that creates custodial property under Section 9.

(16) "Transferor" means a person who makes a transfer under this [Act].

(17) "Trust company" means a financial institution, corporation, or other legal entity, authorized to exercise general trust powers.

COMMENT

To reflect the broader scope and the unlimited types of property to which the new Act will apply, a number of definitional changes have been made from the 1966 Act. In addition, several definitions specifically applicable to the limited types of property (cash, securities and insurance policies) subject to the 1966 Act have been eliminated as unnecessary. These include the definitions of "bank," "issuer," "life insurance policy or annuity contract," "security," and "transfer agent." No change in the meaning or construction of these terms as used in this Act is intended by such deletions.

The definitions of "domestic financial institution" and "insured financial institution" have been eliminated because few if any states limit deposits by custodians to local institutions, and the prudent person rule of SECTION 12(b) of this Act may dictate the use of insured institutions as depositories, without having the Act so specify.

The principal changes or additions to the remaining definitions are discussed below.

Paragraph (2). The definition of "benefit plan" is intentionally very broad and is meant to cover any contract, plan, system, account or trust such as a pension plan, retirement plan, death benefit plan, deferred compensation plan, employment agency arrangement or, stock bonus, option or profit sharing plan.

Paragraph (4). The term "conservator" rather than "guardian of the estate" has been employed in the Act to conform to Uniform Probate Code terminology. The term includes a guardian of the minor's property, whether general, limited or temporary, and includes a committee, tutor, or curator of the minor's property.

Paragraph (6). The definition of "custodial property" has been generalized and expanded to encompass every conceivable legal or equitable interest in property of any kind, including real estate and tangible or intangible personal property. The term is intended, for example, to include joint interests with right of survivorship, beneficial interests in land trusts, as well as all other intangible interests in property. Contingent or expectancy interests such as the designation as a beneficiary under insurance policies or benefit plans become "custodial property" only if the designation is irrevocable, or when it becomes so, but the Act specifically authorizes the "nomination" of a future custodian as beneficiary of such interests (see SECTION 3). Proceeds of custodial property, both immediate and remote, are themselves custodial property, as is the case under UGMA.

Custodial property is defined without reference to the physical location of the property, even if it has one. No useful purpose would be served by restricting the application of the Act to, for example, real estate "located in this state," since a conveyance recorded in the state of the property's location, if done with proper formalities, should be effective even if that state has not enacted this Act. The rights, duties and powers of the custodian should be determined by reference to the law of the state under which the custodianship is created, assuming there is sufficient nexus under SECTION 2 between that state and the transferor, the minor or the custodian.

Paragraph (11). This definition of "minor" retains the historical age of 21 as the age of majority, even though most states have lowered the age for most other purposes, as well as in their versions of the 1966 Act. Nevertheless, because the Internal Revenue Code continues to permit "minority trusts" under Section 2503(c), IRC, to continue in effect until age 21, and because it is believed that most donors creating minority trusts or custodianships prefer to retain the property under management for the benefit of the young person as long as possible, it is strongly suggested that the age of 21 be retained as the age of majority under this Act. For states that have reduced the age of majority in their versions of the 1966 Act, SEC-

TION 22(c) of this Act provides that a change back to 21 will not affect custodianships that have already terminated at an earlier age.

Paragraph (13). The definition of the term "personal representative" is based upon that definition in Sec. 1-201(30) of the Uniform Probate Code.

Paragraph (15). The new definition of "transfer" is necessary to reflect the application of the Act not only to gifts, but also to distributions from trusts and estates, obligors of the minor, and transfers of the minor's own assets to a custodianship by the legal representative of a minor, all of which are now permitted by this Act.

Paragraph (16). The new definition of "transferor" is required because the term includes not only the maker of a gift, i.e., a donor in the usual sense, but also fiduciaries and obligors who control or own property that is the subject of the transfer. Nothing in this Act requires that a transferor be an "adult." If permitted under other law of the enacting state relating to emancipation or competence to make a will, gift, or other transfer, a minor may make an effective transfer of property to a custodian for his benefit or for the benefit of another minor.

Paragraph (17). Only entities authorized to exercise "general" trust powers qualify as "trust companies"; that is, the authority to exercise only limited fiduciary responsibilities, such as the authority to accept Individual Retirement Account deposits, is not sufficient.

§ 2. Scope and Jurisdiction

(a) This [Act] applies to a transfer that refers to this [Act] in the designation under Section 9(a) by which the transfer is made if at the time of the transfer, the transferor, the minor, or the custodian is a resident of this State or the custodial property is located in this State. The custodianship so created remains subject to this [Act] despite a subsequent change in residence of a transferor, the minor, or the custodian, or the removal of custodial property from this State.

(b) A person designated as custodian under this [Act] is subject to personal jurisdiction in this State with respect to any matter relating to the custodianship.

(c) A transfer that purports to be made and which is valid under the Uniform Transfers to Minors Act, the Uniform Gifts to Minors Act, or a substantially similar act, of another state is governed by the law of the designated state and may be executed and is enforceable in this State if at the time of the transfer, the transferor, the minor, or the custodian is a resident of the designated state or the custodial property is located in the designated state.

COMMENT

This section has no counterpart in the 1966 Act. It attempts to resolve uncertainties and conflicts-of-laws questions that have frequently arisen because of the present nonuniformity of UGMA in the various states and which may continue to arise during the transition from UGMA to this Act.

The creation of a custodianship must invoke the law of a particular state because of the form of the transfer required under SECTION 9(a). This section provides that a choice of the UTMA of the enacting state is appropriate and effective if any of the nexus factors specified in subsection (a) exists at the time of the transfer. This Act continues to govern, and subsection (b) makes the custodian accountable and subject to personal jurisdiction in the courts of the enacting state for the duration of the custodianship, despite subsequent relocation of the parties or the property.

Subsection (c) recognizes that residents of the enacting state may elect to have the law of another state apply to a transfer. That choice is valid if a nexus with the chosen state exists at the time of the transfer. If personal jurisdiction can be obtained in the enacting state under other law apart from this Act, the custodianship may be enforced in its courts, which are directed to apply the law of the state elected by the transferor.

If the choice of law under subsection (a) or (c) is ineffective because of the absence of the required nexus, the transfer may still be effective under the Act of another state with which a nexus does exist. See SECTION 21.

§ 3. Nomination of Custodian

(a) A person having the right to designate the recipient of property transferable upon the occurrence of a future event may revocably nominate a custodian to receive the property for a minor beneficiary upon the occurrence of the event by naming the custodian followed in substance by the words: "as custodian for _____ (name of minor) under the [name of Enacting State] Uniform Transfers to Minors Act." The nomination may name one or more persons as substitute custodians to whom the property must be transferred, in the order named, if the first nominated custodian dies before the transfer or is unable, declines, or is ineligible to serve. The nomination may be made in a will, a trust, a deed, an instrument exercising a power of appointment, or in a writing designating a beneficiary of contractual rights which is registered with or delivered to the payor, issuer, or other obligor of the contractual rights.

(b) A custodian nominated under this section must be a person to whom a transfer of property of that kind may be made under Section 9(a).

(c) The nomination of a custodian under this section does not create custodial property until the nominating instrument becomes irrevocable or a transfer to the nominated custodian is completed under Section 9. Unless the nomination of a custodian has been revoked, upon the occurrence of the future event the custodianship becomes effective and the custodian shall enforce a transfer of the custodial property pursuant to Section 9.

COMMENT

This section is new and permits a future custodian for a minor to be nominated to receive a distribution under a will or trust, or as a beneficiary of a power of appointment, or of contractual rights such as a life or endowment insurance policy, annuity contract, P. O.D. Account, benefit plan, or similar future payment right. Nomination of a future custodian does not constitute a "transfer" under this Act and does not create custodial property. If it did, the nomination and beneficiary designation would have to be permanent, since a "transfer" is irrevocable and indefeasibly vests ownership of the interest in the minor under SECTION 11(b).

Instead, this section permits a revocable beneficiary designation that takes effect only when the donor dies, or when a lifetime transfer to the custodian for the minor beneficiary occurs, such as a distribution under an inter vivos trust. However, an unrevoked nomination under this section is binding on a personal representative or trustee (see SECTION 5(b)) and on insurance companies and other obligors who contract to pay in the future (see SECTION 7(b)).

The person making the nomination may name contingent or successive future custodians to serve, in the order named, in the event that the person first nominated dies, or is unable, declines, or is ineligible to serve. Such a substitute future custodian is a custodian "nominated . . . under Section 3" to whom the transfer must be made under SECTIONS 5(b) and 7(b).

Any person nominated as future custodian may decline to serve before the transfer occurs and may resign at any time after the transfer. See SECTION 18.

§ 4. Transfer by Gift or Exercise of Power of Appointment

A person may make a transfer by irrevocable gift to, or the irrevocable exercise of a power of appointment in favor of, a custodian for the benefit of a minor pursuant to Section 9.

COMMENT

To emphasize the different kinds of transfers that create presently effective custodianships under this Act, they are separately described in SECTIONS 4, 5, 6 and 7. This section in part corresponds to Section 2(a) of the 1966 Act and covers the traditional lifetime gift that was the only kind of transfer authorized by the 1966 Act. It also covers an irrevocable exercise of a power of appointment in favor of a custodian, as distinguished from the exercise of a power in a revocable instrument that results only in the nomination of a future custodian under SECTION 3.

§ 5. Transfer Authorized by Will or Trust

(a) A personal representative or trustee may make an irrevocable transfer pursuant to Section 9 to a custodian for the benefit of a minor as authorized in the governing will or trust.

(b) If the testator or settlor has nominated a custodian under Section 3 to receive the custodial property, the transfer must be made to that person.

(c) If the testator or settlor has not nominated a custodian under Section 3, or all persons so nominated as custodian die before the transfer or are unable, decline, or are ineligible to serve, the personal representative or the trustee, as the case may be, shall designate the custodian from among those eligible to serve as custodian for property of that kind under Section 9(a).

COMMENT

This section is new and has no counterpart in the 1966 Act. It is based on nonuniform provisions adopted by Connecticut, Illinois, Wisconsin and other states to validate distributions from trusts and estates to a custodian for a minor beneficiary, when the use of a custodian is expressly authorized by the governing instrument. It also covers the designation of the custodian whenever the settlor or testator fails to make a nomination, or the future custodian nominated under SECTION 3 (and any alternate named) fails to qualify.

§ 6. Other Transfer by Fiduciary

(a) Subject to subsection (c), a personal representative or trustee may make an irrevocable transfer to another adult or trust company as custodian for the benefit of a minor pursuant to Section 9, in the absence of a will or under a will or trust that does not contain an authorization to do so.

(b) Subject to subsection (c), a conservator may make an irrevocable transfer to another adult or trust company as custodian for the benefit of the minor pursuant to Section 9.

(c) A transfer under subsection (a) or (b) may be made only if (i) the personal representative, trustee, or conservator considers the transfer to be in the best interest of the minor, (ii) the transfer is not prohibited by or inconsistent with provisions of the applicable will, trust agreement, or other governing instrument, and (iii) the transfer is authorized by the court if it exceeds [$10,000] in value.

COMMENT

This section is new and has no counterpart in the 1966 Act. It covers a new concept, already authorized by the law of some states through nonuniform amendments to the 1966 Act, to permit custodianships to be used as guardianship or conservator substitutes, even though not specifically authorized by the person whose property is the subject of the transfer. It also permits the legal representative of the minor, such as a conservator or guardian, to transfer the minor's own property to a new or existing custodianship for the purposes of convenience or economies of administration.

A custodianship may be created under this section even though not specifically authorized by the transferor, the testator, or the settlor of the trust if three tests are satisfied. First, the fiduciary making the transfer must determine in good faith and in his fiduciary capacity that a custodianship will be in the best interests of the minor. Second, a custodianship may not be prohibited by, or inconsistent with, the terms of any governing instrument. Inconsistent terms would include, for example, a spendthrift clause in a governing trust, provisions terminating a governing trust for the minor's benefit at a time other than the time of the minor's age of majority, and provisions for mandatory distributions of income or principal at specific times or periodic intervals. Provisions for other outright distributions or bequests would not be inconsistent with the creation of a custodianship under this section. Third, the amount of property transferred, (as measured by its value) must be of such relatively small amount that the lack of court supervision and the typically stricter investment standards that would apply to the conservator otherwise required will not be important. However, if the property is of significant size, transfer to a custodian may still be made if the court approves and if the other two tests are met.

The custodianship created under this section without express authority in the governing instrument will terminate upon the minor's attainment of the statutory age of majority of the enacting state apart from this Act, i.e., at the same age a conservatorship of the minor would end. See SECTION 20(b) and the Comment thereto.

§ 7. Transfer by Obligor

(a) Subject to subsections (b) and (c), a person not subject to Section 5 or 6 who holds property of or owes a liquidated debt to a minor not having a conservator may make an irrevocable transfer to a custodian for the benefit of the minor pursuant to Section 9.

(b) If a person having the right to do so under Section 3 has nominated a custodian under that section to receive the custodial property, the transfer must be made to that person.

(c) If no custodian has been nominated under Section 3, or all persons so nominated as custodian die before the transfer or are unable, decline, or are ineligible to serve, a transfer under this section may be made to an adult member of the minor's family or to a trust company unless the property exceeds [$10,000] in value.

COMMENT

This section is new and, like SECTION 6, permits a custodianship to be established as a substitute for a conservator to receive payments due a minor from sources other than estates, trusts, and existing guardianships covered by SECTIONS 5 and 6. For example, a tort judgment debtor of a minor, a bank holding a joint or P.O.D. account of which a minor is the surviving payee, or an insurance company holding life insurance policy or benefit plan proceeds payable to a minor may create a custodianship under this section.

Use of this section is mandatory when a future custodian has been nominated under SECTION 3 as a named beneficiary of an insurance policy, benefit plan, deposit account, or the like, because the original owner of the property specified a custodianship (and a future custodian) to receive the property. If that custodian (or any alternate named) is not available, if none was nominated, or none could have been nominated (as in the case of a tort judgment payable to the minor), this section is permissive and does not preclude the obligor from requiring the appointment of a conservator to receive payment. It allows the obligor to transfer to a custodian unless the property exceeds the stated value, in which case a conservator must be appointed to receive it.

§ 8. Receipt for Custodial Property

A written acknowledgment of delivery by a custodian constitutes a sufficient receipt and discharge for custodial property transferred to the custodian pursuant to this [Act].

COMMENT

This section discharges transferors from further responsibility for custodial property delivered to and receipted for by the custodian. See also SECTION 16 which protects transferors and other third parties dealing with custodians. Because a discharge or release for a donative transfer is not necessary, this section had no counterpart in the 1966 Act.

This section does not authorize an existing custodian, or a custodian to whom an obligor makes a transfer under SECTION 7, to settle or release a claim of the minor against a third party. Only a conservator, guardian ad litem or other person authorized under other law to act for the minor may release such a claim.

§ 9. Manner of Creating Custodial Property and Effecting Transfer; Designation of Initial Custodian; Control

(a) Custodial property is created and a transfer is made whenever:

(1) an uncertificated security or a certificated security in registered form is either:

(i) registered in the name of the transferor, an adult other than the transferor, or a trust company, followed in substance by the words: "as custodian for _____ (name of minor) under the [Name of Enacting State] Uniform Transfers to Minors Act"; or

(ii) delivered if in certificated form, or any document necessary for the transfer of an uncertificated security is delivered, together with any necessary endorsement to an adult other than the transferor or to a trust company as custodian, accompanied by an instrument in substantially the form set forth in subsection (b);

(2) money is paid or delivered to a broker or financial institution for credit to an account in the name of the transferor, an adult other than the transferor, or a trust company, followed in substance by the words: "as custodian for _____ (name of minor) under the [Name of Enacting State] Uniform Transfers to Minors Act" ;

(3) the ownership of a life or endowment insurance policy or annuity contract is either:

(i) registered with the issuer in the name of the transferor, an adult other than the transferor, or a trust company, followed in substance by the words: "as custodian for _____ (name of minor) under the [Name of Enacting State] Uniform Transfers to Minors Act"; or

(ii) assigned in a writing delivered to an adult other than the transferor or to a trust company whose name in the assignment is followed in substance by the words: "as custodian for _____ (name of minor) under the [Name of Enacting State] Uniform Transfers to Minors Act";

(4) an irrevocable exercise of a power of appointment or an irrevocable present right to future payment under a contract is the subject of a written notification delivered to the payor, issuer, or other obligor that the right is transferred to the transferor, an adult other than the transferor, or a trust company, whose name in the notification is followed in substance by the words: "as custodian for _____ (name of minor) under the [Name of Enacting State] Uniform Transfers to Minors Act";

(5) an interest in real property is recorded in the name of the transferor, an adult other than the transferor, or a trust company, followed in substance by the words: "as custodian for _____ (name of minor) under the [Name of Enacting State] Uniform Transfers to Minors Act";

(6) a certificate of title issued by a department or agency of a state or of the United States which evidences title to tangible personal property is either:

(i) issued in the name of the transferor, an adult other than the transferor, or a trust company, followed in substance by the words: "as custodian for _____ (name of minor) under the [Name of Enacting State] Uniform Transfers to Minors Act"; or

(ii) delivered to an adult other than the transferor or to a trust company, endorsed to that person followed in substance by the words: "as custodian for _____ (name of minor) under the [Name of Enacting State] Uniform Transfers to Minors Act"; or

(7) an interest in any property not described in paragraphs (1) through (6) is transferred to an adult other than the transferor or to a trust company by a written instrument in substantially the form set forth in subsection (b).

(b) An instrument in the following form satisfies the requirements of paragraphs (1)(ii) and (7) of subsection (a):

"TRANSFER UNDER THE [NAME OF ENACTING STATE] UNIFORM TRANSFERS TO MINORS ACT

I, _____ (name of transferor or name and representative capacity if a fiduciary) hereby transfer to _____ (name of custodian), as custodian for _____ (name of minor) under the [Name of Enacting State] Uniform Transfers to Minors Act, the following: (insert a description of the custodial property sufficient to identify it).

Dated: _____

_____

(Signature)

_____ (name of custodian) acknowledges receipt of the property described above as custodian for the minor named above under the [Name of Enacting State] Uniform Transfers to Minors Act.

Dated: _____

_____"

(Signature of Custodian)

(c) A transferor shall place the custodian in control of the custodial property as soon as practicable.

COMMENT

The 1966 Act contained optional bracketed language permitting an adopting state to limit the class of eligible initial custodians to an adult member of the minor's family or a guardian of the minor. This optional limitation has been deleted because it would preclude the use of an individual and uncompensated custodian if no qualified or willing family member is available.

Otherwise, with respect to transfers of securities, cash, and insurance or annuity contracts, this section tracks the cognate provisions of subsection 2(a) of the 1966 Act, with one exception. Under subsection (a)(1)(ii) of this section, a transfer of securities in registered form may be accomplished without registering the transfer in the name of the custodian so that transfers may be accomplished more expeditiously, and so that securities may be held by custodians in street name. In other words, subsection (a)(1)(i) is not the exclusive manner for making effective transfers of securities in registered form.

In addition, subsection (a) creates new procedures for handling the additional types of property now subject to the Act; specifically:

Paragraph (3) covers the irrevocable transfer of ownership of like and endowment insurance policies and annuity contracts.

Paragraph (4) covers the *irrevocable* exercise of a power of appointment and the *irrevocable* present assignment of future payment rights, such as royalties, interest and principal payments under a promissory note, or beneficial interests under life or endowment or annuity insurance contracts or benefit plans. The payor, issuer, or obligor may require additional formalities such as completion of a specific assignment form and an endorsement, but the transfer is effective upon delivery of the notification. See SECTION 3 and the Comment thereto for the procedure for revocably "nominating" a future custodian as a beneficiary of a power of appointment or such payment rights.

Paragraph (5) is the exclusive method for the transfer of real estate and includes a disposition effected by will. Under the law of

those states in which a devise of real estate vests in the devisee without the need for a deed from the personal representative of the decedent, a document such as the will must still be "recorded" under this provision to make the transfer effective. For inter vivos transfers, of course, a conveyance in recordable form would be employed for dispositions of real estate to a custodian.

Paragraph (6) covers the transfer of personal property such as automobiles, aircraft, and other property subject to registration of ownership with a state or federal agency. Either registration of the transfer in the name of the custodian or delivery of the endorsed certificate in registerable form makes the transfer effective.

Paragraph (7) is a residual classification, covering all property not otherwise covered in the preceding paragraphs. Examples would include nonregistered securities, partnership interests, and tangible personal property not subject to title certificates.

The form of transfer document recommended and set forth in subsection (b) contains an acceptance that must be executed by the custodian to make the disposition effective. While such a form of written acceptance is not specifically required in the case of registered securities under subsection (a)(1), money under (a)(2), insurance contracts or interests under (a)(3) or (4), real estate under (a)(5), or titled personal property under (a)(6), it is certainly the better and recommended practice to obtain the acknowledgment, consent, and acceptance of the designated custodian on the instrument of transfer, or otherwise.

A transferor may create a custodianship by naming himself as custodian, except for transfers of securities under subsection (a)(1)(ii), insurance and annuity contracts under (a)(3)(ii), and titled personalty under (a)(6)(ii), which are made without registering them in the name of the custodian, and transfers of the residual class of property covered by (a)(7). In all of these cases a transfer of possession and control to a third party is necessary to establish donative intent and consummation of the transfer, and designation of the transferor as custodian renders the transfer invalid under SECTION 11(a)(2).

Note, also, that the Internal Revenue Service takes the position that custodial property is includable in the gross estate of the donor if he appoints himself custodian and dies while serving in that capacity before the minor attains the age of 21. Rev.Rul. 57-366, C.B. 1957-2, 618; Rev.Rul. 59-357, C.B. 1959-2, 212; Rev.Rul. 70-348, C.B. 1970-2, 193; Estate of Prudowsky v. Comm'r, 55 T.C. 890 (1971), affd. per curiam, 465 F.2d 62 (7th Cir. 1972).

This Act has been drafted in an attempt to avoid income attribution to the parent or inclusion of custodial insurance policies on a custodian's life in the estate of the custodian through the changes made in the standards for expenditure of custodial property and the custodian's incidents of ownership in custodial property. See SECTIONS 13 and 14 and the Comments thereto. However, the much greater problem of inclusion of custodial property in the estate of the donor who serves as custodian remains. Therefore, despite the fact that this section of the Act permits it in the case of registered securities, money, life insurance, real estate, and personal property subject to titling laws, it is generally still inadvisable for a donor to appoint himself custodian or for a parent of the minor to serve as custodian. See, generally Sections 2036 and 2038 I.R.C. and Rulings and cases cited above; with respect to gifts of closely held stock when a donor retains voting rights by serving as custodian, see Section 2036(b), I.R.C., overruling U.S. v. Byrum, 408 U.S. 125 (1972), rehearing denied 409 U.S. 898.

Subsection (c) tracks in substance Section 2(c) of the 1966 Act. However, it replaces the requirement that the transferor "promptly do all things within his power" to complete the transfer, with the requirement that such action must be taken "as soon as practicable." This change is intended only to reflect the fact that possession and control of property transferred from an estate can rarely be accomplished with the immediacy that the term "promptly" may have implied. In the case of inter vivos transfers, no relaxation of the former requirement is intended, since "prompt" transfer of dominion is usually practicable.

§ 10. Single Custodianship

A transfer may be made only for one minor, and only one person may be the custodian. All custodial property held under this [Act] by the same custodian for the benefit of the same minor constitutes a single custodianship.

COMMENT

The first sentence follows Section 2(b) of the 1966 Act. The second sentence states what was implicit in the 1966 Act, that additional transfers at different times and from different sources may be made to an existing custodian for the minor and do not create multiple custodianships. This provision also permits an existing custodian to be named as successor custodian by another custodian for the same minor who resigns under SECTION 18 for the purpose of consolidating the assets in a single custodianship.

Note, however, that these results are limited to transfers made "under this Act." Gifts previously made under the enacting state's UGMA or under the UGMA or UTMA of another state must be treated as separate custodianships, even though the same custodian and minor are involved, because of possible differences in the age of distribution and custodian's powers under those other Acts.

Even when all transfers to a single custodian are made "under this Act" and a single custodianship results, custodial property transferred under SECTIONS 6 and 7 must be accounted for separately from property transferred under SECTIONS 4 and 5 because the custodianship will terminate sooner with respect to the former property if the enacting state has a statutory age of majority lower than 21. See SECTION 20 and the Comment thereto.

§ 11. Validity and Effect of Transfer

(a) The validity of a transfer made in a manner prescribed in this [Act] is not affected by:

(1) failure of the transferor to comply with Section 9(c) concerning possession and control;

(2) designation of an ineligible custodian, except designation of the transferor in the case of property for which the transferor is ineligible to serve as custodian under Section 9(a); or

(3) death or incapacity of a person nominated under Section 3 or designated under Section 9 as custodian or the disclaimer of the office by that person.

(b) A transfer made pursuant to Section 9 is irrevocable, and the custodial property is indefeasibly vested in the minor, but the custodian has all the rights, powers, duties, and authority provided in this [Act], and neither the minor nor the minor's legal representative has any right, power, duty, or authority with respect to the custodial property except as provided in this [Act].

(c) By making a transfer, the transferor incorporates in the disposition all the provisions of this [Act] and grants to the custodian, and to any third person dealing with a person designated as custodian, the respective powers, rights, and immunities provided in this [Act].

COMMENT

Subsection (a) generally tracks Section 2(c) of the 1966 Act, except that the transferor's designation of himself as custodian of property for which he is not eligible to serve under SECTION 9(a) makes the transfer ineffective. See Comment to SECTION 9.

The balance of this section generally tracks Section 3 of the 1966 Act with a number of necessary, and perhaps significant, changes required by the new kinds of property subject to custodianships. The 1966 Act provides that a transfer made in accordance

with its terms "conveys to the minor indefeasibly vested legal title to the [custodial property]." Because equitable interests in property may be the subject of a transfer under this Act, the reference to "legal title" has been deleted, but no change concerning the effect or finality of the transfer is intended.

However, subsection (b) qualifies the rights of the minor in the property, by making them subject to "the rights, powers, duties and authority" of the custodian under this Act, a concept that may have been implicit and intended in the 1966 Act, but not expressed. The concept is important because of the kinds of property, particularly real estate, now subject to custodianship. If the minor is married, it would be possible for homestead, dower, or community property rights to attach to real estate (or other property) acquired after marriage by the minor through a transfer to a custodianship for his benefit. The quoted language qualifying the minor's interest in the property is intended to override these rights insofar as they may conflict with the custodian's ability and authority to manage, sell, or transfer such property while it is custodial property. Upon termination of the custodianship and transfer of the custodial property to the former minor, the custodial property would then become subject to such spousal rights for the first time.

For a list of the immunities enjoyed by third persons under subsection (c), see SECTION 16 and the Comment thereto.

Because a custodianship under this Act can extend beyond the age of majority in many states, or beyond emancipation of a minor through marriage or otherwise, the Drafting Committee considered the addition of a spendthrift clause to this section. The idea was rejected because neither the 1966 Act nor its predecessors had such a provision, because spendthrift protection would extend only until 21 in any event and judgments against the minor would then be enforceable, and because the spendthrift qualification on the interest of the minor in the property may be inconsistent with the theory of the Act to convey the property indefeasibly to the minor.

§ 12. Care of Custodial Property

(a) A custodian shall:

(1) take control of custodial property;

(2) register or record title to custodial property if appropriate; and

(3) collect, hold, manage, invest, and reinvest custodial property.

(b) In dealing with custodial property, a custodian shall observe the standard of care that would be observed by a prudent person dealing with property of another and is not limited by any other statute restricting investments by fiduciaries. If a custodian has a special skill or expertise or is named custodian on the basis of representations of a special skill or expertise, the custodian shall use that skill or expertise. However, a custodian, in the custodian's discretion and without liability to the minor or the minor's estate, may retain any custodial property received from a transferor.

(c) A custodian may invest in or pay premiums on life insurance or endowment policies on (i) the life of the minor only if the minor or the minor's estate is the sole beneficiary, or (ii) the life of another person in whom the minor has an insurable interest only to the extent that the minor, the minor's estate, or the custodian in the capacity of custodian, is the irrevocable beneficiary.

(d) A custodian at all times shall keep custodial property separate and distinct from all other property in a manner sufficient to identify it clearly as custodial property of the minor. Custodial property consisting of an undivided interest is so identified if the minor's interest is held as a tenant in common and is fixed. Custodial property subject to recordation is so identified if it is recorded, and custodial property subject to registration is so identified if it is either registered, or held in an account designated, in the name of the custodian, followed in substance by the words: "as a custodian

for _____ (name of minor) under the [Name of Enacting State] Uniform Transfers to Minors Act."

(c) A custodian shall keep records of all transactions with respect to custodial property, including information necessary for the preparation of the minor's tax returns, and shall make them available for inspection at reasonable intervals by a parent or legal representative of the minor or by the minor if the minor has attained the age of 14 years.

COMMENT

Subsection (a) expands Section 4(a) of the 1966 Act to include the duties to take control and appropriately register or record custodial property in the name of the custodian.

Subsection (b) restates and makes somewhat stricter the prudent man fiduciary standard for the custodian, since it is now cast in terms of a prudent person "dealing with property *of another*" rather than one "who is seeking a reasonable income and the preservation of *his* capital," as under the 1966 Act. The rule also adds a slightly higher standard for professional fiduciaries. The rule parallels section 7-302 of the Uniform Probate Code in order to refer to the existing and growing body of law interpreting that standard. The 1966 Act permitted a custodian to retain any security or bank account received, without the obligation to diversify investment. This subsection extends that rule to any property received.

In order to eliminate any uncertainty that existed under the 1966 Act, subsection (c) grants specific authority to invest custodial property in life insurance on the minor's life, provided the minor's estate is the sole beneficiary, or on the life of another person in whom the minor has an insurable interest, provided the minor, the minor's estate, or the custodian in his custodial capacity is made the beneficiary of such policies.

Subsection (d) generally tracks Section 4(g) of the 1966 Act but adds the provision requiring that custodial property consisting of an undivided interest be held as a tenant in common. This provision permits the custodian to invest custodial property in common trust funds, mutual funds, or in a proportional interest in a "jumbo" certificate of deposit. Investment in property held in joint tenancy with right of survivorship is not permitted, but the Act does not preclude a transfer of such an interest to a custodian, and the custodian is authorized under subsection (b) to retain a joint tenancy interest so received.

Subsection (e) follows Section 4(h) of the 1966 Act, but adds the requirement that income tax information be maintained and made available for preparation of the minor's tax returns. Because the custodianship is not a separate legal entity or taxpayer, the minor's tax identification number should be used to identify all custodial property accounts.

§ 13. Powers of Custodian

(a) A custodian, acting in a custodial capacity, has all the rights, powers, and authority over custodial property that unmarried adult owners have over their own property, but a custodian may exercise those rights, powers, and authority in that capacity only.

(b) This section does not relieve a custodian from liability for breach of Section 12.

COMMENT

Subsection (a) replaces the specific list of custodian's powers in Section 4(f) of the 1966 Act which related only to securities, money, and insurance, then the only permitted kinds of custodial property. It was determined not to expand the list to try to deal with all forms of property now covered by the Act and to specify all powers that might be appropriate for each kind of property, or to refer to an existing body of state law, such as the

Trustee's Powers Act, since such powers would not be uniform. Instead, this provision grants the custodian the very broad and general powers of an unmarried adult owner of the property, subject to the prudent person rule and to the duties of segregation and record keeping specified in SECTION 12. This approach permits the Act to be self-contained and more readily understandable by volunteer, non-professional fiduciaries, who most often serve as custodians. It is intended that the authority granted includes the powers most often suggested for custodians, such as the power to borrow, whether at interest or interest free, the power to invest in common trust funds, and the power to enter contracts that extend beyond the termination of the custodianship.

Subsection (a) further specifies that the custodian's powers or incidents of ownership in custodial property such as insurance policies may be exercised only in his capacity as custodian. This provision is intended to prevent the exercise of those powers for the direct or indirect benefit of the custodian, so as to avoid as nearly as possible the result that a custodian who dies while holding an insurance policy on his own life for the benefit of a minor will have the policy taxed in his estate. See, Section 2042, I.R.C.; but compare Terriberry v. U.S., 517 F.2d 286 (5th Cir. 1975), and Rose v. U.S., 511 F.2d 259 (5th Cir. 1975).

§ 14. Use of Custodial Property

(a) A custodian may deliver or pay to the minor or expend for the minor's benefit so much of the custodial property as the custodian considers advisable for the use and benefit of the minor, without court order and without regard to (i) the duty or ability of the custodian personally or of any other person to support the minor, or (ii) any other income or property of the minor which may be applicable or available for that purpose.

(b) On petition of an interested person or the minor if the minor has attained the age of 14 years, the court may order the custodian to deliver or pay to the minor or expend for the minor's benefit so much of the custodial property as the court considers advisable for the use and benefit of the minor.

(c) A delivery, payment, or expenditure under this section is in addition to, not in substitution for, and does not affect any obligation of a person to support the minor.

COMMENT

Subsections (a) and (b) track subsections (b) and (c) of Section 4 of the 1966 Act, but with two significant changes. The standard for expenditure of custodial property has been amended to read "for the use and benefit of the minor," rather than "for the support, maintenance, education and benefit of the minor" as specified under the 1966 Act. This change is intended to avoid the implication that the custodial property can be used only for the required support of the minor.

The IRS has taken the position that the income from custodial property, to the extent it is used for the support of the minor-donee, is includable in the gross income of any person who is legally obligated to support the minor-donee, whether or not that person or parent is serving as the custodian. Rev.Rul. 56-484, C.B. 1956-2, 23; Rev.Rul. 59-357, C.B. 1959-2, 212. However, Reg. 1.662(a)-4 provides that the term "legal obligation" includes a legal obligation to support another person if, and only if, the obligation is not affected by the adequacy of the dependent's own resources. Thus, if under local law a parent may use the resources of a child for the child's support in lieu of supporting the child himself or herself, no obligation of support exists, whether or not income is actually used for support, at least if the child's resources are adequate. See, Bittker, *Federal Taxation of Income Estates and Gifts* ¶ 80.44 (1981).

For this reason, new subsection (c) has been added to specify that distributions or expenditures may be made for the minor without regard to the duty or ability of any other person to

support the minor and that distributions or expenditures are not in substitution for, and shall not affect, the obligation of any person to support the minor. Other possible methods of avoiding the attribution of custodial property income to the person obligated to support the minor would be to prohibit the use of custodial property or its income for that purpose, or to provide that any such use gives rise to a cause of action by the minor against his parent to the extent that custodial property or income is so used. The first alternative was rejected as too restrictive, and the second as too cumbersome.

The "use and benefit" standard in subsections (a) and (b) is intended to include payment of the minor's legally enforceable obligations such as tax or child support obligations or tort claims. Custodial property could be reached by levy of a judgment creditor in any event, so there is no reason not to permit custodian or court-ordered expenditures for enforceable claims.

An "interested person" entitled to seek court ordered distributions under subsection (b) would include not only the parent or conservator or guardian of the minor and a transferor or a transferor's legal representative, but also a public agency or official with custody of the minor and a third party to whom the minor owes legally enforceable debts.

§ 15. Custodian's Expenses, Compensation, and Bond

(a) A custodian is entitled to reimbursement from custodial property for reasonable expenses incurred in the performance of the custodian's duties.

(b) Except for one who is a transferor under Section 4, a custodian has a non-cumulative election during each calendar year to charge reasonable compensation for services performed during that year.

(c) Except as provided in Section 18(f), a custodian need not give a bond.

COMMENT

This section parallels and restates Section 5 of the 1966 Act. It deletes the statement that a custodian may act without compensation for services, since that concept is implied in the retained provision that a custodian has an "election" to be compensated. However, to prevent abuse, the latter provision for permissive compensation is denied to a custodian who is also the donor of the custodial property.

The custodian's election to charge compensation must be exercised (although the compensation need not be actually paid) at least annually or it lapses and may not be exercised later. This provision is intended to avoid imputed income to the custodian who waives compensation, and also to avoid the accumulation of a large unanticipated claim for compensation exercisable at termination of the custodianship.

This section deletes as surplusage the bracketed optional standards contained in the 1966 Act for determining "reasonable compensation" which included, "in the order stated," a direction by the donor, statutes governing compensation of custodians or guardians, or court order. While compensation of custodians becomes a more likely occurrence and a more important issue under this Act because property requiring increased management may now be subject to custodianship, compensation can still be determined by agreement, by reference to a statute or by court order, without the need to so state in this Act.

§ 16. Exemption of Third Person from Liability

A third person in good faith and without court order may act on the instructions of or otherwise deal with any person purporting to make a transfer

or purporting to act in the capacity of a custodian and, in the absence of knowledge, is not responsible for determining:

(1) the validity of the purported custodian's designation;

(2) the propriety of, or the authority under this [Act] for, any act of the purported custodian;

(3) the validity or propriety under this [Act] of any instrument or instructions executed or given either by the person purporting to make a transfer or by the purported custodian; or

(4) the propriety of the application of any property of the minor delivered to the purported custodian.

COMMENT

This section carries forward, but shortens and simplifies, Section 6 of the 1966 Act, with no substantive change intended. The 1966 revision permitted a 14-year old minor to appoint a successor custodian and specifically provided that third parties were entitled to rely on the appointment. Because this section refers to any custodian, and "custodian" is defined to include successor custodians (SECTION 1(7)), a successor custodian appointed by the minor is included among those upon whom third parties may rely.

Similarly, because this section protects any third "person," it is not necessary to specify here or in SECTION 11(c) that it extends to any "issuer, transfer agent, bank, life insurance company, broker, or other person or financial institution," as did the 1966 Act. See the definition of "person" in SECTION 1(12).

This section excludes from its protection persons with "knowledge" of the irregularity of a transaction, a concept not expressed but probably implied in Section 6 of the 1966 Act. See, e.g., State ex rel. Paden v. Currel, 597 S.W.2d 167 (Mo.App.1980) disapproving the pledge of custodial property to secure a personal loan to the custodian.

Similarly, this section does not alter the requirements for bona fide purchaser or holder in due course status under other law for persons who acquire from a custodian custodial property subject to recordation or registration.

§ 17. Liability to Third Persons

(a) A claim based on (i) a contract entered into by a custodian acting in a custodial capacity, (ii) an obligation arising from the ownership or control of custodial property, or (iii) a tort committed during the custodianship, may be asserted against the custodial property by proceeding against the custodian in the custodial capacity, whether or not the custodian or the minor is personally liable therefor.

(b) A custodian is not personally liable:

(1) on a contract properly entered into in the custodial capacity unless the custodian fails to reveal that capacity and to identify the custodianship in the contract; or

(2) for an obligation arising from control of custodial property or for a tort committed during the custodianship unless the custodian is personally at fault.

(c) A minor is not personally liable for an obligation arising from ownership of custodial property or for a tort committed during the custodianship unless the minor is personally at fault.

COMMENT

This section has no counterpart in the 1966 Act and is based upon Section 5-429 of the Uniform Probate Code, relating to limitations on the liability of conservators. Because some forms of custodial property now permitted

under this Act can give rise to liabilities as well as benefits (e.g., general partnership interests, interests in real estate or business proprietorships, automobiles, etc.) the Committee believes it is necessary to protect the minor and other assets he might have or acquire from such liabilities, since the minor is unable to disclaim a transfer to a custodian for his benefit. Similar protection for the custodian is necessary so as not to discourage nonprofessional or uncompensated persons from accepting the office. Therefore this section generally limits the claims of third parties to recourse against the custodial property, as third parties dealing with a trust are generally limited to recourse against the trust corpus.

The custodian incurs personal liability only as provided in subsection (b) for actual fault or for failure to disclose his custodial capacity "in the contract" when contracting with third parties. In oral contracts, oral disclosure of the custodial capacity is sufficient. The minor, on the other hand, incurs personal liability under subsection (c) only for actual fault.

When custodial property is subjected to claims of third parties under this section, the minor or his legal representative, if not a party to the action by which the claim is successfully established, may seek to recover the loss from the custodian in a separate action. See SECTION 19 and the Comment thereto.

§ 18. Renunciation, Resignation, Death, or Removal of Custodian; Designation of Successor Custodian

(a) A person nominated under Section 3 or designated under Section 9 as custodian may decline to serve by delivering a valid disclaimer [under the Uniform Disclaimer of Property Interests Act of the Enacting State] to the person who made the nomination or to the transferor or the transferor's legal representative. If the event giving rise to a transfer has not occurred and no substitute custodian able, willing, and eligible to serve was nominated under Section 3, the person who made the nomination may nominate a substitute custodian under Section 3; otherwise the transferor or the transferor's legal representative shall designate a substitute custodian at the time of the transfer, in either case from among the persons eligible to serve as custodian for that kind of property under Section 9(a). The custodian so designated has the rights of a successor custodian.

(b) A custodian at any time may designate a trust company or an adult other than a transferor under Section 4 as successor custodian by executing and dating an instrument of designation before a subscribing witness other than the successor. If the instrument of designation does not contain or is not accompanied by the resignation of the custodian, the designation of the successor does not take effect until the custodian resigns, dies, becomes incapacitated, or is removed.

(c) A custodian may resign at any time by delivering written notice to the minor if the minor has attained the age of 14 years and to the successor custodian and by delivering the custodial property to the successor custodian.

(d) If a custodian is ineligible, dies, or becomes incapacitated without having effectively designated a successor and the minor has attained the age of 14 years, the minor may designate as successor custodian, in the manner prescribed in subsection (b), an adult member of the minor's family, a conservator of the minor, or a trust company. If the minor has not attained the age of 14 years or fails to act within 60 days after the ineligibility, death, or incapacity, the conservator of the minor becomes successor custodian. If the minor has no conservator or the conservator declines to act, the transferor, the legal representative of the transferor or of the custodian, an adult member of the minor's family, or any other interested person may petition the court to designate a successor custodian.

(e) A custodian who declines to serve under subsection (a) or resigns under subsection (c), or the legal representative of a deceased or incapacitated custodian, as soon as practicable, shall put the custodial property and records in the possession and control of the successor custodian. The successor custodian by action may enforce the obligation to deliver custodial property and records and becomes responsible for each item as received.

(f) A transferor, the legal representative of a transferor, an adult member of the minor's family, a guardian of the person of the minor, the conservator of the minor, or the minor if the minor has attained the age of 14 years may petition the court to remove the custodian for cause and to designate a successor custodian other than a transferor under Section 4 or to require the custodian to give appropriate bond.

COMMENT

This section tracks but condenses Section 7 of the 1966 Act to provide that the custodian, or if the custodian does not do so, the minor if he is 14, may appoint the successor custodian, or failing that, that the conservator of the minor or a court appointee shall serve. It also covers disclaimer of the office by designated or successor custodians or by nominated future custodians who decline to serve.

This Act broadens the category of persons who may be designated by the initial custodian as successor custodian from an adult member of the minor's family, his conservator, or a trust company to any adult or trust company. However, the minor's designation remains limited to an adult member of his family (expanded to include a spouse and a stepparent, see SECTION 1(10)), his conservator, or a trust company.

§ 19. Accounting by and Determination of Liability of Custodian

(a) A minor who has attained the age of 14 years, the minor's guardian of the person or legal representative, an adult member of the minor's family, a transferor, or a transferor's legal representative may petition the court (i) for an accounting by the custodian or the custodian's legal representative; or (ii) for a determination of responsibility, as between the custodial property and the custodian personally, for claims against the custodial property unless the responsibility has been adjudicated in an action under Section 17 to which the minor or the minor's legal representative was a party.

(b) A successor custodian may petition the court for an accounting by the predecessor custodian.

(c) The court, in a proceeding under this [Act] or in any other proceeding, may require or permit the custodian or the custodian's legal representative to account.

(d) If a custodian is removed under Section 18(f), the court shall require an accounting and order delivery of the custodial property and records to the successor custodian and the execution of all instruments required for transfer of the custodial property.

COMMENT

This section carries forward Section 8 of the 1966 Act, but expands the class of parties who may require an accounting by the custodian to include any person who made a transfer to him (or any such person's legal representative), the minor's guardian of the person, and the successor custodian.

Subsection (b) authorizes but does not obligate a successor custodian to seek an accounting by the predecessor custodian. Since the minor and other persons mentioned in subsection (a) may also seek an accounting from the predecessor at any time, it is anticipated that the exercise of this right by the successor should be rare.

Subsection (a) also gives the same parties (other than a successor custodian) the right to seek recovery from the custodian for loss or diminution of custodial property resulting from successful claims by third persons under SECTION 17, unless that issue has already been adjudicated in an action under that section to which the minor was a party.

This section does not contain a separate statute of limitations precluding petitions for accounting after termination of the custodianship. Because custodianships can be created without the knowledge of the minor, a person might learn of a custodian's failure to turn over custodial property long after reaching majority, and should not be precluded from asserting his rights in the case of such fraud. In addition, the 1966 Act has no such preclusion and seems to have worked well. Other law, such as general statutes of limitation and the doctrine of laches, should serve adequately to protect former custodians from harassment.

§ 20. Termination of Custodianship

The custodian shall transfer in an appropriate manner the custodial property to the minor or to the minor's estate upon the earlier of:

(1) the minor's attainment of 21 years of age with respect to custodial property transferred under Section 4 or 5;

(2) the minor's attainment of [majority under the laws of this State other than this [Act]] [age 18 or other statutory age of majority of Enacting State] with respect to coustodial property transferred under Section 6 or 7; or

(3) the minor's death.

COMMENT

This section tracks Section 4(d) of the 1966 Act, but provides that custodianships created by fiduciaries without express authority from the donor of the property under SECTION 6 and by obligors of the minor under SECTION 7 terminate upon the minor's attaining the age of majority under the general laws of the state, since these custodianships are substitutes for conservatorships that would otherwise terminate at that time. Because property in a single custodianship may be distributable at different times, separate accounting for custodial property by source may be required. See Comment to SECTION 10.

§ 21. Applicability

This [Act] applies to a transfer within the scope of Section 2 made after its effective date if:

(1) the transfer purports to have been made under [the Uniform Gifts to Minors Act of the Enacting State]; or

(2) the instrument by which the transfer purports to have been made uses in substance the designation "as custodian under the Uniform Gifts to Minors Act" or "as custodian under the Uniform Transfers to Minors Act" of any other state, and the application of this [Act] is necessary to validate the transfer.

COMMENT

This section is new and has two purposes. First, it operates as a "savings clause" to validate transfers made after its effective date which mistakenly refer to the enacting state's UGMA rather than to this Act. Second, it validates transfers attempted under the UGMA of another state which would not permit transfers from that source or of property of that kind or under

the UTMA of another state with no nexus to the transaction, provided in each case that the enacting state has a sufficient nexus to the transaction under SECTION 2.

§ 22. Effect on Existing Custodianships

(a) Any transfer of custodial property as now defined in this [Act] made before [the effective date of this Act] is validated notwithstanding that there was no specific authority in [the Uniform Gifts to Minors Act of the Enacting State] for the coverage of custodial property of that kind or for a transfer from that source at the time the transfer was made.

(b) This [Act] applies to all transfers made before the effective date of this [Act] in a manner and form prescribed in [the Uniform Gifts to Minors Act of the Enacting State], except insofar as the application impairs constitutionally vested rights or extends the duration of custodianships in existence on the effective date of this [Act].

[(c) Sections 1 and 20 with respect to the age of a minor for whom custodial property is held under this [Act] do not apply to custodial property held in a custodianship that terminated because of the minor's attainment of the age of [18] after [date prior Act was amended to specify [18] as age of majority] and before [the effective date of this Act].]

COMMENT

Subsection (a) is new and is based on Section 45–109a of the Connecticut Act which validates gifts of real estate and partnership interests made prior to their inclusion as "custodial property" under that Act. However, this provision goes further and purports also to validate prior transfers of the kind now covered by the Act, i.e., transfers from estates, trusts, guardianships, and obligors.

All states have previously enacted some version of UGMA, and it will be more orderly to subject gifts or other transfers under the prior Act to the procedures of this Act, rather than to keep both Acts in force, presumably for 18 or 21 years until all custodianships created under prior law have terminated. Subsection (b) is intended to apply this Act to prior gifts and existing custodianships insofar as it is constitutionally permissible to do so. However, prior custodianships will continue to terminate at the age prescribed under the prior Act.

Optional subsection (c) is also new and is based upon Section 45–109b of the Connecticut Act. It is intended for adoption in those states that amended their Acts to reduce the age of majority to 18, but which adopt the recommended return to 21 as the age at which custodianships terminate. Its purpose is to avoid resurrecting custodianships for persons not yet 21 which terminated during the period that the age of 18 governed termination.

§ 23. Uniformity of Application and Construction

This [Act] shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this [Act] among states enacting it.

§ 24. Short Title

This [Act] may be cited as the "[Name of Enacting State] Uniform Transfers to Minors Act."

§ 25. Severability

If any provisions of this [Act] or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this [Act] which can be given effect without the invalid provision or application, and to this end provisions of this [Act] are severable.

§ 26. Effective Date

This [Act] takes effect _____.

§ 27. Repeals

[Insert appropriate reference to the existing Gifts to Minors Act of the Enacting State or other jurisdiction] is hereby repealed. To the extent that this [Act], by virtue of Section 22(b), does not apply to transfers made in a manner prescribed in [the Gifts to Minors Act of the Enacting State] or to the powers, duties, and immunities conferred by transfers in that manner upon custodians and persons dealing with custodians, the repeal of [the Gifts to Minors Act of the Enacting State] does not affect those transfers or those powers, duties, and immunities.

APPENDIX B

Michigan UGMA

554.451. Definitions

Sec. 1. In this act, unless the context otherwise requires:

(a) * * * "Adult" means a person who has attained the age of 18 years.

(b) * * * "Bank" means a bank, trust company, national banking association, savings bank, credit union, savings and loan association, building and loan association, federal savings and loan association, or industrial bank.

(c) * * * "Broker" means a person lawfully engaged in the business of effecting transactions in securities for the account of others. The term includes a bank which effects such transactions. The term also includes a person lawfully engaged in buying and selling securities for his own account, through a broker or otherwise, as a part of a regular business.

(d) "Court" means the probate court of the county in which the minor resides.

(e) * * * "Custodial property" means:

(i) All securities, money, * * * life insurance, and annuities under the supervision of the same custodian for the same minor as a consequence of a gift or gifts made to the minor in a manner prescribed in this act.

(ii) The income from the custodial property.

(iii) The proceeds, immediate and remote, from the sale, exchange, conversion, investment, reinvestment, or other disposition of such securities, money, and income.

(f) * * * "Custodian" means a person so designated in a manner prescribed in this act; the term includes a successor custodian.

(g) * * * "Guardian" of a minor means the general guardian, guardian, tutor, or curator of his property, estate, or person.

(h) * * * "Issuer" means a person who places or authorizes the placing of his name on a security, other than as a transfer agent, to evidence that it represents a share, participation, or other interest in his property or in an enterprise or to evidence his duty or undertaking to perform an obligation evidenced by the security, or who becomes responsible for or in place of any such person.

(i) * * * "Legal representative" of a person means his executor or the administrator, general guardian, guardian, committee, conservator, tutor, or curator of his property or estate.

(j) * * * "Member of a minor's family" means any of the minor's parents, grandparents, brothers, sisters, uncles, and aunts, whether of the whole blood or the half blood, or by or through legal adoption.

(k) * * * "Minor" means a person who has not attained the age of 18 years.

(*l*) * * * "Security" means a note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such a title or lease, collateral trust certificate, transferable share, voting trust certificate or, in general, any interest or instrument commonly known as a security, or any certificate of interest or participation in, any temporary or interim certificate, receipt or certificate of deposit for, or any warrant or right to subscribe to or purchase, any of the foregoing. The term does not include a security of which the donor is the issuer. A security is in "registered form" when it specifies a person entitled to it or to the rights it evidences and its transfer may be registered upon books maintained for that purpose by or on behalf of the issuer.

(m) * * * "Transfer agent" means a person who acts as authenticating trustee, transfer agent, registrar, or other agent for an issuer in the registration of transfers of its securities or in the issue of new securities or in the cancellation of surrendered securities.

(n) * * * "Trust company" means a bank authorized to exercise trust powers.

554.452. Gifts of securities, money, insurance, and annuities

Sec. 2. (1) An adult person, during his lifetime, may make a gift of * * * security or money to a person who is a minor on the date of the gift:

(a) If the subject of the gift is a security in registered form, by registering it in the name of the donor, another adult person, an adult member of the minor's family, a guardian of the minor, or a trust company, followed, in substance, by the words: "as custodian for .....
(name of minor)
under the Michigan uniform gifts to minors act".

(b) If the subject of the gift is a security not in registered form, by delivering it to an adult person other than the donor, an adult member of the minor's family other than the donor, a guardian of the minor, or a trust company, accompanied by a statement of gift in the following form, in substance, signed by the donor and the person designated as custodian:

"GIFT UNDER THE MICHIGAN UNIFORM GIFTS TO MINORS ACT

I, ..., hereby deliver to ..... as custodian for
(name of donor) (name of custodian)
..... under the Michigan uniform gifts to minors act, the following
(name of minor)
security(ies): (insert an appropriate description of the security or securities delivered sufficient to identify it or them)

.....
(signature of donor)

..... hereby acknowledges receipt of the above described
(name of custodian)
security(ies) as custodian for the above minor under the Michigan uniform gifts to minors act.
Dated .....

.....
(signature of custodian)"

(c) If the subject of the gift is money, by paying or delivering it to broker or a bank for credit to an account in the name of the donor, another adult person, an adult member of the minor's family, a guardian of the minor, or a bank with trust powers, followed, in substance, by the words: "as custodian for ..... under the Michigan
(name of minor)
uniform gifts to minors act".

(d) If the subject of the gift is life insurance or an annuity, the ownership of the policy of life insurance or annuity shall be registered by the donor of the policy in his own name or in the name of an adult member of the minor's family or in the name of any guardian of the minor, followed by the words "as custodian for ..... under the
(name of minor)
Michigan uniform gifts to minors act", and the policy of life insurance or annuity shall be delivered to the person in whose name it is thus registered as custodian. If the policy is registered in the name of the donor, as custodian, the registration shall of itself constitute the delivery required by this section.

(2) A gift made in a manner prescribed in subsection (1) may be made to only 1 minor and only 1 person may be the custodian.

(3) A donor who makes a gift to a minor in a manner prescribed in subsection (1) shall promptly do all things within his power to put the subject of the gift in the possession and control of the custodian, but neither the donor's failure to comply with this subsection, nor his designation of an ineligible person as custodian, nor renunciation by the person designated as custodian affects the consummation of the gift.

554.453. Irrevocability; legal title; guardian; custodian; persons dealing with custodian

Sec. 3. (1) A gift made in a manner prescribed in this act is irrevocable and conveys to the minor indefeasibly vested legal title to the security, money, * * * life insurance, or annuity given, but no guardian of the minor has any right, power, duty, or authority with respect to the custodial property except as provided in this act.

(2) By making a gift in a manner prescribed in this act, the donor incorporates in his gift all the provisions of this act and grants to the custodian, and to any issuer, transfer agent, bank, broker, or third person dealing with a person designated as custodian, the respective powers, rights, and immunities provided in this act.

554.454. Custodian; powers and duties

Property collection, holding, management, investment

Sec. 4. (1) The custodian shall collect, hold, manage, invest, and reinvest the custodial property.

Payments to minor or for his benefit

(2) The custodian shall pay over to the minor for expenditure by him, or expend for the minor's benefit, so much of or all the custodial property as the custodian deems advisable for the support, maintenance, education, and benefit of the minor in the manner, at the time or times, and to the extent that the custodian in his discretion deems suitable and proper, with or without court order, with or without regard to the duty of himself or of another person to support the minor or his ability to do so, and with or without regard to any other income or property of the minor which may be applicable or available for the purpose.

Court-ordered payments

(3) The court, on the petition of a parent or guardian of the minor, or of the minor if he has attained the age of 14 years, may order the custodian to pay over to the minor for expenditure by him or to expend so much of or all the custodial property as is necessary for the minor's support, maintenance, or education.

Delivery of custodial property, age, death

(4) To the extent that the custodial property is not so expended, the custodian shall deliver or pay it over to the minor on his attaining the age of 18 years or, if the minor dies before attaining the age of 18 years, the custodian shall thereupon deliver or pay it over to the estate of the minor.

Investments

(5) The custodian, notwithstanding statutes restricting investments by fiduciaries, shall invest and reinvest the custodial property as would a prudent man of discretion and intelligence who is seeking a reasonable income and the preservation of his capital, except that in his discretion and without liability to the minor or his estate, he may retain a security given to the minor in a manner prescribed in this act.

Powers as to securities

(6) The custodian may sell, exchange, convert, or otherwise dispose of custodial property in the manner, at the time or times, for the price or prices and upon the terms he deems advisable. He may vote in person or by general or limited proxy a security which is custodial property. He may consent, directly or through a committee or other agent, to the reorganization, consolidation, merger, dissolution, or liquidation of an issuer, a security which is custodial property, and to the sale, lease, pledge, or mortgage of any property by or to an issuer, and to any other action by an issuer. He may execute and deliver all instruments in writing which he deems advisable to carry out any of his powers as custodian.

Registered securities; separation of custodial property from custodian's personal property

(7) The custodian shall register each security which is custodial property and in registered form in the name of the custodian, followed in substance by the words: "As custodian for ..... under the Michigan uniform gifts to minors act". The custodian shall hold all money which is custodial property in an account with a broker or in a bank in the name of the custodian, followed in substance by the words: "As custodian for .....
(name of minor)
under the Michigan uniform gifts to minors act". The custodian shall keep all other custodial property separate and distinct from his own property in a manner to identify it clearly as custodial property.

Custodian's records, inspection

(8) The custodian shall keep records of all transactions with respect to the custodial property and make them available for inspection at reasonable intervals by a parent or legal representative of the minor or by the minor if he has attained the age of 14 years.

Trust powers of custodian

(9) A custodian has, and holds as powers in trust, with respect to the custodial property, in addition to the rights and powers provided in this act, all the rights and powers which a guardian has with respect to property not held as custodial property.

Insurance or annuity, incidents of ownership, beneficiaries, payment of premiums

(10) If the subject of the gift is a life insurance policy or an annuity contract, the custodian in his capacity as custodian has all of the incidents of ownership in the life insurance policy or annuity contract to the same extent as if the custodian were personally the owner. The designated beneficiary of a policy or contract on the life of a minor shall be the minor or, in the event of his death, the minor's estate. The designated beneficiary of a policy or contract on the life of a person other than the minor shall be the custodian as custodian for the minor for whom the custodian is acting. The custodian may pay premiums on the policy or contract out of the custodial property.

554.455 Same; expenses; compensation; bond; liability for losses

Sec. 5. (a) A custodian is entitled to reimbursement from the custodial property for his reasonable expenses incurred in the performance of his duties.

(b) A custodian may act without compensation for his services.

(c) Unless he is a donor, a custodian may receive from the custodial property reasonable compensation for his services determined by 1 of the following standards in the order stated:

(1) A direction by the donor when the gift is made;

(2) A statute of this state applicable to custodians;

(3) A statute of this state applicable to guardians;

(4) An order of the court.

(d) Except as otherwise provided in this act, a custodian shall not be required to give a bond for the performance of his duties.

(e) A custodian not compensated for his services is not liable for losses to the custodial property unless they result from his bad faith, intentional wrongdoing or gross negligence or from his failure to maintain the standard of prudence in investing the custodial property provided in this act. P.A.1959, No. 172, § 5, Eff. March 19, 1960.

554.456. Liability of persons dealing with custodian or donor

Sec. 6. An issuer, transfer agent, bank, broker, or other person acting on the instructions of or otherwise dealing with a person purporting to act as a donor or in the capacity of a custodian is not responsible for determining whether the person designated as custodian by the purported donor or by the custodian or purporting to act as a custodian has been duly designated, or whether any purchase, sale, or transfer to or by or any other act of any person purporting to act in the capacity of custodian is in accordance with or authorized by this act, or is not obliged to inquire into the validity or propriety under this act of an instrument or instructions executed or given by a person purporting to act as a donor or in the capacity of a custodian, or is not bound to see to the application by a person purporting to act in the capacity of a custodian or money or other property paid or delivered to him. An issuer, transfer agent, bank, broker, or other person acting on any instrument of designation of a successor custodian, executed as provided in * * * section 7(1) [1] by a minor to whom a gift has been made in a manner prescribed in this act and who has attained the age of 14 years, is not responsible for determining whether the person designated by the minor as successor custodian has been duly designated, or is not obliged to inquire into the validity or propriety under this act of the instrument of designation.

554.457. Successor custodian; eligibility; removal of custodian; transfer of custodial property to guardian

Sec. 7. (1) Only an adult member of the minor's family, a guardian of the minor, or a trust company is eligible to become successor custodian. A custodian may designate his successor by executing and dating an instrument of designation before a subscribing witness other than the successor; the instrument of designation may but need not contain the resignation of the custodian. If the custodian does not so designate his successor before he dies or becomes legally incapacitated, and the minor has attained the age of 14 years, the minor may designate a successor custodian by executing an instrument of designation before a subscribing witness other than the successor. A successor custodian has all the rights, powers, duties, and immunities of a custodian prescribed by this act.

(2) The designation of a successor custodian as provided in subsection (1) takes effect as to each item of the custodial property when the custodian resigns, dies, or becomes legally incapacitated and the custodian or his legal representative both:

(a) Causes the item, if it is a security in registered form, * * * a life insurance policy, or an annuity to be registered, with the issuing insurance company in the case of a life insurance policy or annuity in the name of the successor custodian followed in substance by the words: "As custodian for .....
(name of minor)
under the Michigan uniform gifts to minors act".

(b) Delivers or causes to the delivered to the successor custodian any other item of the custodial property, together with the instrument of designation of the successor custodian or a true copy thereof and any additional instruments required for the transfer thereof to the successor custodian.

(3) A custodian who executes an instrument of designation of his successor containing the custodian's resignation as provided in subsection (1) shall promptly do all things within his power to put each item of the custodial property in the possession and control of the successor custodian named in the instrument. The legal representative of a custodian who dies or becomes legally incapacitated shall promptly do all things within his power to put each item of the custodial property in the possession and control of the successor custodian named in an instrument of designation executed as provided in subsection (1) by the custodian or, if none, by the minor if he has no guardian and has attained the age of 14 years, or in the possession and control of the guardian of the minor if he has a guardian. If the custodian has executed as provided in subsection (1) more than 1 instrument of designation, his legal representative shall treat the instrument dated on an earlier date as having been revoked by the instrument dated on a later date.

(4) If a person designated as custodian or as successor custodian by the custodian as provided in subsection (1) is not eligible, dies, or becomes legally incapacitated before the minor attains the age of 18 years, and if the minor has a guardian, the guardian of the minor shall be successor custodian. If the minor has no guardian and if no successor custodian who is eligible and has not died or become legally incapacitated has been designated as provided in subsection (1), a donor, his legal representative, the legal representative of the custodian, or an adult member of the minor's family may petition the court for the designation of a successor custodian.

(5) A donor, the legal representative of a donor, a successor custodian, an adult member of the minor's family, a guardian of the minor, or the minor if he has attained the age of 14 years may petition the court that for cause shown in the petition, the custodian be removed and a successor custodian be designated or, in the alternative, that the custodian be required to give bond for the performance of his duties.

(6) Upon the filing of a petition as provided in this section, the court shall grant an order, directed to the persons and returnable on such notice as the court may require, to show cause why the relief prayed for in the petition should not be granted and grant * * relief * * * the court finds to be in the best interests of the minor.

(7) A custodian, whether or not the donor, against whom no proceedings have been commenced under subsection (6), may transfer the custodial property to a guardian for the minor, acting under court appointment by causing each security which is custodial property to be registered in the name of the guardian and delivering the security and all other custodial property to the guardian, together with any additional instruments required for the transfer thereof. Thereafter the custodial property shall be held by the guardian and administered as a part of the guardianship estate and the custodian shall be relieved of all liability therefor.

554.458 Accounting

Sec. 8. (a) The minor, if he has attained the age of 14 years, or the legal representative of the minor, an adult member of the minor's family, or a donor or his legal representative may petition the court for an accounting by the custodian or his legal representative.

(b) The court, in a proceeding under this act or otherwise, may require or permit the custodian or his legal representative to account and, if the custodian is removed, shall so require and order delivery of all custodial property to the successor custodian and the execution of all instruments required for the transfer thereof. P.A.1959, No. 172, § 8, Eff. March 19, 1960.

554.459 Construction of act

Sec. 9. (a) This act shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it.

(b) This act shall not be construed as providing an exclusive method for making gifts to minors. P.A.1959, No. 172, § 9, Eff. March 19, 1960.

554.460 Short title

Sec. 10. This act shall be known and may be cited as the "Michigan uniform gifts to minors act". P.A.1959, No. 172, § 10, Eff. March 19, 1960.

554.461 Repeal; saving clause

Sec. 11. Act No. 43 of the Public Acts of 1956, being sections 554.431 to 554.443 of the Compiled Laws of 1948, is hereby repealed, but the repeal does not affect gifts made in a manner prescribed therein nor the powers, duties and immunities conferred by gifts in such manner upon custodians and persons dealing with custodians. The provisions of this act henceforth apply, however, to all gifts made in a manner and form prescribed in Act No. 43 of the Public Acts of 1956 hereby repealed except insofar as such application impairs constitutionally vested rights. The sections of this act shall be construed as a continuation of the provisions of Act No. 43 of the Public Acts of 1956 hereby repealed, modified or amended according to the language employed, and not as a new enactment. P.A.1959, No. 172, § 11, Eff. March 19, 1960.

UNIFORM TRANSBOUNDARY POLLUTION RECIPROCAL ACCESS ACT

The Uniform Transboundary Pollution Reciprocal Access Act (hereafter UTPRAA) has been proposed to modify common-law and statutory rules of jurisdiction, venue, and choice of law which have historically stood as barriers to effective pollution litigation across state and national boundaries. In addition, the Act would effect an equalization of remedies available to resident and non-resident victims bringing suit against a polluter in its home jurisdiction. The UTPRAA is keyed to reciprocity and does not impose an obligation unless the non-Michigan plaintiff is from a jurisdiction that has also adopted the Act. On the other hand, only if Michigan adopts the UTPRAA will Michigan residents clearly have the advantage of the Act when bringing suit in other jurisdictions that have adopted it.[1]

Pollution actions have been brought under a wide variety of statutory and common-law causes of action, including trespass and nuisance. Although it is theoretically possible to obtain a judgment against an out-state polluter, a combination of local-action jurisdiction rules, limitations on personal jurisdiction, inconsistent choice of law rules, and the unenforceability of judgments across boundaries has rendered recovery for transboundary pollution unsatisfactory if not actually impossible.

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1. Since Michigan currently allows out-state victims of pollution to bring suit here, having rejected the local-action limitation, we conceivably would come within the UTPRAA's reciprocity provision in any event. UTPRAA's section one refers to jurisdictions providing "substantially equivalent access to their courts" to that required under the UTPRAA, and that standard arguably could include Michigan. Thus, the commentary to Section 1 notes that there would be no need to adopt the Act in jurisdictions that "already provide access to their courts for non-resident pollution victims by rejecting the rule of Livingston v. Jefferson (the local action rule)." However, Michigan does not apply the law of the forum to such actions, but the lex loci delicti choice-of-law standard. This is inconsistent with the UTPRAA (see Section 4) and may result in different treatment of resident and non-resident victims, which arguably could place Michigan outside of the "substantially equivalent" standard. Adoption of the UTPRAA would ensure that Michigan will be viewed as a reciprocating jurisdiction (particularly for Canadian listing) and would bring the Michigan choice-of-law rule into line with that which will be applied to Michigan residents suing in other reciprocating jurisdictions.

The primary difficulty for the injured party, at least for Michigan residents, lies in enforcing a judgment against the out-state polluter. Because of the particular nature of pollution actions, equitable remedies are often the most desirable solution for a plaintiff, but an equitable judgment obtained by the injured party in his home state ordinarily cannot be enforced in the state in which the polluter resides. When the boundary involved is international rather than state, the problem of enforcement is even greater; Canadian courts have refused to enforce both law and equity judgments of U.S. courts that rest on typical long-arm jurisdiction.

The inability to enforce a judgment from his home state should logically lead the injured party to bring suit in the jurisdiction in which the polluter resides. However, a new set of barriers may arise in this circumstance, depending upon that jurisdiction's rules regarding venue and jurisdiction. Traditionally, the common law has favored local-action rules where real property is at issue. Since pollution actions typically involve a gravamen of damage to real property, many jurisdictions will refuse to try the case if the plaintiff's property lies outside the court's jurisdictional boundaries.

The primary attribute of the UTPRAA is its elimination of the local-action bar in reciprocating jurisdictions. The injured party may bring suit in the jurisdiction of the polluter and is entitled there to all of the relief that would be available under the law of that jurisdiction to a resident plaintiff. As noted in the memorandum attached as Appendix A, this will work to the benefit of Michigan residents injured by transboundary pollution and it will not impose any additional burden on Michigan residents sued as polluters. With the adoption of the UTPRAA, the Michigan plaintiff will have the choice between (1) bringing suit in the alleged polluter's jurisdiction, thereby obtaining a clearly enforceable judgment or, (2) using long-arm jurisdiction to sue the polluter in Michigan, thereby obtaining a judgment that may or may not be enforceable. The second alternative is now available, but the first is not as to Canada and such states as still follow the local-action rule. Under the UTPRAA, the Michigan resident alleged to have caused pollution damage in another jurisdiction will be subject to suit in Michigan, but such a suit is already available since Michigan does not adhere to the local-action rule.

The UTPRAA does produce one major change that alters the relief currently available in Michigan. As noted in the Appendix A memorandum, Michigan courts probably would apply the law of the place of harm to a transboundary pollution suit brought in their state -- e.g., a Canadian plaintiff bringing suit in Michigan against an alleged Michigan polluter would have his cause of action resolved under Canadian law. Under the UTPRAA, the law of the forum would be applicable. As the memorandum notes, the wisdom of the current Michigan reliance on the lex loci delicti

rule is open to debate. At least in the pollution area, the possible polluter is most likely to have looked to the law of its home state in governing its activities since most of the potential harm arising from its actions is likely to occur in that state. In any event, even if one assumes that lex loci might be the better rule, a Michigan shift to application of the law of the forum is an appropriate inducement to encourage jurisdictions like Canada to discard the local-action rule through adoption of the UTPRAA. As noted in the official Commentary to Section 4, application of the law of the forum is desirable if only to avoid the "problems of renvoi" that would unduly complicate a jurisdiction's decision to reject the local-action rule.

The Uniform Act, as approved by the N.C.C.U.S.L. and the Canadian Uniform Law Conference, is reprinted in Appendix B, along with commentary. The proposed bill follows:

UNIFORM TRANSBOUNDARY POLLUTION RECIPROCAL ACCESS ACT

A bill to provide reciprocal access for suits based on injury or threatened injury to property in person in another jurisdiction where caused by pollution originating in this jurisdiction.

THE PEOPLE OF THE STATE OF MICHIGAN ENACT

Section 1. In this Act:

(a) "Reciprocating jurisdiction" means a state of the United States of American, the District of Columbia, the Commonwealth of Puerto Rico, a territory or possession of the United States of America, or a province or territory of Canada, which has enacted this [Act] or provides substantially equivalent access to its courts and administrative agencies.

(b) "Person" means an individual person, corporation, business trust, estate, trust, partnership, association, joint venture, government in its private or public capacity, governmental subdivision or agency, or any other legal entity.

Section 2. An action or other proceeding for injury or threated injury to property or person in a reciprocating jurisdiction caused by pollution originating, or that may originate, in this jurisdiction may be brought in this jurisdiction.

Section 3. A person who suffers, or is threatened with, injury to his person or property in a reciprocating jurisdiction caused by pollution originating, or that may originate, in this jurisdiction has the same rights to relief with respect to the injury or threatened injury, and may enforce those rights this jurisdiction as if the injury or threatened injury occurred in this jurisdiction.

Section 4. The law to be applied in an action or other proceeding brought pursuant to this act, including what constitutes "pollution," is the law of this jurisdiction excluding choice of law rules.

Section 5. This Act does not accord a person injured or threatened with injury in another jurisdiction any rights superior to those that the person would have if injured or threatened with injury in this jurisdiction.

Section 6. The right provides in this Act is in addition to and not in derogation of any other rights.

Section 7. The defense of sovereign immunity is applicable in any action or other proceeding brought pursuant to this Act only to the extent that it would apply to a person injured or threatened with injury in this jurisdiction.

Section 8. This Act shall be applied and construed to carryout its general purpose to make uniform the law with respect to the subject of this Act among jurisdictions enacting it.

Section 9. This Act may be cited as the Uniform Transboundary Pollution Reciprocal Access Act.

APPENDIX A

THE UNIFORM TRANSBOUNDARY POLLUTION RECIPROCAL ACCESS ACT AND MICHIGAN LAW[1]

I. COMPARISON BETWEEN THE UTPRAA AND CURRENT MICHIGAN LAW

A. Section 2 of the UTPRAA and the Designation of Forum

Section 2 of the UTPRAA provides that an action for pollution-caused injuries may be brought in the jurisdiction where the pollution originated. As such, it explicitly overrules the local-action limitation followed at common law. It does not conflict with existing Michigan law, however, as Michigan has not applied a local-action limitation for injuries to real property for many years. While, the usual personal jurisdiction requirements must be met, Michigan courts have not required that defendants be "found" in the county where the injury to the land occurred; suits also have been permitted in the county where the cause of action arose or where the defendant is resident.

Michigan's venue rules are included in the Revised Judicature Act, Mich.Comp.Laws Section 600.1601 et seq.. Section 1605, dealing with venue in real actions, provides as follows:

> The county in which the subject of action, or any part thereof, is situated, is a proper county in which to commence and try the following actions:
>
> a. the recovery of real property, or of an estate or interests therein, of for the determination in any form of such right or interest;
>
> . . . . .
>
> d. the recovery of tangible personal property.

Carl S. Hawkins, in his 1968 Practice Commentary in Mich.Comp. Laws Ann. Section 600.1605 (West 1976) notes at p. 389:

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1. A memorandum prepared by Andrea Lodahl, 2nd year student, University of Michigan Law School.

> Traditionally, "local" actions had to be brought where the subject property was located, and this was frequently construed as a "jurisdictional" requirement. While these actions are still properly brought in the county where the property is located, the Committee Comment to RJA Section 1605 emphasizes that this is not a jurisdictional requirement. . . .
>
> Actions for trespass or negligent injury to land have, in times past, been classified as "local" actions, so that they had to be brought in the county where the subject property was located. Such actions are not included under RJA Section 1605. The Committee Comment states that this was an advertant omission, since there was no "compelling reason . . . for requiring trespass actions to be brought in the county where the subject of action or any part thereof is situated." Therefore, such actions are governed by the general provisions of RJA Sections 1621, 1625, and 1627, rather than RJA Section 1605.

Since Section 1605 does not apply to tort actions involving property, Michigan's normal civil venue rules apply. Section 1621 of the RJA provides for venue where the defendant is resident, has a place of business, conducts business, or where the registered office of a defendant corporation is located; if those criteria fail to yield a forum, subsection (b) allows venue where the plaintiff is located. As an alternative to venue where the defendant or plaintiff is established, for all but certain specified actions (e.g., those under Section 1605), Section 1627 establishes as proper venue the county in which "all or part of the cause of action arose." Hawkins' Practice Commentary on this section notes:

> Tort actions for injury to land are no longer mandatorily "local." . . . Consequently, such actions may be brought where the cause of action arose or where the defendant is established. . . .
>
> Normally there is no difficulty in defining where a cause of action arose, since the acts of the defendant which gave rise to the action and the resulting injuries to the plaintiff have occurred in the same county. But where it is otherwise, a problem of definition must be resolved. For venue purposes, did the cause of action arise in the county where the defendant committed his wrongful acts or omissions, or did

> it arise in the county where the plaintiff suffered injury? . . .
>
> Under a former statute, actions against public officers had to be brought in the county where the cause of action arose. In a case where the action of highway officers in one county caused flooding of the plaintiff's lands in another county, the court construed the statute as placing venue in the county where the lands were located, since there was no cause of action until the lands were flooded. . . .
>
> We submit that this would be the preferred construction of the new statute. The wrongful act of the defendant gives rise to no cause of action until an invasion of the plaintiff's interests occurs. . . . If that is not the most convenient place for trial, the defendant can obtain a transfer. . .

Thus, the statutory language and the legislative history (as described by Hawkins) establishes that Michigan does not apply a local-action rule for injuries to real property but that it will find proper venue under three basic criteria: location of the defendant, location of the plaintiff or, where the cause of action arose. Pollution originating in Michigan would almost certainly be caused by a business establishment, such as a factory, which would satisfy the terms of Mich.Comp.Laws Section 600.1621 as to the location of the defendant. The UTPRAA would not, therefore, open a new forum that is unavailable under current law when it allows a Michigan defendant to be sued for pollution caused to out-state property.

B. Section 3 of the UTPRAA (Equal Right to Relief)

Section 3 of the UTPRAA establishes equality of rights to relief between plaintiff resident in the forum and a plaintiff from outside the forum who is suing based on pollution originating in the forum. Essentially, this provision ensures that remedies will not be denied to pollution victims because they came from outside the jurisdiction. It prevents courts from differentiating between in-jurisdiction and extra-jurisdiction plaintiffs at the remedy stage, perhaps by denying equitable relief. Available remedies would usually turn upon choice of law issues under the current common-law system. This section combines with Sections 4, 5 and 6 to standardize remedies between in-jurisdiction and out-of-jurisdiction plaintiffs, and to base them on the law of the jurisdiction where the pollution originated. The general purpose of the Act, accomplished primarily by abolishing the local-action rule and eliminating choice of law rules, is bolstered here by specifically

prohibiting discrimination. Apart from the alteration of the applicable choice-of-law rule (see below), this provision has no special bearing to Michigan.

C. Section 4 of the UTPRAA (Applicable Law)

Section 4 of the UTPRAA provides that the law of a jurisdiction hearing a pollution action under the provisions of the Act will control the issues of the case, including whether a cause of action is stated. This section explicitly overrules contrary common-law rules regarding conflicts of law in tort actions. It provides:

> The law to be applied in an action or other proceeding brought pursuant to this [Act], including what constitutes "pollution," is the law of this jurisdiction excluding choice of law rules.

This "law of the forum" provision directly contradicts what appears to be the current Michigan position on choice of law in tort actions. Michigan has traditionally applied the "lex loci delicti" rule, sticking to it even under criticism and after many other jurisdictions have switched to a test applying the law of the locus of the most significant relationship to the action. Therefore, a Michigan court today probably would apply the law of the jurisdiction where the injury to the land occurred -- the plaintiff's jurisdiction -- not the law of the forum.

The rule of lex loci delicti as applied to tort actions has a somewhat stormy history in Michigan. Many jurisdictions changed over to a rule applying the law of a jurisdiction having the "dominant contacts" when the Restatement of Torts adopted such a test following a seminal New York case Babcock v. Johnson. The Michigan Court of Appeals sharply criticized the lex loci delicti rule in Abendschein v. Earrell, 11 Mich.App. 662, 162 N.E.2d 165 (1968), aff'd 382 Mich. 510, 170 N.W.2d 137 (1969). The Court of Appeals applied the lex loci delicti rule but did so under protest, calling for the Supreme Court to overrule its earlier decisions establishing it. The Supreme Court, however, affirmed the lower court's decision and criticized the "dominant contacts" rule in turn, calling it unwieldy and problematical. A few cases have been exceptions to the lex loci delicti rule, but they have primarily involved fact situations either where the law of the situs of injury would have been a completely arbitrary choice are Banyan v. Alpena Flying Service, 65 Mich.App. 1, 236 N.W.2d 739 (1979) or where Michigan public policy would be directly contravened by applying the law of the situs of injury, see Sweeney v. Sweeney, 402 Mich. 234, 262 N.W.2d 625 (1978) (Ohio parental immunity rules would not be applied where Michigan had abolished parental immunity; holding explicitly limited to facts of case). On the other hand, the

most recent Supreme Court decision casts some doubt on the continued vitality of the lex loci delicti rule in general. In Sexton v. Ryder Truck Rental, 413 Mich. 406, 320 N.W.2d 843 (1982), the Supreme Court delivered a split opinion which muddied the waters regarding choice of laws:

> Upon consideration of all the arguments for lex loci and the alternative choice-of-law methodologies as well as the Michigan precedents, we presently adopt no extant methodology outright but hold that when two residents, or two corporations doing business in the state, or any combination thereof, are involved in an accident in another state, the forum will apply its own law. Id., at 845 (per Williams, J., with one Judge concurring and two Judges concurring in the result and one Judge concurring and concurring in the result).

The safest interpretation of this holding is that lex loci probably applies to tort actions where the parties are residents of different jurisdictions, but not when both parties are Michigan residents.

The final issue regarding Michigan choice of law rules in the pollution context would be whether Michigan courts would consider the tort to have occurred where the pollution was released or where the plaintiff's damaged land was located. Although there are no published opinions dealing with pollution cases, the rules applied in products liability are analogous since the issue there is between the location of defective manufacture and location where the defect actually produced an injury. In the products liability context, it has been held that the situs of the actual injury to the plaintiff, rather than the situs of the defective manufacture, was the "locus delicti." Koretz v. Amsted Industries, Inc., 472 F.Supp. 136 (E.D. Mich. 1979).

It appears, then, that the UTPRAA would overrule a longstanding rule of Michigan law regarding the applicable substantive law in cases of tortious injury. This would have a bearing in cases brought by residents of other states only as to state law, since federal law would be applicable in any event. As to suits by foreign plaintiffs, the UTPRAA would require application of U.S. national law as well as Michigan state law.

E. Sections 5 and 6 of the UTPRAA (Equality of Rights and Additional Rights)

Along with Sections 3 and 4, these Sections also are designed to equalize the treatment of an out-of-jurisdiction plaintiff with that of a plaintiff from within the jurisdiction. Section 5 states that the Act "does not accord a person injured or threatened with injury in another jurisdiction any rights superior to those that the person would have if injured or threatened with injury in this jurisdiction." Section 6 states that "the right provided in this Act is in addition to and not in derogation of any other rights."

As is noted in the discussion on applicable law, under current Michigan law the out-state plaintiff would be treated differently in so far as the choice-of-law rule required application of his jurisdiction's law rather than Michigan law. Other than this change, Section 5 has no special bearing in Michigan. Section 6 preserves remedies otherwise available under State law -- e.g., a long-arm suit might still be brought by a Michigan victim against a foreign polluter. In such a suit, Michigan would apparently apply Michigan law so there would be no departure from the principles of equality formulated in this Act.

F. Section 7 of the UTPRAA (Sovereign Immunity)

Section 7 (with alternatives for the U.S. and Canada) provides that sovereign immunity shall apply to suits brought by extra-jurisdiction plaintiffs as if they were in-jurisdiction plaintiffs. It thus merely affirms that the law of the sitting jurisdiction will control any issues of sovereign immunity that might apply, as it controls all other issues of law not specified in the Act itself.

II. EFFECT OF ADOPTION OF THE UTPRAA ON HYPOTHETICAL PARTIES TO A POLLUTION SUIT

This section will consider, for various hypothetical parties to a pollution suit, how the provisions of the UTPRAA, if adopted by Michigan and the other jurisdictions involved, would change their cases. The following parties will be considered:

(A) a Michigan plaintiff, (1) suing a Canadian defendant, (2) a defendant in a neighboring state

(B) a Canadian plaintiff suing a Michigan defendant

(C) an out-of-state plaintiff suing a Michigan defendant

A. Effects of the UTPRAA on a Michigan Plaintiff

1. Suit Against a Canadian Defendant

(a) Can a Michigan Plaintiff Sue a Canadian Polluter Here?

Michigan's long-arm statute makes every effort to reach defendants causing tortious consequences in-state. Mich. Comp. Laws 600.705, 600.715. The two relevant provisions, with equivalent language applied to individuals (Section 705) and corporations (Section 715), both state:

> The existence of any of the following relationships between a(n) [individual] [corporation or its agent] and the state shall constitute a sufficient basis of jurisdiction to enable the courts of record of this state to exercise limited personal jurisdiction . . . and enable such courts to render personal judgments against such [individual] [corporation] arising out of the act or acts which create any of the following relationships:
>
> . . .
>
> (2) The doing or causing any act to be done, or consequences to occur, in the state resulting in an action for tort. . . .

The constitutionality of provisions such as subsection (2) has been questioned on due process grounds when the defendant arguably has no "minimum contacts" in the International Shoe sense, such as doing business in the state. Generally, the Michigan cases have held that for long-arm jurisdiction to be consistent with due process, it must arise from one of the relationships enumerated in Sections 705 and 715, and that the due process inquiry must proceed on a case-by-case basis. Schneider v. Linkfield, 40 Mich.App. 131, 198 N.W.2d 834 (Mich.App. 1972). In addition, in inquiring into "tortious consequences * * * in the state," courts have refused to consider mere effects such as damages to be sufficient Clavenna v. Holsey, 81 Mich.App. 472, 265 N.W.2d 378 (Mich.App. 1978) and have required that the contact between the tortious act and the plaintiff -- the event on which the cause of action is based -- must have occurred in-state. Clavenna v. Holsey, supra (boat crash between Canadian and Michigan resident in Canadian waters -- no jurisdiction); Storie v. Beech

Aircraft, 417 F.Supp. 141 (E.D. Mich. 1976) (plane crash occurred in Ohio, D was Delaware Corporation -- no jurisdiction); Amburn v. Harold Forster Industries, 412 F.Supp.. 1302 (E.D. Mich. 1976) (Canadian defendant in patent infringement case -- not doing business here -- no jurisdiction); Price v. Shessel, 415 F.Supp. 306 (E.D. Mich. 1976) (negligent medical treatment in Georgia caused "effects" to Michigan plaintiff here -- ruled event not here -- no jurisdiction). There are no reported pollution cases. Analogizing from the citations above, however, it does seem that jurisdiction might be had where pollution originating in Canada (or another state) "contacted" the plaintiff's interests here in Michigan.

As noted earlier, however, the value of obtaining jurisdiction under Mich. Comp. Laws Sections 600.705, 600.715 is tempered by the difficulty of obtaining and enforcing equitable remedies across state, and particularly national, boundaries. Speaking conservatively, we can assume that a Michigan plaintiff could probably get personal jurisdiction over an out-of-state or Canadian defendant for tort damages based on tortious consequences, but that equitable remedies (often the most valuable in the pollution context) would normally be outside of the reach of the Michigan court's subject-matter jurisdiction because of their "in rem" nature. Against Canadians, no effective enforcement suit could be brought. So at present, the Michigan plaintiff can obtain (but not enforce) money judgments against Canadians by suing here. Of course, adoption of the Uniform Act would not alter the availability of this remedy. See Section 6.

(b) Can a Michigan Plaintiff Sue a Canadian in Canada?

The second major controlling factor in successful pollution litigation at present is whether a suit can be brought in the defendant's jurisdiction, which in turn depends upon whether the defendant's jurisdiction applies the local-action rule as a jurisdictional requirement for actions involving damages to real property. Canada applies it strictly.

The Commonwealth has strictly applied the local-action rule at common law, with the principal case being British South Africa Co. v. Companbia de Mozambique, [1893] A.C. 602 (H.L.). In that case, the court held that no nation can execute its judgments against land situate elsewhere. Canada has followed the British South Africa Company rule: In Duke v. Adler, [1932] S.C.R. 734, the court held that only where decrees operate "in personam" and where the defendant can be found in the jurisdiction may any cases involving land situate elsewhere be tried. In Albert v. Eraser Companies, [1937] 1 D.L.R. 39, the court held that jurisdiction was excluded completely when the controversy related to land in a foreign country. Thus, it is apparent that any action in Canada attempted by a Michigan plaintiff would not be

heard if it involved damages to Michigan property.

Under the Uniform Act, a Michigan plaintiff's prospects in a suit against a Canadian defendant from an enacting Canadian province would improve dramatically. At present, the Michigan plaintiff is caught between an inability to bring any suit in Canada due to the local-action rule and an inability to enforce any judgment rendered here unless the defendant happens to be doing business here. Under the UTPRAA, Michigan plaintiffs would gain access to the Canadian courts as the local-action rule would be set aside. They could obtain any relief available under Canadian law that would have been available if they were a resident of the Canadian jurisdiction. While the substantive law of the defendant's jurisdiction might be less favorable, nothing is lost to the Michigan plaintiff. It is a movement from no practical ability to obtain relief to the ability to obtain whatever relief the Canadian court will grant according to its law.

2. Suit Against A Neighboring-State Defendant

Generally, the effect of the Act on interstate pollution suits depends on whether the other state, assumed here to also be enacting the UTPRAA, currently applies the local-action rule.

(a) Can a Michigan Plaintiff Sue An Out-of-State Defendant in Michigan?

Under the long-arm, Michigan plaintiffs can probably gain jurisdiction to sue the out-of-state defendant here. Because of the Full Faith and Credit Clause, the Michigan plaintiff obtaining a money judgment here can get that judgment enforced in the courts of the defendant's state. However, the ability to enforce equitable relief is tied up with the local-action rule, as are the prospects for suing the defendant in his own state so as to obtain equitable relief. Since the Act would not prevent Michigan plaintiffs from suing here under the existing long-arm provisions, the significance of the change in a Michigan plaintiff's prospects depends primarily upon whether the defendant's state currently applies the local action-rule as a jurisdictional requirement.

(b) Can a Michigan Plaintiff Sue an Out-of-State Defendant in that Defendant's State? (Four states whose rules might be especially relevant to a Michigan plaintiff -- Illinois, Indiana, Ohio, and Wisconsin -- will be examined).

Illinois does not follow the local action rule as a jurisdictional requirement where actions involving damage to a real property are concerned, though it does apply such a requirement to title actions. The Illinois Code of Civil Procedure, Section 2-101 et. seq. controls venue for civil actions. Section 2-101 fixes venue generally where the defendant resides or where the transaction giving rise to the cause of action occurred. Section 2-103, applying to public corporations and local actions, provides:

> (a) Actions must be brought against a public, municipal, governmental or quasi-municipal corporation in the county in which its principal office is located. Actions to recover damages to real estate which may be overflowed or otherwise damaged by reason of any act of the corporation may be brought in the county where the real estate or some part of it is situated, or in the county where the corporation is located, at the option of the party claiming to be injured.
>
> (b) Any action to quiet title to real estate . . . must be brought in the county in which the real estate or some part of it is situated.

This statute provides that only title and partition-type "real" actions are mandatorily local, and the alternative provision of sub-(A) suggests that while proper venue would probably be found in the county where the land is situated, a resident could also be sued in his county of residence. This interpretation is supported by one case, De Licen v. Beyes, 410 N.E.2d 179 (Ill.App. 1980) which held that, although courts must generally have jurisdiction over land to affect rights and interests in it, if jurisdiction over the parties is had and equitable powers are invoked, the court may affect the land indirectly by acting directly on the interested party.

Since a Michigan plaintiff would not be barred by the local-action rule from suing an Illinois defendant in Illinois, the primary area of possible change under the UTPRAA would be in the choice of applicable law. Although Illinois has adopted the significant contacts test to choice of law questions in tort, Jackson v. Miller-Davis Co., 358 N.E.2d 328 (Ill.App. 1976), there is a rebuttable presumption in favor of lex loci delicti as the place of the most significant relationship, Pittway Corp. v. Lockheed Aircraft Corp., 641 F.2d 524 (7th Cir. 1981). If lex loci delicti is chosen as the source of law, the place where the injury occurred rather than the place of the act or omission is considered the source of law, Ingersoll v. Klein, 262 N.E.2d 593 (Ill. 1970). In an earlier diversity case, it was ruled that

where an injury occurred in Michigan as a result of defendant's acts in Illinois, the common law of Michigan as to tort liability was controlling. Waynick v. Chicago's Last Dept. Store, 269 F.2d 322 (7th Cir. 1959). Thus, where a Michigan plaintiff traveled to Illinois to bring suit today, he would have the benefit of Michigan's law, whereas if the UTPRAA is adopted, he would be subject to Illinois law.

Indiana "follows" the local-action rule in the sense that proper venue may be fixed where the land is located. However, the rule is not followed as a jurisdictional requirement, and proper venue may also be obtained where the defendant resides even in cases involving land. Ind. Code Ann., Court Rules, T.R. 75 (A). It lists ten criteria for finding proper venue, of which Sections 1 and 2 are most relevant here:

> (1) the county where the greater percentage of individual defendants included in the original complaint resides, or, if there is no such greater percentage, the place where any individual defendant so named resides; or
>
> (2) the county where the land or some part thereof is located or the chattels or some part thereof are located or kept, if the complaint includes a claim for injuries thereto. . . .

Cases construing the statute have found the "or" between the subsections to mean that these are alternatives and that therefore proper venue may be found under any one of the subsections. Grove v. Thomas, 446 N.E.2d 333 (Ind. App. 1983); Board of Comm'rs v. Nevitt, 448 N.E.2d 333 (Ind. App. 1983). Thus, actions are not precluded under a jurisdictional version of the local-action rule; a Michigan plaintiff could sue an Indiana defendant in his county of residence. The Act would not materially change the prospects of obtaining and enforcing a judgment by going to the defendant's state. Choice of laws rules would again represent the largest area of potential change. Indiana follows the lex loci delicti rule and looks to the place of injury in choosing controlling substantive law, Lee v. Lincoln Nat'l Bank and Trust Co., 442 N.E.2d 404 (Ind. App. 1982). At present, Michigan law would apply to a suit by a Michigan victim in Indiana. Under the UTPRAA, Indiana law would control the substantive issues of the case.

Ohio also does not apply the local action rule as a jurisdictional requirement. Ohio has ruled that damages to land (as opposed to actions involving title and the like) are not local but transitory actions, and that proper venue therefore lies where the defendant is resident. Snyder v. Clough, 50

N.E.2d 384 (Ohio App. 1943). Again, the area for potential change would be in choice of law rules. Ohio, like Illinois, applies the lex loci delicti test but appears to be considering abandoning it, Michell v. General Motors Corp., 439 F.Supp. 24 (N.D. Oh. 1977); Moats v. Metropolitan Bank of Lima, 319 N.E.2d 604 (Ohio 1974). At present, the rule has only been directly overturned for wrongful death cases, Fox v. Morrison Motor Freight, Inc., 25 O.S. 2d 193, 267 N.E.2d 405 (Ohio 1971). Thus, lex loci delicti would probably still govern, and would refer to the place of injury, not of the wrongful act.

Wisconsin does apply the local action rule as an absolute bar to suits involving out-of-state land according to Bettys v. Milwaukee & St. Paul Ry. Co., 37 Wis. 323 (1875). A later case makes it difficult to say with certainty, however, how a Wisconsin court would deal with interstate pollution today. In Mueller v. Brown, 313 N.W.2d 790 (Wis. 1982), the court held that (1) salt contamination of a well was not an "injury to real property" and so was not mandatorily local; and (2) that any defect that might have existed from failing to bring the suit where the land was located was not a defect of subject-matter jurisdiction. The Mueller ruling seems to suggest that (1) Wisconsin courts may no longer consider Bettys good law, and (2) that even under the Wisconsin venue statute, Wisc. Stat. Ann. Section 801.50 et. seq. (which states the the proper court is the one where the land is located) certain types of damage may be considered exempt from the rule as not being "injury to real property."

Assuming arguendo that Wisconsin would hear a case brought by a Michigan pollution victim for injury to his land, Wisconsin would probably apply Wisconsin law. The rule of lex loci delicti has been abandoned in Wisconsin in favor of the significant contacts test, and a weak presumption of lex fori is the starting point for the choice of law inquiry, Decker v. Fox River Tractor Co., 324 F.Supp. 1089 (N.D. Wis. 1971); Conklin v. Horner, 157 N.W.2d 579 (Wis. 1968). Under the UTPRAA, the law applied would also be Wisconsin law, so adoption of the UTPRAA would not impose a disadvantage as to controlling law.

In sum, under the UTPRAA, the Michigan plaintiff would retain what power he currently has to bring defendants to Michigan under the long-arm. He would gain: (1) access for the first time to enforceable judgments against Canadians; (2) greater access to enforceable equitable remedies in other states; and (3) greater access in general in Wisconsin, which might apply the local-action rule as a jurisdictional bar to the Michigan plaintiff. In return for those gains, he would be limited to the remedies available under the law of the defendant's state, and while Michigan law might be applied today, it might well be the law of the forum will eventually be adopted even without the UTPRAA.

B. Effects of the UTPRAA on a Canadian Plaintiff

(a) Can a Canadian Plaintiff Sue a Michigan Defendant in Canada?

Under most provincial laws, Canadian courts will not extend personal jurisdiction to reach nonresidents of the jurisdiction unless they can be "found" in the jurisdiction and personally served with process. The Canadian Encyclopedic Digest, Ontario version, for example, states:

> If a party has been personally served within the jurisdiction, even though merely temporarily there, the jurisdiction of the court is generally established. But a Court will not generally be entitled to assume jurisdiction over a person who is outside the jurisdiction and has not been personally served within it and who does not submit to the jurisdiction. If that power is to be exercised, it must be given to the court by legislation. [Citing: Trower & Sons Ltd. v. Ripstein, (1944), A.C. 254 (P.C.)].
>
> Canadian Encyclopedic Digest, Ontario Version, Third Edition, Volume 6, Title 38 (Courts) Section 31 (Carswell 1975).

Thus, Canadians in general have no way to reach Michigan defendants in Canada except by statutory authorization.

(b) Can a Canadian Sue a Michigan Defendant in Michigan?

Since Michigan does not apply the local-action rule as a jurisdictional requirement, a Canadian can currently bring suit against a Michigan resident in the Michigan courts. Under Michigan's choice of law rules, if the injury was to land in Canada, then Canadian law would currently be applied to control the substantive issues of the case. Under the UTPRAA, the substantive issues of a Canadian plaintiff's case would be controlled by Michigan law.

C. Effects of the UTPRAA on an Out-Of-State Plaintiff

Since Michigan does not currently apply the local-action rule, plaintiffs from other states can sue Michigan residents here at present and obtain enforceable judgments. The main difference in their cases under the UTPRAA is that instead of Michigan courts applying the law of their own forum, Michigan courts would apply Michigan law to the substantive issues of the case where the suit took place in Michigan. Whether this change would constitute an advantage or a disadvantage, of course, depends upon the substantive law itself.

Of course, out-of-state plaintiffs whose state long-arm statutes can reach Michigan defendants could still pursue that route and sue in their own jurisdiction. If that jurisdiction would apply the law of the forum, the plaintiffs from those states would have an opportunity to forum-shop between their own state's substantive pollution law and Michigan's substantive pollution law. In effect, they gain access to Michigan's law where previously they always would have been limited by their own law in either forum.

SUMMARY: EFFECTS OF UTPRAA ADOPTION ON PARTIES TO POLLUTION SUITS

Adoption of the UTPRAA would be advantageous to Michigan plaintiffs. They would gain access to Canadian defendants for the first time, and would gain access to a certainty of enforceability and a likely ability to get equitable relief in all cases in contrast to the limits that exist at present. In addition, Michigan plaintiffs would retain the ability to sue here in the alternative under the long-arm statute, and have Michigan law control the substantive issues of the case.

Adoption of the UTPRAA would not be particularly disadvantageous to the Michigan defendant. He can already be reached here because Michigan does not adhere to the local-action rule. While under the UTPRAA, Michigan defendants would be subject to Michigan law, that might actually make things more predictable for the potential Michigan defendant; if sued here, a Michigan defendant would know exactly what standards of substantive law would control the issues. It makes it easier for a Michigan industrial company, for example, to take measures to comply with the law because a single standard would control the majority of cases. Only where an out-of-state plaintiff pursued relief through use of his long-arm statute would a different standard potentially apply. Here, where Michigan law is less favorable that the other state, and that state would apply its own law, adoption of the Act might encourage plaintiffs to use the long-arm statute rather than to bring suit in Michigan.

APPENDIX B

UNIFORM TRANSBOUNDARY POLLUTION RECIPROCAL ACCESS ACT

Drafted, Approved and Recommended for Enactment by the

NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS
and
UNIFORM LAW CONFERENCE OF CANADA

Prefatory Note

In 1979, the Canadian Bar Association and the American Bar Association each adopted a report prepared by a joint committee of the two Associations on "The Settlement of International Disputes Between Canada and the United States of America." One of the areas on which the report focussed was the equalization of rights and remedies of citizens in Canada and the U.S.A. affected by pollution emanating from the other jurisdiction. The Committee drafted enacting legislation on this topic, in treaty form, basing its draft upon the Organization for Economic Co-operation and Development's Recommendation for the Implementation of A Regime of Equal Right of Access and Non-Discrimination in Relation to Transfrontier Pollution.

The ABA-CBA Committee's Report suggested that a liaison group ought to be established between the National Conference of Commissioners on Uniform State Laws and the Uniform Law Conference of Canada, the two organizations in their respective countries dedicated to the promotion of uniformity of law. The group was to have a mandate covering review, co-ordination and drafting of legislation on topics of mutual interest. The liaison committee was established in 1979 and has held five meetings in Canada and the U.S. to discuss the drafting of a Transboundary Pollution Reciprocal Access Act.

Pollution is no respecter of artificial lines on maps. Damage can occur in one jurisdiction from pollution produced in another jurisdiction. Reported caselaw reveals many examples of this phenomenon. A discharge of waste into a river in one jurisdiction can damage property in states downstream: see for example Missouri v. Illinois, 26 S.Ct. 268, 200 U.S. 496, 50 L.Ed.2d 572 (1906). Smoke can blow from one adjoining city to another: see for example Michie et al. v. Great Lakes Steel Division, National Steel Corporation, 495 F.2d 213 (6th Circ.), certiorari denied 95 S.Ct. 310, 419 U.S. 997, 42 L.Ed.2d 270. Metal smelters can generate pollutants that can travel into other jurisdictions: see for example The Trail Smelter Arbitration, 3 U.N.R.I.A.A. 1905 (1941) or Ducktown Sulphur, Copper and Iron Company v. Barnes et al., 60 S.W. 593 (Tenn.1900). At times, pollution from a number of jurisdictions may contribute to the damage: see for example Ohio v. Wyandotte Chemicals Corp. et al., 91 S.Ct. 1005, 401 U.S. 493, 28 L.Ed.2d 256 (1971). Pollution crossing boundaries may take a variety of forms ranging from simple escapes between adjacent land to immensely difficult problems, such as acid rain and nuclear emissions whose very complexity renders them as intractable to coherent policy or legislative treatment as they are to definitive scientific analysis and explanation.

It is a generally recognized rule of law in the Anglo-American tradition that actions for damages for trespass, nuisance, or negligent injury in respect to lands located in another state are local actions and may be brought only in the state where the land is situated. This rule has been criticized, but most courts still follow it. Its significance is that unless the alleged tortfeasor can be "found" in the state where the injury took place, an action for damages is for all intents and purposes precluded.

When only states of the United States are involved, the increasing number of state long-arm statutes may reduce the significance of this rule because valid in personam jurisdiction over the defendant can be obtained under a long-arm stat-

ute and judgment rendered, and that judgment is entitled to full faith and credit within the United States. But even if a long-arm statute is involved, two suits may be necessary—the first to obtain the judgment and a second in another state to enforce the judgment. Furthermore, whether equitable relief will be granted by the second state, is open to question.

If there is no long-arm statute, or it is not as extensive as it might be, and the prospective defendant is not "found" within the jurisdiction where the injury occurred, then the plaintiff, for all practical purposes, is without a forum. The problem can become acute in an international setting. Suppose that on the northern shore of Lake Ontario there is a manufacturing plant that regularly emits highly toxic materials into the air and these are carried by the prevailing winds across Lake Ontario and into the State of New York. A fish hatchery there is severely damaged. Assuming that a person in New York, who is damaged can establish causation, can he bring suit?

The Canadian courts will probably not entertain the action because of the rule in British South Africa Co. v. Companhia de Mozambique, [1893] AC 602 (H.L.). The New York state courts could entertain the action, but would they be able to acquire personal jurisdiction over the Canadian defendant in order to permit the action to proceed? Under the New York State long-arm statute, N.Y.C.P.L.R. § 302, perhaps it could; and perhaps New York would reduce the claim to a money judgment. But no Canadian court would be bound by the doctrine of full faith and credit, and the chances are great that a judgment of a United States court reached upon a long-arm statute would not be honored by a Canadian court.

In British South Africa Company v. Companhia de Mozambique, the House of Lords decided that only the courts of a jurisdiction where an immovable is situated can adjudicate upon its title. An English court thus had no jurisdiction to try a damage action for trespass to land situated abroad. Courts in Canada have extended this rule to an extreme. Dealing with an action in New Brunswick for damages to Quebec land caused by the negligent blocking of an interprovincial river, Chief Justice Baxter of New Brunswick stated:

> ". . . whether title to land comes into question or not appears to be immaterial. The moment it appears that the controversy relates to land in a foreign country our jurisdiction is excluded:"

Albert v. Fraser Companies Ltd., [1937] 1 D.L.R. 39, 45, 11 M.P.R. 209, 216 [N.B.C.A.]. Applying this rule to transboundary pollution, it would prevent an American citizen from suing in Canadian courts for damage caused by a Canadian polluter, if the controversy relates in any way to land in the United States. The same obstacle for Canadians is created in the United States by the "local action rule," established in Livingston v. Jefferson, 15 Fed.Cas. 660 (No. 8411) (Cir. Ct.D.Va.1811).

This Act is designed to eliminate this particular problem with respect to pollution. While conceptually the Act could be extended to deal with all unintentional tort actions affecting property, the Committee's mandate, and indeed the earlier work of the Joint ABA/CBA Committee and the OECD, was limited to inter-jurisdictional pollution problems and the difficulties which the local action rule presented in preventing non-resident litigants getting inside the courthouse door. Whether the pollution originated in Ontario or Ohio, a New Yorker injured in New York thereby, would be entitled to go into a Canadian court or an Ohio court and maintain an action for damages for injury to New York land. In other words, this proposed statute abrogates the rules in Livingston v. Jefferson and British South Africa Co. v. Companhia de Mozambique, which many believe to be anachronisms in any event.

While the joint committee of the ABA/CBA had recommended that the local action rule should be changed by way of bilateral treaty, the joint uniform law committee took a different position. Because of the difficulty of achieving such a treaty and the desirability of providing local rather than federal solutions to problems, the Committee decided at an early stage that changing the rules could be done more effectively and expeditiously through the enactment of uniform state and provincial laws than through a treaty.

The basic thrust of reform is to change the local action rules and provide equal access for the victims of transfrontier pollution to the courts of the jurisdiction where the contaminant originated. As Stephen McCaffrey puts it "the mere existence of a political boundary line should prevent neither the 'upstream' state from considering the transfrontier effects of an activity, nor the 'downstream' state from having an input into the decision-making process concerning the permissibility of that activity. Nor should the boundary line constitute an impedi-

ment to victims of transfrontier pollution seeking redress in the same country": Stephen McCaffrey, "Transboundary Pollution Injuries: Jurisdictional Consideration in Private Litigation Between Canada and the United States" (1973), 3 Cal. W.Int.L.J. 191.

The proposed statute also provides that in the event suit is brought in the province or state where the alleged pollution actually originated, the local law of that state (as distinguished from its whole law including conflict of laws rule) applies. This means that an alleged polluter sued in the state where the alleged pollution originated is governed by the substantive laws of that jurisdiction. Insofar as the courts of that state are concerned, he has one standard to meet, and he has the opportunity to defend the action on the basis of the substantive and procedural rules with which he is most familiar. Everyone would prefer to be sued in the courts of his own jurisdiction.

Of course, if service of process is achieved in the state where the pollution actually caused harm, then that state would be free, within constitutional restraints, to apply either its own law or the law of the state where the alleged pollution originated. That situation is not changed by this Act. Although total uniformity and predictability are not established, an injured party will know when choosing a particular court what law will be applied. The Act is designed to fill a procedural gap, and is not intended to alter substantive laws or standards, or change the ground rules under which individuals, corporations, or governments conduct their affairs.

UNIFORM TRANSBOUNDARY POLLUTION RECIPROCAL ACCESS ACT

Sec.

§ 1. Definitions

As used in this [Act]:

(1) "Reciprocating jurisdiction" means a state of the United States of America, the District of Columbia, the Commonwealth of Puerto Rico, a territory or possession of the United States of America, or a province or territory of Canada, which has enacted this [Act] or provides substantially equivalent access to its courts and administrative agencies.

(2) "Person" means an individual person, corporation, business trust, estate, trust, partnership, association, joint venture, government in its private or public capacity, governmental subdivision or agency, or any other legal entity.

Comment

The definition of "jurisdiction" performs a number of functions. It enables the Act to be applied in interstate and inter-provincial pollution actions, in addition to actions involving pollution spanning the U.S./Canada International boundary. The Act does not apply to U.S./Mexico transboundary pollution or to pollution from any other nation.

The reciprocal aspect of the Act is achieved by Section 1(1) providing that both the "polluting" and "polluted" jurisdictions must have "enacted this Act" or "provide substantially equivalent access to the courts and administrative agencies." The requirement of reciprocity applies to access only. This threshold test is applied by the courts in the U.S. on a case by case basis, it being regarded as a question of fact whether a particular jurisdiction is a reciprocating jurisdiction. In Canada, by contrast, it is usual for reciprocity to be formally recognized through provincial governments designating by regulation lists of reciprocating states, where they are satisfied that reciprocity exists. Section 7(b) is designed to permit this procedure to be followed. For jurisdictions, such as Minnesota by judicial decision and New York by statute, that already provide access to their courts for non-resident

pollution victims by abandoning the rule of Livingston v. Jefferson, the words "provide substantially equivalent access" ensure that these jurisdictions will be recognized as reciprocating jurisdictions without the need to enact formally the Act. Finally, it should be noted that Section 1(1) concludes with the words "access to the courts and administrative agencies," a specific reference to the fact that it is contemplated that the Act will also apply to proceedings before tribunals.

The definition of "person" derives from standard wording used in many uniform acts adopted by the National Conference of Commissioners on Uniform State Laws. It is designed to include all natural and legal persons within the ambit of the Act. In addition, if the Attorney General, or another public official of the state or province where the injury occurred, is able to bring an action with respect to environmental injury, then the Attorney General of another state harmed by the "originating state's" pollution should also be able to bring an action in the "originating state."

§ 2. Forum

An action or other proceeding for injury or threatened injury to property or person in a reciprocating jurisdiction caused by pollution originating, or that may originate, in this jurisdiction may be brought in this jurisdiction.

Comment

Together with Section 3, this section forms the main operative provision of the statute. Section 2 provides access to the courts in one jurisdiction for pollution victims in another jurisdiction. A question may arise whether the pollution originated in a particular jurisdiction, and this is a question of fact which the courts must decide. It should be noted that the statute is not restricted in its scope to civil trials; it also extends to other proceedings before tribunals concerning environmental injury or threatened injury.

As used in this Act, "injury" includes wrongful death and "property" includes both real and personal property.

It has been suggested that enactment of this proposed statute would cause a rush of litigants from out of state to the state where the alleged pollution originated or where it may originate. So far as is known states with very extensive long-arm statutes have not experienced this rush of litigation, and this suggests that it would not happen if a new, and less convenient forum was made available to them.

§ 3. Right to Relief

A person who suffers, or is threatened with, injury to his person or property in a reciprocating jurisdiction caused by pollution originating, or that may originate, in this jurisdiction has the same rights to relief with respect to the injury or threatened injury, and may enforce those rights this jurisdiction as if the injury or threatened injury occurred in this jurisdiction.

Comment

This section equates the rights of an extra-jurisdictional pollution victim to those of a victim who is a resident of the jurisdiction. It is designed to ensure that the actual or potential victim of transfrontier pollution will have a remedy in the courts of the jurisdiction where the pollution originated, if a victim residing in that jurisdiction would have had a remedy for injury or threatened injury in the case of pollution caused locally. Whether or not particular pollution did originate in a jurisdiction is a question of fact for the court to decide.

§ 4. Applicable Law

The law to be applied in an action or other proceeding brought pursuant to this [Act], including what constitutes "pollution", is the law of this jurisdiction excluding choice of law rules.

Comment

This section provides that the law of this jurisdiction will apply in actions brought under the Act. In the United States this includes federal, state and local law where applicable. The applicable law is defined to exclude choice of law rules so as to avoid the whole problem of *renvoi*. While the Committee initially considered drafting a definition of "pollution" for inclusion in this Act, it was decided that it would be exceptionally difficult to draft such a definition without it degenerating into an unmanageable "shopping list" and difficult to harmonize such a list in practice with the definitions provided in the substantive law of a particular jurisdiction. Jurisdictions differ markedly in their treatment of matters such as smells, radiation, vibration, and visual pollution. To avoid difficulties in interpretation, it was decided that what constitutes pollution would be decided by reference to the law of an enacting jurisdiction; such a definition might encompass both statutory definitions as well as any applicable judicial decisions under the common law. It is contemplated that it would include but not be limited to discharges and emissions into land, air or water.

§ 5. Equality of Rights

This [Act] does not accord a person injured or threatened with injury in another jurisdiction any rights superior to those that the person would have if injured or threatened with injury in this jurisdiction.

Comment

See Comment following Section 6.

§ 6. Right Additional to Other Rights

The right provided in this Act is in addition to and not in derogation of any other rights.

Comment

These two sections clarify that the Act is designed to put non-residents on the same footing as residents with respect to access to courts and tribunals in claims involving transboundary pollution. The rights of non-residents under this Act will be no higher than those of residents, and they must accept any procedural or substantive limitations that may happen to exist under the applicable law of the originating jurisdiction. Section 6 ensures that the right of access provided by the Act is supplementary and is not intended in any way to diminish existing rights under the laws of this jurisdiction, which may be enforced independently of this Act.

ALTERNATIVE FOR THE U.S.A.

[§ 7. Waiver of Sovereign Immunity

The defense of sovereignty immunity is applicable in any action or other proceeding brought pursuant to this [Act] only to the extent that it would apply to a person injured or threatened with injury in this jurisdiction.]

Comment

See Comment following Section 7(b).

ALTERNATIVE FOR CANADA

[§ 7(a). Act Binds Crown

This [Act] binds the Crown in right of (Province or Territory) only to the extent that the Crown would be bound if the person were injured or threatened with injury in this jurisdiction.]

Comment

See Comment following Section 7(b).

SECTION 7(b) FOR CANADA ONLY

[§ 7(b). Regulations

The Lieutenant Governor in Council may, where he is satisfied that a jurisdiction is a reciprocating jurisdiction, make a declaratory order, to that effect, and upon the making of such order, the jurisdiction is a reciprocating jurisdiction for the purposes of this [Act].]

Comment

The two alternative drafts, the one applicable in Canada, and the other in the United States, are provided to deal with the question of sovereign or crown immunity, and to ensure that extra-jurisdictional actions will be treated under the doctrines in the same way as actions brought by residents.

Section 7(b) establishes a procedure for Canadian provinces and territories to develop and maintain an authoritative list of reciprocating jurisdictions. In developing such a list, regard might be had to the lists of enacting jurisdictions contained in the Annual Handbook of the National Conference of Commissioners on Uniform State Laws.

§ 8. Uniformity of Application and Construction

This [Act] shall be applied and construed to carry out its general purpose to make uniform the law with respect to the subject of this [Act] among jurisdictions enacting it.

§ 9. Title

This [Act] may be cited as the Uniform Transboundary Pollution Reciprocal Access Act.

§ 10. Time of Taking Effect

This [Act] takes effect on ————.

Comment

[To be included in the Canadian version only.

Sections 8, 9 and 10 are formal sections which, under Rule 22 of the Drafting Rules for Writing Uniform or Model Acts of the National Conference of Commissioners on Uniform State Laws, must close every Uniform Act.]

AMENDMENTS TO ARTICLE 8 OF THE UNIFORM COMMERCIAL CODE

Article 8 of the Uniform Commercial Code sets forth the rights, duties, and liabilities of certificated security holders, creditors and issuers. This 1977 proposed revision of Article 8 would extend its provisions to the transfer and issuance of uncertificated securities. Instead of receiving a certificate to evidence a security, a purchaser would receive an initial transaction statement (ITS). The ITS would constitute the record of the transaction and provide notice of the terms, restrictions and adverse claims relating to the security involved. The regulatory system designed for such uncertificated securities would be closely analogous to that imposed under Article 8 for certificated securities.

At present, dividend reinvestment plans and mutual funds rarely send certificates to shareholders. In some instances, certificates do exist, with the issuer or its transfer agent holding a certificate as the agent-bailer of all of the shareholders in the plan. Thus, it was reported that "somewhere in the A.T.&T. transfer office, there reposes a certificate representing 9 million shares beneficially owned by 541,000 dividend reinvestment plan participants." Aronstein, A Certificateless Article 8? We Can Have It Both Ways, 31 Bus.Lawyer 727, 732 (1976). As long as the transaction is between the shareholder and the issuer, the lack of certificate causes the shareholder no difficulty. But when a third-party appears, such as a lender who want to acquire an interest in the stock, that third-party will insist upon a certificate that falls within the original Article 8. As noted in Aronstein, supra:

> While the agency-bailment rationale lends an aura of validity to uncertificated shares that may satisfy a law professor or even a judge, it does not respond to the questions which the prudent businessman or his counsel needs to have answered before he can proceed with confidence. By what means and with what frequency must the issuer evidence the ownership of shares? What must a shareholder do, and what may an issuer require, to effect the registration of transfer? When does a purchaser become the owner of the shares he has bought? By what means can a secured lender perfect a security interest in his debtor's share? How may an unsecured creditor reach his debtor's shares?

The function of 1977 Amendments is to eliminate such questions by creating a structure for certificateless securities that comes as close as possible to that applicable to

certificates. The revision would not only facilitate the continued use of the certificateless security concept in the areas where it is now used, but would allow expanded use of that concept by all types of issuers as part of the general movement in the commercial field toward electronic transfers. Indeed, it was thought that the certificateless security might even be used by small corporations, whose internal securities transactions are often simple enough that certificates just create unnecessary paperwork.

Commentators have advanced two major criticisms of the revision. The first is that uncertificated securities may not achieve significant cost reductions for issuers since there will still be the paper workwork associated with the processing, the initial transaction statements. See Gillette and Maher, "Revised Article 8: Issuers Beware!", 15 U.C.C.L.J. 146 (1982). This criticism is met by the response that issuers are in the best position to decide whether uncertificated securities will result in a substantial administrative savings. That some would find it useful is evidenced by the large number of issuers (e.g., dividend reinvestment plans) that are presently operating without the general issuance of certificates by using a depository system. Indeed, the certificateless security would give them an added savings to that which they already have achieved, since "safekeeping facilities, deliveries between depositories and issuers, deliveries among depositories, and deliveries between depositories and nonparticipants are all time-consuming and expensive procedures that could be eliminated or greatly reduced by a truly certificateless system." Aronstein, Haydock, and Scott, "Article 8 Is Ready," 93 Harv.L.Rev. 889 (1980).

A second criticism charges that the 1977 Revision is inadequate in its substance, that it generates problems in the creation of security interests. While the objective of Article 8 is to achieve a parallel legal framework for certificateless and certificated securities, there are certain differences, as explained in a summary of the Article 8 revision prepared by N.C.C.U.S.L.:

> The "Initial Transaction Statement," * * * provide notice of terms, restrictions, and adverse claims to the addressee, and runs against the issuer if it does not. This is a similar function to the written instrument which constitutes a "certificated" security. The rights of purchasers which depend on this information are affected almost exactly as a purchaser's rights are affected by a "certificated" security. There are differences, however. A purchaser of an "uncertificated" security, in general, can rise no higher than his transferor's knowledge, even if he doesn't. A "certificated" security does not hold a purchaser to the knowledge of his transferor, but bases his rights on his own knowledge. That is a distinct difference between

the two forms of security.

Further, an Initial Transfer Statement warrants only that the acknowledged owner is so at the time of its issuance. It does not do so for any following time period. In contrast, a purchaser may normally assume that the holder of a "certificated" security is the owner and entitled to transfer it. In these respects, the Initial Transfer Statement does not offer the assurances of a "certificated" security. * * *

A "certificated" security is merely delivered to the pledgee with a proper endorsement. That creates the security interest. Where "uncertificated" securities are concerned, the security interest must be registered. The procedure for doing this is identical to the procedure for a transfer. An instruction is sent to, and a confirmatory statement returned from, the issuer of the security. Once registered, the owner continues all powers with respect to the security except the power of transfer. That belongs to the registered pledgee.

The "uncertificated" security offers a bit more protection to the pledgee than a "certificated" security does. If a pledge of a "certificated" security is not registered, additional securities and dividends will be distributed to the owner, not the pledgee. The procedure relating to "uncertificated" securities precludes the problem. It is also to be noted that perfection of the security interest is by possession of the instrument for a "certificated" security, and by the mere procedure of creating the interest for "uncertificated" securities. Perfection is the means of determining the priority between competing security interests.

Warranties also differ between "certificated" and "uncertificated" securities. The face of the instrument provides a basis of warranties for "certificated" securities. The presentor to an issuer for registration, the transferor to a purchaser, all warrant aspects of the transaction because of the instrument and its enforcements and signature guarantees. For "uncertificated" securities, the only warranty can be on the part of the originator of an instruction to the issuer, and that the transfer has no defects to a purchaser for value.

Signature guarantees, an essential part of the transfer process for widely-held securities, also

cannot be the same for "certificated" and "uncertificated" securities. The guarantor of a "certificated" security warrants that the endorser is an appropriate person acting for the owner. This is evident to the guarantor from the instrument. Without the instrument, the guarantees are limited to the genuineness of the signature, and that the endorser purports to act for the owner or or pledgee. There are special, broader guarantees of an "uncertificated" security which cannot be demanded by an issuer, but which can be made to further secure a transaction.

The difference between a "certificated" security and the items of paper relating to registration of an "uncertificated" security cause a difference in the treatment of a bona fide purchaser for value, also. Essentially, a bona fide purchaser for value is held for only those things on the instrument with respect to a "certificated" security. The bona fide purchaser for value of an "uncertificated" security essentially takes free of what does not appear on the initial transaction statement. Practically, this may expose him to greater liability, but also forces him to seek a clean transaction statement before accepting liability.

Third party claims also provide a difference. For "certificated" securities, notice in writing to the issuer suffices. For "uncertificated" securities, the claim must be in the legal process before the issuer has notice. Judic ial liens are also treated differently. Seizure of the security works for "certificated" securities, but not at all for the "uncertificated" breed. It is necessary to serve process on the issuer.

There are those who argue that the Article 8 Revision has failed to answer satisfactorily the various legal questions that will be presented by its structure for certificateless securities. See e.g., Coogan, Security Uniform Commercial Code, 92 Harv.L.Rev. 1013 (1979). Others disagree. See e.g., Aronstein, Haydad, and Scott, supra. Consider also Barnard, Bowman, and Robertson, Uncertificated Securities, Article 8 and 9 of the U.C.C. and The Texas Business Corporation Act, 11 Tex.Tech.L.Rev. 813 (1980). Here again, the appropriate response may be to leave to the issuer the question of whether any legal uncertainties as to hypothetical situations are sufficient to offset the advantages of the new Article 8 structure. Certainly any substantive questions are not so significant to cast doubt on the general usefulness of the structure created. It should be noted in this regard that Article 8 revisions have been endorsed by the New York Stock Exchange and the Securities Industry

Association.

Article 8 has been adopted in over a dozen states, including Delaware (a key state of incorporation) and New York.[1] The New York adoption included a series of amendments. Most of those changes were designed to clarify, but several added to the scope of the article (e.g., the New York version of Section 8-320 expands the definition of a clearing corporation to include banks or trust companies that deal in securities backed by federal or state insured mortgages). In light of the desirability of maintaining uniformity of language and the uniqueness of some of the concerns of the New York draftsmen, the Commission concluded that its proposal would follow without change in the 1977 revision.

The proposed bill follows. It is set forth with the explanation of changes as reprinted from an Appendix to the official U.C.C. Commentary. We have also reprinted, at the end of this material, the Reporters' Introductory Comment.

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1. Apart from the intrinsic merits of the Article 8 proposal, its adoption in other jurisdictions could create certain competitive pressures for states without the revision. New firms desiring the benefits of certificateless transfer might look to the jurisdictions with the new Article 8 as the preferred place for incorporation. If there is a general movement to the certificateless securities outside of those areas dominated by issuer-shareholder transactions, traders in jurisdictions without the new Article 8 may suffer, as they may be viewed as less well equipped to do business with the uncertified companies.

ARTICLE 8 AMENDMENTS

PROPOSED BILL[1]

AN ACT to amend Act No. 174 of the Public Acts of 1962, entitled "An act to enact the uniform commercial code, relating to certain commercial transactions in or regarding personal property and contracts and other documents concerning them, including sales, commercial paper, bank deposits and collections, letters of credit, bulk transfers, warehouse receipts, bills of lading, other documents of title, investment securities and secured transactions, including certain sales of accounts, chattel paper and contract rights; to provide for public notice to third parties in certain circumstances; to regulate procedure, evidence and damages in certain court actions involving such transactions, contracts or documents; to make uniform the law with respect thereto; and to repeal certain acts and parts of acts," as amended, being sections 440.1101 to 440.9907 of the Compiled Laws of 1970, by amending sections 8101, 8102, 8103, 8104, 8105, 8106, 8107, 8201, 8202, 8203, 8204, 8205, 8206, 8207, 8208, 8301, 8302, 8303, 8304, 8305, 8306, 8307, 8308, 8309, 8310, 8311, 8312, 8313, 8314, 8315, 8316, 8317, 8318, 8319, 8320, 8401, 8402, 8403, 8404, 8405, and 8406 thereof, and by adding sections 8108, 8321, 8407, and 8408.

THE PEOPLE OF THE STATE OF MICHIGAN ENACT:

Section 1. Sections 8101, 8102, 8103, 8104, 8105, 8106, 8107, 8201, 8202, 8203, 8204, 8205, 8206, 8207, 8208, 8301, 8302, 8303, 8304, 8305, 8306, 8307, 8308, 8309, 8310, 8311, 8312, 8313, 8314, 8315, 8316, 8317, 8318, 8319, 8320, 8401, 8402, 8403, 8404, 8405, and 8406 of Act No. 174 of the Public Acts of 1962, as amended, being sections 440.8101, 440.8102, 440.8103, 440.8104, 440.8105, 440.8106, 440.8107, 440.8201, 440.8202, 440.8203, 440.8204, 440.8205, 440.8206, 440.8207, 440.8208, 440.8301, 440.8302, 440.8303, 440.8304, 440.8305, 440.8306, 440.8307, 440.8308, 440.8309, 440.8310, 440.8311, 440.8312, 440.8313, 440.8314, 440.8315, 440.8316, 440.8317, 440.8318, 440.8319, 440.8320, 440.8401, 449.8402, 440.8403, 440.8404, 440.8405, and 440.8406 of the Compiled Laws of 1970, are amended and sections 8108, 8321, 8407, and 8408 are added to read as follows:

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1. Additions are indicated by underlining and deletions are indicated by brackets.

ARTICLE 8

INVESTMENT SECURITIES

PART 1

SHORT TITLE AND GENERAL MATTERS

§ 8—101. Short Title

This Article shall be known and may be cited as Uniform Commercial Code—Investment Securities.

Reasons for 1977 Change

Although the title of the Article has not been changed, its coverage has been broadened, by amendment to Section 8—102, to include both securities which are reified, i. e., represented by certificates or other instruments, and those which are not. The former are defined as "certificated securities" and constitute the entire subject matter of present Article 8. The latter are defined as "uncertificated securities" and are not now expressly covered by the Uniform Commercial Code. The revised Article is intended to govern the relationships, rights and duties of the issuers of and the parties that deal with both certificated and uncertificated securities to the same extent that present Article 8 governs such relationships, rights and duties with respect to certificated securities alone.

This Article does not purport to determine whether a particular issue of securities should be represented by certificates, in whole or in part. It is contemplated that such determination will be made by the issuer under appropriate state or federal law. It is further contemplated that a particular issue of securities may be partly certificated and partly uncertificated, in which event the determination will be at the option of the owner to the extent that the issuer permits.

The form of the Article has been disturbed as little as possible and each numbered section deals with the subject matter of the similarly numbered section of the present Article. Only four new sections, 8—108, 8—321, 8—407 and 8—408, have been added.

§ 8—102. Definitions and Index of Definitions

(1) In this Article, unless the context otherwise requires:

[(a) A "security" is an instrument which

(i) is issued in bearer or registered form; and

(ii) is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and

(iii) is either one of a class or series or by its terms is divisible into a class or series of instruments; and

(iv) evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.]

(a) A "certificated security" is a share, participation, or other interest in property of or an enterprise of the issuer or an obligation of the issuer which is

(i) represented by an instrument issued in bearer or registered form;

(ii) of a type commonly dealt in on securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and

(iii) either one of a class or series or by its terms divisible into a class or series of shares, participations, interests, or obligations.

(b) An "uncertificated security" is a share, participation, or other interest in property or an enterprise of the issuer or an obligation of the issuer which is

(i) not represented by an instrument and the transfer of which is registered upon books maintained for that purpose by or on behalf of the issuer;

(ii) of a type commonly dealt in on securities exchanges or markets; and

(iii) either one of a class or series or by its terms divisible into a class or series of shares, participations, interests, or obligations.

(c) [(b)] A "security" is either a certificated or an uncertificated security. If a security is certificated, the terms "security" and "certificated security" may mean either

the intangible interest, the instrument representing that interest, or both, as the context requires. A writing [which] that is a certificated security is governed by this Article and not by [Uniform Commercial Code—Commercial Paper] Article 3, even though it also meets the requirements of that Article. This Article does not apply to money. If a certificated security has been retained by or surrendered to the issuer or its transfer agent for reasons other than registration of transfer, other temporary purpose, payment, exchange, or acquisition by the issuer, that security shall be treated as an uncertificated security for purposes of this Article.

(d) [(c)] A certificated security is in "registered form" [when] if

(i) it specifies a person entitled to the security or the rights it [evidences] represents, and [when]

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

(e) [(d)] A certificated security is in "bearer form" [when] if it runs to bearer according to its terms and not by reason of any indorsement.

(2) A "subsequent purchaser" is a person who takes other than by original issue.

(3) A "clearing corporation" is a corporation registered as a "clearing agency" under the federal securities laws or a corporation:

(a) at least [ninety] 90 percent of [the] whose capital stock [of which] is held by or for one or more [persons (other than individuals)] organizations, none of which, other than a national securities exchange or association, holds in excess of 20 percent of the capital stock of the corporation, and each of [whom] which is

(i) [is] subject to supervision or regulation pursuant to the provisions of federal or state banking laws or state insurance laws, [or]

(ii) [is] a broker or dealer or investment company registered under the [Securities Exchange Act of 1934 or the Investment Company Act of 1940] federal securities laws, or

(iii) [is] a national securities exchange or association registered under [a statute of the United States

such as the Securities Exchange Act of 1934,] the federal securities laws; and [none of whom, other than a national securities exchange or association, holds in excess of twenty per cent of the capital stock of such corporation; and]

(b) any remaining capital stock of which is held by individuals who have purchased [such capital stock] it at or prior to the time of their taking office as directors of [such] the corporation and who have purchased only so much of the capital stock as [may be] is necessary to permit them to qualify as [such] directors.

(4) A "custodian bank" is [any] a bank or trust company [which] that is supervised and examined by state or federal authority having supervision over banks and [which] is acting as custodian for a clearing corporation.

(5) Other definitions applying to this Article or to specified Parts thereof and the sections in which they appear are:

"Adverse claim".	Section [8—301] 8—302.
"Bona fide purchaser".	Section 8—302.
"Broker".	Section 8—303.
"Debtor".	Section 9—105.
"Financial intermediary".	Section 8—313.
"Guarantee of the signature".	Section 8—402.
"Initial transaction statement".	Section 8—408.
"Instruction".	Section 8—308.
"Intermediary Bank".	Section 4—105.
"Issuer".	Section 8—201.
"Overissue".	Section 8—104.
"Secured Party".	Section 9—105.
"Security Agreement".	Section 9—105.

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

Reasons for 1977 Change

New paragraph (1)(a) defines "certificated security" in essentially the same terms as present paragraph (1)(a) defines "security". The definition is rearranged in order to permit a parallel definition of "uncertificated security" in new paragraph (1)(b). Two minor changes have been made. The phrase "of the issuer" has been repeated in order to make

clear that it modifies "property" and "enterprise" as well as "obligation". It is understood that this was intended in the present statute. The word "represented" has been substituted for "evidenced" as more accurately conveying the notion that a certificated security is, in many ways, treated as if it were the property itself, e. g., ownership is transferred by delivery. Compare the definition of "instrument" in Section 9—105(1)(g).

This terminology, which is used throughout the revised Article, conforms to that of Section 23 of the Model Business Corporation Act and avoids confusion since there will be pieces of paper, statements and the like that will "evidence" uncertificated securities.

The definition of "uncertificated security" in paragraph (1)(b) differs from the definition of certificated security in two respects. The first change is in subparagraph (i) which provides that it is not represented by an instrument and is always registered. The second change is the omission from subparagraph (ii) of the phrase "or commonly recognized in any area in which it is issued or dealt in as a medium for investment". It was thought that where there was no requirement of representation by an instrument a great many interests which might be regarded as media for investment would be classified as securities under the umbrella of the omitted phrase. Although the official comment to the present section calls attention to the possible difference in coverage of Article 8 and other securities laws, the definition has been narrowed in order to minimize, if not eliminate, the need for strained distinctions. The remaining language of subparagraph (ii) is intended to cover such interests as the stock of closely-held corporations which, although not in fact dealt in on exchanges or markets, is "of a type" that is. Interests like bank accounts are intended to be excluded by the omission of the medium for investment language.

Paragraph (1)(c) defines "security" as either a certificated security or an uncertificated security, defined in the two preceding paragraphs. The second sentence of (1)(c) is intended to eliminate confusion arising from the fact that certificated securities (all securities under the present statute) are alternatively viewed as the actual pieces of paper and the interests they represent. See, e. g., present Section 8—103, which provides "A lien upon a security [the intangible interest] . . . is valid . . . only if . . . noted conspicuously on the security [the piece of paper]." The final sentence of (1)(c) is to recognize that an issuer which nominally issues certificated securities but does not normally send the certificates to the owners is functionally

identical to the issuer of uncertificated securities and should be guided by the same rules.

Subsection (3), which represents a change from the 1972 Official Text of the present statute, is, with limited exceptions, not part of this proposed revision. Rather, it is a revision proposed by the Banking and Securities Industry Committee to facilitate the development of the securities depository system. It has been previously approved by the Permanent Editorial Board for the Uniform Commercial Code and has been adopted by more than forty states. The changes made by this revision include the addition of "a corporation registered as a 'clearing agency' under the federal securities laws" in the opening sentence, the substitution of "organizations" for "persons (other than individuals)" and the substitution of "federal securities laws" for the specific statutory references in subparagraphs (a)(ii) and (iii).

In subsection (5) the section reference to the definition of "Adverse claim" has been changed and three new terms have been added to the list of definitions. Three terms, defined in Section 9—105, have also been included.

§ 8—103. Issuer's Lien

A lien upon a security in favor of an issuer thereof is valid against a purchaser only if:

(a) the security is certificated and the right of the issuer to [such] the lien is noted conspicuously [on the security] thereon; or

(b) the security is uncertificated and a notation of the right of the issuer to the lien is contained in the initial transaction statement sent to the purchaser or, if his interest is transferred to him other than by registration of transfer, pledge, or release, the initial transaction statement sent to the registered owner or the registered pledgee.

Reasons for 1977 Change

The substance of the present section has been preserved in paragraph (a) which deals with certificated securities. An analogous rule for uncertificated securities is set forth in paragraph (b) which conditions the validity of an issuer's lien on a notation in the statement which must be sent to a purchaser upon registration of transfer, pledge or release under Section 8—408. When transfer is not effected by registration, see Section 8–313(1)(d), (f), (g), (h), (i) or (j), the notation must appear in the statement sent to the

registered owner or pledgee who "holds" for the purchaser. Compare Sections 8—202 and 8—204 which deal, respectively, with issuers' defenses and restrictions imposed by issuers.

§ 8—104. Effect of Overissue; "Overissue"

(1) The provisions of this Article which validate a security or compel its issue or reissue do not apply to the extent that validation, issue, or reissue would result in overissue; but if:

(a) [if] an identical security which does not constitute an overissue is reasonably available for purchase, the person entitled to issue or validation may compel the issuer to purchase [and deliver such a] the security [to] for him and either to deliver a certificated security or to register the transfer of an uncertificated security to him, against surrender of [the] any certificated security [, if any, which] he holds; or

(b) [if] a security is not so available for purchase, the person entitled to issue or validation may recover from the issuer the price he or the last purchaser for value paid for it with interest from the date of his demand.

(2) "Overissue" means the issue of securities in excess of the amount [which] the issuer has corporate power to issue.

Reasons for 1977 Change

The language added to subparagraph (1)(a) gives the issuer obligated to transfer a security the alternatives of delivering a certificated security or registering the transfer of an uncertificated security to the person entitled. As a practical matter, the alternatives will be available only when the securities of the particular issue involved are partly certificated and partly uncertificated. In that event, either the registered owner or the registered pledgee will have the right, under Section 8—407, to exchange one form of security for the other, thus giving that person the ultimate choice.

§ 8—105. Certificated Securities Negotiable; Statements and Instructions Not Negotiable; Presumptions

(1) Certificated securities governed by this Article are negotiable instruments.

(2) Statements (Section 8—408), notices, or the like, sent by the issuer of uncertificated securities and instructions (Section

8—308) are neither negotiable instruments nor certificated securities.

(3) [(2)] In any action on a security:

(a) unless specifically denied in the pleadings, each signature on [the] a certificated security [or], in a necessary indorsement, on an initial transaction statement, or on an instruction, is admitted;

(b) [when] if the effectiveness of a signature is put in issue, the burden of establishing it is on the party claiming under the signature, but the signature is presumed to be genuine or authorized;

(c) [when] if signatures on a certificated security are admitted or established, production of the [instrument] security entitles a holder to recover on it unless the defendant establishes a defense or a defect going to the validity of the security; [and]

(d) if signatures on an initial transaction statement are admitted or established, the facts stated in the statement are presumed to be true as of the time of its issuance; and

(e) [(d)] after it is shown that a defense or defect exists, the plaintiff has the burden of establishing that he or some person under whom he claims is a person against whom the defense or defect is ineffective (Section 8—202).

Reasons for 1977 Change

This section is substantially unchanged with respect to certificated securities. Subsection (2) has been added, through an abundance of caution, to make it clear that neither the various writings which must or may be sent by the issuers of uncertificated securities nor instructions, which are orders to the issuer requesting registration, are to be regarded as negotiable instruments or certificated securities. Section 8—408(9) requires an appropriate warning legend on the statements that issuers must send.

Language has been added to paragraph (3)(a) to extend the presumption of validity to signatures on initial transaction statements, sent by the issuers of uncertificated securities, and on instructions, originated by owners and pledgees of uncertificated securities. Paragraph (3)(d) has been added to give the same evidentiary value to a genuine initial transaction statement that paragraph (3)(c) accords to a genuine certificated security. It should be noted that the

representations typically contained in a certificated security are of a continuing nature while the initial transaction statement speaks only as of the time of its issuance.

§ 8—106. Applicability

The law (including the conflict of laws rules) of the jurisdiction of organization of the issuer governs the validity of a security, the effectiveness of registration by the issuer, and the rights and duties of the issuer with respect to:

(a) registration of transfer of a certificated security;

(b) registration of transfer, pledge, or release of an uncertificated security; and

(c) sending of statements of uncertificated securities.

[are governed by the law (including the conflict of laws rules) of the jurisdiction of organization of the issuer.]

Reasons for 1977 Change

No change is intended in the coverage of this section with respect to certificated securities. The transfer of certificated securities, effected by delivery, will continue to be governed by present conflict of laws rules, not included in this Article. The transfer of uncertificated securities is, under Section 8—313, generally effected by registration on the books of the issuer. Hence, the effectiveness of such registration is included in the section's coverage.

Section 8—321 provides that certain security interests in uncertificated securities can be created and released by registration. Section 8—408 obligates the issuer of uncertificated securities to send certain statements. Both these matters are brought within the coverage of this section by the addition of subparagraphs (b) and (c). The pledge and release of certificated securities is not intended to be covered by this section and continues to be governed by other conflict of laws rules, e. g., Section 9—103.

§ 8—107. Securities [Deliverable] Transferable; Action for Price

(1) Unless otherwise agreed and subject to any applicable law or regulation respecting short sales, a person obligated to [deliver] transfer securities may [deliver] transfer any certificated security of the specified issue in bearer form or registered in the name of the transferee, or indorsed to him or in blank, or

he may transfer an equivalent uncertificated security to the transferee or a person designated by the transferee.

(2) [When] If the buyer fails to pay the price as it comes due under a contract of sale, the seller may recover the price of:

(a) [of] certificated securities accepted by the buyer; [and]

(b) uncertificated securities that have been transferred to the buyer or a person designated by the buyer; and

(c) [(b) of] other securities if efforts at their resale would be unduly burdensome or if there is no readily available market for their resale.

Reasons for 1977 Change

In order to make this section equally applicable to all securities, the words "Deliverable" in the title and "deliver" in subsection (1) have been changed to "Transferable" and "transfer", respectively. Since certificated securities continue to be transferred by delivery, there is no change of substance with respect to certificated securities.

Present subsection (1) states the rule that all certificated securities of the same issue are to be regarded as fungible. New subsection (1) extends that concept to uncertificated securities of the same issue. Thus, a seller's obligation may normally be satisfied not only by the transfer of any certificated security of the same issue but also by the transfer of an uncertificated security of that issue.

Paragraph (2)(b) has been added so that the transfer of an uncertificated security to the buyer or his designee, which is the functional equivalent of the delivery of a certificated security, results in the same obligation to pay.

§ 8—108. Registration of Pledge and Release of Uncertificated Securities

A security interest in an uncertificated security may be evidenced by the registration of pledge to the secured party or a person designated by him. There can be no more than one registered pledge of an uncertificated security at any time. The registered owner of an uncertificated security is the person in whose name the security is registered, even if the security is subject to a registered pledge. The rights of a registered pledgee of an uncertificated security under this Article are terminated by the registration of release.

Reasons for 1977 Change

This is an entirely new section which introduces the concept of the registered pledge of uncertificated securities. The term "pledge" is used, notwithstanding the absence of physical delivery, because it reflects common terminology employed in connection with security interests in investment securities. Note that the same term has been used in present Section 8—320 to describe the security interest created by book entry by a securities depository. The rights of a registered pledgee, set forth in other sections (particularly Section 8—207), are intended to resemble, as closely as possible, the rights of the pledgee of a certificated security who retains possession of the pledged security without re-registration. Although the registration of pledge requires communication to the issuer, no details of the security agreement between the debtor and the secured party need be disclosed.

There is no provision for the registration of more than one pledge at a time. This limits the burden on issuers and insulates them from problems of conflicting priorities and the like. The registration of pledge is only one among several methods of creating security interests under Section 8—313 (1) and other methods can be effectively employed to create security interests junior to that of the registered pledgee or even first security interests if, for some reason, the use of the registered pledge mechanism is inadvisable. See new Section 8—321 which deals comprehensively with security interests and incorporates the transfer rules of Section 8—313 (1) by reference.

The third sentence makes it clear that the registered owner, and not the registered pledgee, is the person in whose name an uncertificated security is registered as, for example, to determine how an unsecured creditor may reach his debtor's interest under Section 8—317(2). The registration of release, in effect, nullifies the registration of pledge, and is functionally equivalent to the redelivery of a pledged certificated security to the pledgor.

APPENDIX

PART 2

ISSUE—ISSUER

§ 8—201. "Issuer"

(1) With respect to obligations on or defenses to a security, "issuer" includes a person who:

(a) places or authorizes the placing of his name on a certificated security (otherwise than as authenticating trustee, registrar, transfer agent, or the like) to evidence that it represents a share, participation, or other interest in his property or in an enterprise, or to evidence his duty to perform an obligation [evidenced] represented by the certificated security; [or]

(b) creates shares, participations or other interests in his property or in an enterprise or undertakes obligations, which shares, participations, interests, or obligations are uncertificated securities;

(c) [(b)] directly or indirectly creates fractional interests in his rights or property, which fractional interests are [evidenced] represented by certificated securities; or

(d) [(c)] becomes responsible for or in place of any other person described as an issuer in this section.

(2) With respect to obligations on or defenses to a security, a guarantor is an issuer to the extent of his guaranty, whether or not his obligation is noted on [the] a certificated security or on statements of uncertificated securities sent pursuant to Section 8—408.

(3) With respect to registration of transfer, pledge, or release (Part 4 of this Article), "issuer" means a person on whose behalf transfer books are maintained.

Reasons for 1977 Change

The definition of "issuer" has been broadened to include persons who create either certificated securities, uncertificated securities or both. Because the first two paragraphs of present subsection (1) apply, by their terms, only to securities represented by instruments, a new paragraph (b) has been inserted which deals with uncertificated securities.

The definition of "uncertificated security" in Section 8—102 and the definition of "issuer" in this section contemplate that uncertificated securities may be either equity or debt securities. Current thinking about uncertificated securities has focused primarily on equities and the difference in the relationship between a shareholder and a corporation in contrast to that between a creditor and his debtor may militate in favor of retaining instruments to represent debt securities. It should be noted, however, that the Federal Reserve Banks, as transfer agents for the United States, have a well-developed uncertificated transfer system for United States government bonds.

Language has been added to subsection (2) to refer to the statements which issuers of uncertificated securities are obligated to send. Language has been added to subsection (3) to include the registration of pledge and release, in addition to transfer.

§ 8—202. Issuer's Responsibility and Defenses; Notice of Defect or Defense

(1) Even against a purchaser for value and without notice, the terms of a security include:

(a) if the security is certificated, those stated on the security;

(b) if the security is uncertificated, those contained in the initial transaction statement sent to such purchaser, or if his interest is transferred to him other than by registration of transfer, pledge, or release, the initial transaction statement sent to the registered owner or registered pledgee; and

(c) those made part of the security by reference, on the certificated security or in the initial transaction statement, to another instrument, indenture, or document or to a constitution, statute, ordinance, rule, regulation, order or the like, to the extent that the terms [so] referred to do not conflict with the [stated] terms stated on the certificated security or contained in the statement. [Such] A reference under this paragraph does not of itself charge a purchaser for value with notice of a defect going to the validity of the security, even though the certificated security or statement expressly states that a person accepting it admits [such] notice.

(2) [(a)] A certificated security in the hands of a purchaser for value or an uncertificated security as to which an initial transaction statement has been sent to a purchaser for value, other than [one] a security issued by a government or governmental agency or unit, even though issued with a defect going to its validity, is valid [in the hands of a] with respect to the purchaser [for value and] if he is without notice of the particular defect unless the defect involves a violation of constitutional provisions, in which case the security is valid [in the hands of] with respect to a subsequent purchaser for value and without notice of the defect. [(b) The rule of subparagraph (a)] This subsection applies to an issuer [which] that is a government or governmental agency or unit only if either there has been substantial compliance with the legal requirements governing the issue or the issuer has received a substantial consideration for the issue as a whole or for the particular security and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security.

(3) Except as [otherwise] provided in the case of certain unauthorized signatures [on issue] (Section 8—205), lack of genuineness of a certificated security or an initial transaction statement is a complete defense, even against a purchaser for value and without notice.

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

(5) Nothing in this section shall be construed to affect the right of a party to a "when, as and if issued" or a "when distributed" contract to cancel the contract in the event of a material change in the character of the security [which] that is the subject of the contract or in the plan or arrangement pursuant to which [such] the security is to be issued or distributed.

Reasons for 1977 Change

Subsection (1) has been broadened to provide that not only the terms noted or referred to on a certificated security but also the terms noted or referred to in the initial transaction statement sent to the purchaser of an uncertificated security (or one who "holds" for the purchaser) will constitute constructive notice to persons who deal with the security.

The rule of subsection (2), which estops the issuer of a certificated security from asserting its invalidity against a

purchaser for value without notice has been extended to afford the same protection to the purchaser of an uncertificated security for value and without notice to whom an initial transaction statement has been sent.

The defense of lack of genuineness which is accorded to the alleged issuer of a certificated security by present subsection (3) is similarly accorded to the alleged sender of an initial transaction statement by the added language. The exception of Section 8—205 similarly applies.

Subsection (4) applies to both certificated and uncertificated securities and language has been added to make that clear. Note that a purchaser may be chargeable with notice of an issuer's defense from another source, even in the absence of a notation on a certificated security or an initial transaction statement. Compare Section 8—103 with respect to issuer's liens.

§ 8—203. Staleness as Notice of Defects or Defenses

(1) After an act or event [which creates] creating a right to immediate performance of the principal obligation [evidenced] represented by [the] a certificated security or [which] that sets a date on or after which the security is to be presented or surrendered for redemption or exchange, a purchaser is charged with notice of any defect in its issue or defense of the issuer if:

(a) [if] the act or event is one requiring the payment of money [or], the delivery of certificated securities, the registration of transfer of uncertificated securities, or [both] any of these on presentation or surrender of the certificated security, [and such], the funds or securities are available on the date set for payment or exchange, and he takes the security more than one year after that date; and

(b) [if] the act or event is not covered by paragraph (a) and he takes the security more than [two] 2 years after the date set for surrender or presentation or the date on which [such] performance became due.

(2) A call [which] that has been revoked is not within subsection (1).

Reasons for 1977 Change

The substance of this section applies only to certificated securities because such securities may be transferred to a purchaser by delivery after they have matured, been called or become redeemable or exchangeable. It is contemplated that

uncertificated securities which have matured or been called will merely be cancelled on the books of the issuer and the proceeds sent to the registered owner or registered pledgee, as the case may be. Uncertificated securities which have become redeemable or exchangeable, at the option of the owner, may be transferred to a purchaser, but the transfer is effectuated only by registration of transfer, thus necessitating communication with the issuer. If defects or defenses in such securities exist, the issuer will necessarily have the opportunity to bring them to the attention of the purchaser in the initial transaction statement sent to him.

§ 8—204. Effect of Issuer's Restrictions on Transfer

[Unless noted conspicuously on the security a] A restriction on transfer of a security imposed by the issuer, even though otherwise lawful, is ineffective [except] against [a] any person [with] without actual knowledge of it [.] unless:

(a) the security is certificated and the restriction is noted conspicuously thereon; or

(b) the security is uncertificated and a notation of the restriction is contained in the initial transaction statement sent to the person or, if his interest is transferred to him other than by registration of transfer, pledge, or release, the initial transaction statement sent to the registered owner or the registered pledgee.

Reasons for 1977 Change

The present section provides that an issuer's restriction on transfer is valid against persons with actual knowledge and that a notation on the certificate constitutes constructive knowledge. The revised section preserves these rules with respect to certificated securities and sets forth a coordinate rule that a notation on an initial transaction statement sent with respect to an uncertificated security similarly constitutes constructive knowledge. A prospective transferee of an uncertificated security must communicate with the issuer in order to effectuate transfer by registration.

Registration of transfer by the issuer will negate the existence of restrictions on that particular transfer. Restrictions on further transfer, to be effective against a purchaser without actual knowledge, must be noted in the initial transaction statement sent to the purchaser or one who "holds" for the purchaser. Such restrictions may constitute a breach of the transferor's warranty under Section 8—306. Compare Section 8—103 which precludes the issuer from assert-

ing a lien against a purchaser unless appropriate notations were contained in the initial transaction statement.

§ 8—205. Effect of Unauthorized Signature on [Issue] Certificated Security or Initial Transaction Statement

An unauthorized signature placed on a certificated security prior to or in the course of issue or placed on an initial transaction statement is ineffective, [except that] but the signature is effective in favor of a purchaser for value of the certificated security or a purchaser for value of an uncertificated security to whom such initial transaction statement has been sent, if the purchaser is [and] without notice of the lack of authority and [if] the signing has been done by:

(a) an authenticating trustee, registrar, transfer agent, or other person entrusted by the issuer with the signing of the security [or], of similar securities, or of initial transaction statements or [their] the immediate preparation for signing of any of them; or

(b) an employee of the issuer, or of any of the foregoing, entrusted with responsible handling of the security or initial transaction statement.

Reasons for 1977 Change

It is contemplated that purchasers, including pledgees, of uncertificated securities should be able to and will rely on the initial transaction statements sent to them when a transfer, pledge or release is registered. In order to insure the genuineness of such statements, Section 8—408(4) requires that they be signed. Note that "signed" is a term defined by Section 1—201(39) and does not necessarily involve a manual signature.

The rule of this section with respect to the ineffectiveness of unauthorized signatures, and, more importantly, the exception to that rule in favor of purchasers for value, has been broadened to include signatures on initial transaction statements. Note that the exception, with respect to initial transaction statements, runs in favor of only the purchaser to whom the statement has been sent. Thus, a subsequent purchaser from the addressee of an initial transaction statement on which the signature was unauthorized but was done by a person described in paragraph (a) or (b) cannot rely on the exception of the section if the addressee had notice of the lack of authority.

§ 8—206. Completion or Alteration of [Instrument] Certificated Security or Initial Transaction Statement

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

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

(b) even though the blanks are incorrectly filled in, the security as completed is enforceable by a purchaser who took it for value and without notice of [such] the incorrectness.

(2) A complete certificated security [which] that has been improperly altered, even though fraudulently, remains enforceable, but only according to its original terms.

(3) If an initial transaction statement contains the signatures necessary to its validity, but is incomplete in any other respect:

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

(b) even though the blanks are incorrectly filled in, the statement as completed is effective in favor of the person to whom it is sent if he purchased the security referred to therein for value and without notice of the incorrectness.

(4) A complete initial transaction statement that has been improperly altered, even though fraudulently, is effective in favor of a purchaser to whom it has been sent, but only according to its original terms.

Reasons for 1977 Change

The rules of the present section with respect to certificated securities are restated in subsections (1) and (2). These rules are extended to the completion or alteration of initial transaction statements by new subsections (3) and (4).

Note that the protection of paragraph (3)(b) extends only to the addressee of the initial transaction statement. If, for example, a properly signed initial transaction statement indicated, in the space for notations of liens, the word "None", which had been incorrectly inserted, and the addressee of that statement had actual knowledge that a lien existed, a subsequent purchaser from the addressee would not take free of the lien, despite the incorrect insertion. If, how-

ever, the subsequent purchaser then received an initial transaction statement showing no liens, he would then have the protection of Section 8—103 and this section.

§ 8—207. Rights and Duties of Issuer With Respect to Registered Owners and Registered Pledgees

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

(2) Subject to the provisions of subsections (3), (4), and (6), the issuer or indenture trustee may treat the registered owner of an uncertificated security as the person exclusively entitled to vote, to receive notifications, and otherwise to exercise all the rights and powers of an owner.

(3) The registered owner of an uncertificated security that is subject to a registered pledge is not entitled to registration of transfer prior to the due presentment to the issuer of a release instruction. The exercise of conversion rights with respect to a convertible uncertificated security is a transfer within the meaning of this section.

(4) Upon due presentment of a transfer instruction from the registered pledgee of an uncertificated security, the issuer shall:

(a) register the transfer of the security to the new owner free of pledge, if the instruction specifies a new owner (who may be the registered pledgee) and does not specify a pledgee;

(b) register the transfer of the security to the new owner subject to the interest of the existing pledgee, if the instruction specifies a new owner and the existing pledgee; or

(c) register the release of the security from the existing pledge and register the pledge of the security to the other pledgee, if the instruction specifies the existing owner and another pledgee.

(5) Continuity of perfection of a security interest is not broken by registration of transfer under subsection (4)(b) or by registration of release and pledge under subsection (4)(c), if the security interest is assigned.

(6) If an uncertificated security is subject to a registered pledge:

(a) any uncertificated securities issued in exchange for or distributed with respect to the pledged security shall be registered subject to the pledge;

(b) any certificated securities issued in exchange for or distributed with respect to the pledged security shall be delivered to the registered pledgee; and

(c) any money paid in exchange for or in redemption of part or all of the security shall be paid to the registered pledgee.

(7) [(2)] Nothing in this Article shall be construed to affect the liability of the registered owner of a security for calls, assessments, or the like.

Reasons for 1977 Change

Under present subsection (1), the issuer of a certificated security may and, in the absence of conclusive evidence that the security has been transferred, presumably will rely on the registry to establish the identity of those entitled to ownership rights. New subsection (2) establishes the same rule for the issuer of uncertificated securities, subject, however, to the rights of registered pledgees which are set forth in subsections (3), (4) and (6). It should be noted that an uncertificated security can normally be transferred only by registration of transfer.

Under subsection (3), the owner of an uncertificated security subject to a registered pledge cannot transfer his interest until the pledge has been released by the registered pledgee. Although this requirement appears to conflict with the free alienability of the debtor's interest under Section 9—311, it does so no more than the current practice of delivery of a certificated security to the pledgee, which, in effect, deprives the owner of the power to transfer an interest without the pledgee's cooperation.

The final sentence of subsection (3) makes clear that when a convertible uncertificated security is subject to a registered pledge, it is the pledgee, and not the owner, who has the exclusive power to exercise the conversion rights. Since the exercise of conversion rights for a certificated security generally requires delivery of the security to the issuer, the cooperation of the secured party is similarly required. Note that the proceeds of the conversion are subject to the pledgee's interest or delivered to the pledgee under subsection (6).

Subsection (4) obliges the issuer to comply with the transfer instruction of the registered pledgee of an uncertificated security, thus placing such pledgee in the same position as the pledgee of a certificated security to whom the security has been delivered with all necessary indorsements. The three subparagraphs of subsection (4) provide respectively for (a) the outright transfer of the security, free of the pledgee's interest, to a buyer or any other person, including the pledgee; (b) the transfer of the owner's equity to a third person with the pledgee's interest continuing; and (c) the substitution of a new pledgee for the existing pledgee with ownership continuing undisturbed. Subsection (5) provides for continuity of perfection for purposes of priority under Article 9, the Bankruptcy Act and other statutes.

Subsection (6) protects the pledgee's interest in the proceeds of conversion, exchange or redemption of uncertificated securities, since no instrument need be surrendered to effectuate such transactions. Subsection (6) also provides that additional securities, certificated or uncertificated, issued in connection with stock splits or stock dividends will continue under the control of the registered pledgee. This contrasts with the situation when certificated securities are pledged and dividend certificates are customarily sent to the registered owner—the only party shown on the issuer's records. In that event, the pledgee must obtain the dividend certificates from the pledgor, exposing them, in the interim, to wrongful transfer.

§ 8—208. Effect of Signature of Authenticating Trustee, Registrar, or Transfer Agent

(1) A person placing his signature upon a certificated security or an initial transaction statement as authenticating trustee, registrar, transfer agent, or the like, warrants to a purchaser for value of the certificated security or a purchaser for value of an uncertificated security to whom the initial transaction statement has been sent, if the purchaser is without notice of the particular defect, that:

(a) the certificated security or initial transaction statement is genuine; [and]

(b) his own participation in the issue or registration of the transfer, pledge, or release of the security is within his capacity and within the scope of the [authorization] authority received by him from the issuer; and

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

(2) Unless otherwise agreed, a person by so placing his signature does not assume responsibility for the validity of the security in other respects.

Reasons for 1977 Change

Language has been added to this section to extend the warranties of a signing authenticating trustee, registrar, transfer agent or the like to the addressees of initial transaction statements. It should be noted that this warranty extends only to the addressee. Compare Sections 8—205 and 8—206 and the explanation of changes thereunder.

PART 3

[PURCHASE] TRANSFER

§ 8—301. Rights Acquired by Purchaser [; "Adverse Claim"; Title Acquired by Bona Fide Purchaser]

(1) Upon [delivery] transfer of a security to a purchaser (Section 8—313), the purchaser acquires the rights in the security which his transferor had or had actual authority to convey unless the purchaser's rights are limited by Section 8—302 (4). [except that a purchaser who has himself been a party to any fraud or illegality affecting the security or who as a prior holder had notice of an adverse claim cannot improve his position by taking from a later bona fide purchaser. "Adverse claim" includes a claim that a transfer was or would be wrongful or that a particular adverse person is the owner of or has an interest in the security.]

[(2) A bona fide purchaser in addition to acquiring the rights of a purchaser also acquires the security free of any adverse claim.]

(2) [(3)] A [purchaser] transferee of a limited interest acquires rights only to the extent of the interest [purchased] transferred. The creation or release of a security interest in a security is the transfer of a limited interest in that security.

Reasons for 1977 Change

Although the definition of "Purchase" in Section 1—201 (32) includes any "voluntary transaction", with or without consideration, the title of Part 3 has been changed to "Transfer" as a more natural description of the material covered therein. Similar changes have been made in the statutory text, where appropriate.

Transfers by operation of law, i. e., not to purchasers, are not intended to be covered by Part 3 of either the present or revised Article. Such transfers are effective upon the occurrence of the motivating event (death, bankuptcy or the like) and subsequent delivery and registration are merely confirmatory of what has already happened.

Subsection (1) states the basic rule of the present statute including the so-called shelter principle. The word "transfer" has been substituted for "delivery" in order that appropriate methods for the transfer of uncertificated securities can be included.

The balance of subsection (1) and all of present subsection (2) have been deleted from this Section but are now included in Section 8—302 which is intended to deal completely with the concept of bona fide purchase.

A sentence has been added to former subsection (3) to make clear that the creation and release of security interests are included in the statute's coverage.

§ 8—302. "Bona Fide Purchaser"; "Adverse Claim"; Title Acquired by Bona Fide Purchaser

(1) A "bona fide purchaser" is a purchaser for value in good faith and without notice of any adverse claim:

(a) who takes delivery of a certificated security in bearer form or [of one] in registered form, issued [to him] or indorsed to him or in blank;

(b) to whom the transfer, pledge or release of an uncertificated security is registered on the books of the issuer; or

(c) to whom a security is transferred under the provisions of paragraph (c), (d)(i), or (g) of Section 8—313(1).

(2) "Adverse claim" includes a claim that a transfer was or would be wrongful or that a particular adverse person is the owner of or has an interest in the security.

(3) A bona fide purchaser in addition to acquiring the rights of a purchaser (Section 8—301) also acquires his interest in the security free of any adverse claim.

(4) Notwithstanding Section 8—301(1), the transferee of a particular certificated security who has been a party to any fraud or illegality affecting the security, or who as a prior holder of that certificated security had notice of an adverse claim, cannot improve his position by taking from a bona fide purchaser.

Reasons for 1977 Change

The definition of bona fide purchaser of a certificated security is preserved in subparagraph (1)(a). A coordinate rule for the purchaser of an uncertificated security is stated in subparagraph (1)(b). The relevant time for testing the knowledge or constructive knowledge of a purchaser is the time of delivery in the case of a certificated security and the time of registration in the case of an uncertificated security. Note that the purchaser of an uncertificated security is charged with knowledge of adverse claims noted in the initial transaction statement sent to him as provided in Section 8—304.

In the present statute, Section 8—313 equates certain events with delivery and subsection (2) thereof provides that a purchaser who is deemed to have taken delivery through his broker under certain of the procedures in subsection (1) can be a "holder." It was thought advisable to add subparagraph (1)(c) to this section in order to identify expressly those provisions of revised Section 8—313(1) that will confer "holder" status on a purchaser and thus enable him to be a bona fide purchaser under this section.

The definition of adverse claim, the description of the title of a bona fide purchaser and the exception to the shelter principle, all of which are included in Section 8—301 of the present statute, are set forth as subsections (2), (3) and (4) respectively. Language has been added to subsection (4) to make clear that it is limited to the holder of a particular certificated security.

§ 8—303. "Broker"

"Broker" means a person engaged for all or part of his time in the business of buying and selling securities, who in the transaction concerned acts for, [or] buys a security from, or sells a security to, a customer. Nothing in this Article determines the capacity in which a person acts for purposes of any other statute or rule to which [such] the person is subject.

§ 8—304. Notice to Purchaser of Adverse Claims

(1) A purchaser (including a broker for the seller or buyer, but excluding an intermediary bank) of a certificated security is charged with notice of adverse claims if:

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

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

(2) A purchaser (including a broker for the seller or buyer, but excluding an intermediary bank) to whom the transfer, pledge, or release of an uncertificated security is registered is charged with notice of adverse claims as to which the issuer has a duty under Section 8—403(4) at the time of registration and which are noted in the initial transaction statement sent to the purchaser or, if his interest is transferred to him other than by registration of transfer, pledge, or release, the initial transaction statement sent to the registered owner or the registered pledgee.

(3) [(2)] The fact that the purchaser (including a broker for the seller or buyer) of a certificated or uncertificated security has notice that the security is held for a third person or is registered in the name of or indorsed by a fiduciary does not create a duty of inquiry into the rightfulness of the transfer or constitute constructive notice of adverse claims. [If,] However, if the purchaser (excluding an intermediary bank) has knowledge that the proceeds are being used or [that] the transaction is for the individual benefit of the fiduciary or otherwise in breach of duty, the purchaser is charged with notice of adverse claims.

Reasons for 1977 Change

Subsection (1), which deals with notice arising from what appears on a certificated security is applicable only to the purchaser of a certificated security. New subsection (2) provides that the purchaser of an uncertificated security is subject to those adverse claims that are noted on the initial transaction statement sent to him (or one who "holds" for him) confirming the transfer, pledge or release which has been registered. Subsection (3) is equally applicable to the purchasers of certificated and uncertificated securities and language has been added to make that clear.

§ 8—305. Staleness as Notice of Adverse Claims

An act or event [which] that creates a right to immediate performance of the principal obligation [evidenced] represented by [the] a certificated security or [which] sets a date on or after which [the] a certificated security is to be presented or surrendered for redemption or exchange does not [of] itself constitute any notice of adverse claims except in the case of a [purchase] transfer:

(a) after one year from any date set for [such] presentment or surrender for redemption or exchange; or

(b) after [six] 6 months from any date set for payment of money against presentation or surrender of the security if funds are available for payment on that date.

Reasons for 1977 Change

The substance of this section applies only to certificated securities for the same reasons as Section 8—203. It is not contemplated that uncertificated securities which have been called or have matured will be traded. With uncertificated securities which have become redeemable or exchangeable, effective transfer requires communication with the issuer and, therefore, presents the opportunity for the issuer to give the prospective transferee effective notice of such claims as have been lodged with it.

§ 8—306. Warranties on Presentment and Transfer of Certificated Securities; Warranties of Originators of Instructions

(1) A person who presents a certificated security for registration of transfer or for payment or exchange warrants to the issuer that he is entitled to the registration, payment, or exchange. But, a purchaser for value and without notice of adverse claims who receives a new, reissued, or re-registered certificated security on registration of transfer or receives an initial transaction statement confirming the registration of transfer of an equivalent uncertificated security to him warrants only that he has no knowledge of any unauthorized signature (Section 8—311) in a necessary indorsement.

(2) A person by transferring a certificated security to a purchaser for value warrants only that:

(a) his transfer is effective and rightful; [and]

(b) the security is genuine and has not been materially altered; and

(c) he knows of no fact which might impair the validity of the security.

(3) [Where] If a certificated security is delivered by an intermediary known to be entrusted with delivery of the security on behalf of another or with collection of a draft or other claim against [such] delivery, the intermediary by [such] delivery warrants only his own good faith and authority, even though he has purchased or made advances against the claim to be collected against the delivery.

(4) A pledgee or other holder for security who redelivers [the] a certificated security received, or after payment and on order of the debtor delivers that security to a third person, makes only the warranties of an intermediary under subsection (3).

(5) A person who originates an instruction warrants to the issuer that:

(a) he is an appropriate person to originate the instruction; and

(b) at the time the instruction is presented to the issuer he will be entitled to the registration of transfer, pledge, or release.

(6) A person who originates an instruction warrants to any person specially guaranteeing his signature (subsection 8—312 (3)) that:

(a) he is an appropriate person to originate the instruction; and

(b) at the time the instruction is presented to the issuer

(i) he will be entitled to the registration of transfer, pledge, or release; and

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

(7) A person who originates an instruction warrants to a purchaser for value and to any person guaranteeing the instruction (Section 8—312(6)) that:

(a) he is an appropriate person to originate the instruction;

(b) the uncertificated security referred to therein is valid; and

(c) at the time the instruction is presented to the issuer

(i) the transferor will be entitled to the registration of transfer, pledge, or release;

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

(iii) the requested transfer, pledge, or release will be rightful.

(8) If a secured party is the registered pledgee or the registered owner of an uncertificated security, a person who originates an instruction of release or transfer to the debtor or, after payment and on order of the debtor, a transfer instruction to a third person, warrants to the debtor or the third person only that he is an appropriate person to originate the instruction and at the time the instruction is presented to the issuer, the transferor will be entitled to the registration of release or transfer. If a transfer instruction to a third person who is a purchaser for value is originated on order of the debtor, the debtor makes to the purchaser the warranties of paragraphs (b), (c)(ii) and (c)(iii) of subsection (7).

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

(a) his transfer is effective and rightful; and

(b) the uncertificated security is valid.

(10) [(5)] A broker gives to his customer and to the issuer and a purchaser the applicable warranties provided in this section and has the rights and privileges of a purchaser under this section. The warranties of and in favor of the broker acting as an agent are in addition to applicable warranties given by and in favor of his customer.

Reasons for 1977 Change

The substance of the present section, with respect to certificated securities, has been preserved in the first four subsections. The section title and these subsections have been changed only to make clear that application only to certificated securities is intended. Because the registration of transfer of an uncertificated security to the transferee is functionally equivalent to the delivery of a certificated security to the transferee by the issuer, language has been add-

ed to subsection (1) to equate the position of purchasers for value without notice of adverse claims whether the security they "receive" from the issuer is certificated or uncertificated.

Subsection (5) establishes the warranty made to the issuer by the originator of an instruction, which is an order to the issuer and is defined in Section 8—308(4). These warranties are designed to protect issuers who rely on instructions which may be forged, fraudulent or otherwise improper against the persons who are responsible for the creation of such instructions. If, for example, an issuer should improperly transfer shares out of the name of a shareholder on the basis of a forged instruction, and transfer those shares to a bona fide purchaser to whom a valid initial transaction statement is sent, the issuer would be subject to liability to the purported transferor under Section 8—404(3).

Subsection (6) sets forth the warranty made by the originator of an instruction to a special signature guarantor. It adds to the two warranties of subsection (5) a warranty that the instruction will result in the registration of a "clean" transfer, pledge, or release and is consistent with the warranty made by a special signature guarantor under Section 8—312(3)(b).

Subsection (7) sets forth the warranty made by the originator of an instruction to both a purchaser for value and an instruction guarantor. It adds to the warranties in subsections (5) and (6) additional warranties of rightfulness and validity and is essentially identical to the warranty of the transferor of a certificated security under subsection (2). The absolute warranty of validity, rather than the mere denial of knowledge of invalidity, is appropriate because the instruction must be communicated to the issuer in order to complete the transfer. If, upon receipt of the instruction, the issuer should dispute the validity of the security, it seems proper to place the burden of proving validity on the transferor. It is contemplated that purchasers of uncertificated securities will not normally part with their consideration unless and until they are satisfied that the transaction has been duly registered and acknowledged to be free from defects by the issuer, except when they are relying on their brokers or other third parties.

Because the guarantor of an instruction makes an absolute warranty of rightfulness under Section 8—312(6), he is given the benefit of the originator's warranty under subsection (7).

Subsection (8) limits the warranties of the originator of an instruction when the uncertificated security is subject to a security interest and the originator is or acts for either the

registered pledgee or registered owner who is the secured party. In such cases, when the instruction is for release, transfer to the debtor or transfer, after payment, to a third person on the debtor's order, the originator's warranties are limited in substantially the same way that subsection (4) limits the warranties of the pledgee of a certificated security acting under similar circumstances.

When the transferor of an uncertificated security is neither the registered owner nor the registered pledgee, the transferor will have no occasion to originate an instruction in connection with the transfer. In such cases, the transferor warrants the rightfulness of the transfer and the validity of the security to a purchaser for value, as provided in subsection (9).

§ 8—307. Effect of Delivery Without Indorsement; Right to Compel Indorsement

[Where] If a certificated security in registered form has been delivered to a purchaser without a necessary indorsement he may become a bona fide purchaser only as of the time the indorsement is supplied[,]; but against the transferor, the transfer is complete upon delivery and the purchaser has a specifically enforceable right to have any necessary indorsement supplied.

§ 8—308. [Indorsement, How Made; Special Indorsement; Indorser Not a Guarantor; Partial Assignment] Indorsements; Instructions

(1) An indorsement of a certificated security in registered form is made when an appropriate person signs on it or on a separate document an assignment or transfer of the security or a power to assign or transfer it or [when the] his signature [of such person] is written without more upon the back of the security.

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

(3) [(5)] An indorsement purporting to be only of part of a certificated security representing units intended by the issuer to be separately transferable is effective to the extent of the indorsement.

(4) An "instruction" is an order to the issuer of an uncertificated security requesting that the transfer, pledge, or release from pledge of the uncertificated security specified therein be registered.

(5) An instruction originated by an appropriate person is:

(a) a writing signed by an appropriate person; or

(b) a communication to the issuer in any form agreed upon in a writing signed by the issuer and an appropriate person.

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

(6) [(3)] "An appropriate person" in subsection (1) means [(a)] the person specified by the certificated security or by special indorsement to be entitled to the security [; or].

(7) "An appropriate person" in subsection (5) means:

(a) for an instruction to transfer or pledge an uncertificated security which is then not subject to a registered pledge, the registered owner; or

(b) for an instruction to transfer or release an uncertificated security which is then subject to a registered pledge, the registered pledgee.

(8) In addition to the persons designated in subsections (6) and (7), "an appropriate person" in subsections (1) and (5) includes:

(a) [(b) where] if the person [so specified] designated is described as a fiduciary but is no longer serving in the described capacity,[—]either that person or his successor; [or]

(b) [(c) where] if the [security or indorsement so specifies] persons designated are described as more than one person as fiduciaries and one or more are no longer serving in the described capacity,[—]the remaining fiduciary or fiduciaries, whether or not a successor has been appointed or qualified; [or]

(c) [(d) where] if the person [so specified] designated is an individual and is without capacity to act by virtue of death, incompetence, infancy, or otherwise,[—]his executor, administrator, guardian, or like fiduciary; [or]

(d) [(e) where] if the [security or indorsement so specifies] persons designated are described as more than one person as tenants by the entirety or with right of survivorship and by reason of death all cannot sign,[—] the survivor or survivors; [or]

(e) [(f)] a person having power to sign under applicable law or controlling instrument; [or] and

(f) [(g)] to the extent that the person designated or any of the foregoing persons may act through an agent,[—] his authorized agent.

(9) [(4)] Unless otherwise agreed, the indorser of a certificated security by his indorsement or the originator of an instruction by his origination assumes no obligation that the security will be honored by the issuer but only the obligations provided in Section 8—306.

(10) [(6)] Whether the person signing is appropriate is determined as of the date of signing and an indorsement made by or an instruction originated by [such a person] him does not become unauthorized for the purposes of this Article by virtue of any subsequent change of circumstances.

(11) [(7)] Failure of a fiduciary to comply with a controlling instrument or with the law of the state having jurisdiction of the fiduciary relationship, including any law requiring the fiduciary to obtain court approval of the transfer, pledge, or release, does not render his indorsement or an instruction originated by him unauthorized for the purposes of this Article.

Reasons for 1977 Change

The substance of the present section has been preserved, insofar as it applies to certificated securities, in subsections (1), (2), (3), (6), (8), (9), (10) and (11). Subsections (4), (5) and (7) deal solely with uncertificated securities. Present paragraph (3)(a) has been incorporated in new subsection (6). The remainder of present subsection (3) is incorporated in new subsection (8). Present subsections (4), (6) and (7) have been broadened to cover both forms of securities and are set forth in new subsections (9), (10) and (11). An attempt has been made to integrate the rules in order that issuers can rely on precisely the same documentation and evidence in connection with registration with respect to both certificated and uncertificated securities.

An order for the registration of transfer of a certificated security is the security itself, duly indorsed and presented to the issuer. Because uncertificated securities are not repre-

sented by instruments, a separate order, in some form, written or otherwise, is demanded. Subsection (4) defines an "instruction" as that order and further provides that not only registration of transfer, but also registration of pledge and release, can be requested thereby.

Subsection (5) provides that an instruction may be an appropriately signed writing, and it is contemplated that, in most cases, it will be. It further provides, however, that instructions may be other than signed writings when both parties, the issuer on the one hand and the registered owner or registered pledgee on the other, have agreed, in a signed writing, that some other procedure is mutually acceptable. Thus, paragraph (5)(b) is intended to facilitate the registration of transfers, pledges and releases on the authority of electronic, telegraphic or even oral instructions when the relevant parties are assured that the means selected will provide adequate safeguards against the execution of unauthorized transactions.

Subsection (7) designates the primary party appropriate to originate an instruction. When the uncertificated security is not subject to a registered pledge, the registered owner is that party and may properly originate an instruction to register either a transfer or pledge. When the uncertificated security is subject to a registered pledge, however, only the registered pledgee may properly originate an instruction to register either transfer or release. There is no provision to register a pledge other than that of a single registered pledgee. See Section 8—108.

The final phrase of subsection (9) has been inserted because of a possible ambiguity concerning the word "honored." Under the terms of Section 8—306 the transferor of a certificated security and the originator of an instruction do warrant, in effect, that the issuer will honor their respective orders to register the appropriate transaction. They do not, unless otherwise agreed, become sureties of the obligations of the issuer beyond the duty to register, as, for example, the issuer's obligations to pay interest and principal on a security which is an indebtedness of the issuer.

§ 8—309. Effect of Indorsement Without Delivery

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

§ 8—310. Indorsement of Certificated Security in Bearer Form

An indorsement of a certificated security in bearer form may give notice of adverse claims (Section 8—304) but does not otherwise affect any right to registration the holder [may possess] possesses.

§ 8—311. Effect of Unauthorized Indorsement or Instruction

Unless the owner or pledgee has ratified an unauthorized indorsement or instruction or is otherwise precluded from asserting its ineffectiveness:

(a) he may assert its ineffectiveness against the issuer or any purchaser, other than a purchaser for value and without notice of adverse claims, who has in good faith received a new, reissued, or re-registered certificated security on registration of transfer or received an initial transaction statement confirming the registration of transfer, pledge, or release of an equivalent uncertificated security to him; and

(b) an issuer who registers the transfer of a certificated security upon the unauthorized indorsement or who registers the transfer, pledge, or release of an uncertificated security upon the unauthorized instruction is subject to liability for improper registration (Section 8—404).

Reasons for 1977 Change

This section is broadened to give the same effect to an unauthorized instruction as the present statute gives to an unauthorized indorsement of a certificated security. Thus, the protection which paragraph (a) accords to a bona fide purchaser who receives a certificated security from the issuer is also accorded to a bona fide purchaser who receives an initial transaction statement with respect to an uncertificated security. Similarly, the liability of the issuer for improper registration set forth in paragraph (b) extends to improper registration pursuant to an unauthorized instruction.

§ 8—312. Effect of Guaranteeing Signature, [or] Indorsement or Instruction

(1) Any person guaranteeing a signature of an indorser of a certificated security warrants that at the time of signing:

(a) the signature was genuine; [and]

(b) the signer was an appropriate person to indorse (Section 8—308); and

(c) the signer had legal capacity to sign.

[But the guarantor does not otherwise warrant the rightfulness of the particular transfer.]

(2) Any person guaranteeing a signature of the originator of an instruction warrants that at the time of signing:

(a) the signature was genuine;

(b) the signer was an appropriate person to originate the instruction (Section 8—308) if the person specified in the instruction as the registered owner or registered pledgee of the uncertificated security was, in fact, the registered owner or registered pledgee of such security, as to which fact the signature guarantor makes no warranty;

(c) the signer had legal capacity to sign; and

(d) the taxpayer identification number, if any, appearing on the instruction as that of the registered owner or registered pledgee was the taxpayer identification number of the signer or of the owner or pledgee for whom the signer was acting.

(3) Any person specially guaranteeing the signature of the originator of an instruction makes not only the warranties of a signature guarantor (subsection (2)) but also warrants that at the time the instruction is presented to the issuer:

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

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

(4) [But] The guarantor under subsections (1) and (2) or the special guarantor under subsection (3) does not otherwise warrant the rightfulness of the particular transfer, pledge, or release.

(5) [(2)] Any person [may guarantee] guaranteeing an indorsement of a certificated security [and by so doing warrants not only the signature (subsection 1)] makes not only the warranties of a signature guarantor under subsection (1) but also

warrants the rightfulness of the particular transfer in all respects. [But no issuer may require a guarantee of indorsement as a condition to registration of transfer.]

(6) Any person guaranteeing an instruction requesting the transfer, pledge, or release of an uncertificated security makes not only the warranties of a special signature guarantor under subsection (3) but also warrants the rightfulness of the particular transfer, pledge, or release in all respects.

(7) [But] No issuer may require a special guarantee of signature (subsection (3)), a guarantee of indorsement (subsection (5)), or a guarantee of instruction (subsection (6)) as a condition to registration of transfer, pledge, or release.

(8) [(3)] The foregoing warranties are made to any person taking or dealing with the security in reliance on the guarantee, and the guarantor is liable to [such] the person for any loss resulting from breach of the warranties.

Reasons for 1977 Change

The substance of the present section has been preserved, insofar as it applies to certificated securities, in subsections (1), (4), (5), (7) and (8). Some of the language has been changed and restructured in order to integrate the material concerning uncertificated securities, but no change of substance is intended.

Subsection (2) sets forth the warranties that can reasonably be expected from the guarantor of the signature on an instruction, who, though familiar with the signer, does not have before him any evidence that the purported owner or pledgee is, in fact, the owner or pledgee of the subject uncertificated security. This is in distinct contrast to the position of the person guaranteeing a signature on a certificate who can see a certificate in the signer's possession in the name of or indorsed to the signer or in blank.

Thus, the warranty of appropriateness in clause (b) is expressly conditioned on the actual registration conforming to that represented by the originator. If the signer purports to be the owner or pledgee, the guarantor under clause (b), warrants only his identity. If, however, the signer is acting in a representative capacity, the guarantor warrants both his identity and his authority to act for the purported owner or pledgee. The additional warranty of clause (d) as to the taxpayer identification number is intended to prevent error or fraud resulting from identical or similar names. The warranties of subsection (2) are intended to provide satisfactory assurance to the issuer who needs no warranty as to the facts

of registration because he can ascertain those facts from his own records.

Subsection (3) sets forth a "special guarantee of signature" under which the guarantor additionally warrants both registered ownership or pledge and freedom from undisclosed defects of record. The guarantor of the signature of an indorser of a certificated security effectively makes these warranties to a purchaser for value on the evidence of a clean certificate issued in the name of the indorser, indorsed to the indorser or indorsed in blank. By specially guaranteeing under subsection (3), the guarantor warrants that the instruction will, when presented to the issuer, result in the requested registration free from defects not specified. It is contemplated that the special guarantee of signature will be used principally in brokerage transactions where the broker will be specially guaranteeing the signature on an instruction originated by his own customer. The broker's risk will be no greater than that of a broker who now commonly executes the sale of a security for his customer without the absolute assurance that his customer will deliver a clean certificate at settlement.

§ 8—313. When [Delivery] Transfer to [the] Purchaser Occurs: [; Purchaser's Broker] Financial Intermediary as [Holder] Bona Fide Purchaser; "Financial Intermediary"

(1) [Delivery] Transfer of a security or a limited interest (including a security interest) therein to a purchaser occurs only [when]:

(a) at the time he or a person designated by him acquires possession of a certificated security; [or]

(b) at the time the transfer, pledge, or release of an uncertificated security is registered to him or a person designated by him;

(c) [(b)] at the time his [broker] financial intermediary acquires possession of a certificated security specially indorsed to or issued in the name of the purchaser; [or]

(d) [(c)] at the time [his broker] a financial intermediary, not a clearing corporation, sends him confirmation of the purchase and also by book entry or otherwise identifies [a specific security in the broker's possession] as belonging to the purchaser[; or]

(i) a specific certificated security in the financial intermediary's possession;

(ii) a quantity of securities that constitute or are part of a fungible bulk of certificated securities in the financial intermediary's possession or of uncertificated securities registered in the name of the financial intermediary; or

(iii) a quantity of securities that constitute or are part of a fungible bulk of securities shown on the account of the financial intermediary on the books of another financial intermediary;

(e) [(d)] with respect to an identified certificated security to be delivered while still in the possession of a third person, not a financial intermediary, [when] at the time that person acknowledges that he holds for the purchaser; [or]

(f) with respect to a specific uncertificated security the pledge or transfer of which has been registered to a third person, not a financial intermediary, at the time that person acknowledges that he holds for the purchaser;

(g) [(e)] at the time appropriate entries to the account of the purchaser or a person designated by him on the books of a clearing corporation are made under Section 8—320[.];

(h) with respect to the transfer of a security interest where the debtor has signed a security agreement containing a description of the security, at the time a written notification, which, in the case of the creation of the security interest, is signed by the debtor (which may be a copy of the security agreement) or which, in the case of the release or assignment of the security interest created pursuant to this paragraph, is signed by the secured party, is received by

(i) a financial intermediary on whose books the interest of the transferor in the security appears;

(ii) a third person, not a financial intermediary, in possession of the security, if it is certificated;

(iii) a third person, not a financial intermediary, who is the registered owner of the security, if it is uncertificated and not subject to a registered pledge; or

(iv) a third person, not a financial intermediary, who is the registered pledgee of the security, if it is uncertificated and subject to a registered pledge;

(i) with respect to the transfer of a security interest where the transferor has signed a security agreement containing a description of the security, at the time new value is given by the secured party; or

(j) with respect to the transfer of a security interest where the secured party is a financial intermediary and the security has already been transferred to the financial intermediary under paragraphs (a), (b), (c), (d), or (g), at the time the transferor has signed a security agreement containing a description of the security and value is given by the secured party.

(2) The purchaser is the owner of a security held for him by [his broker] a financial intermediary, but [is not the holder] cannot be a bona fide purchaser of a security so held except [as] in the circumstances specified in [subparagraphs] paragraphs [(b)] (c), (d)(i), and [(e)] (g) of subsection (1). [Where] If a security so held is part of a fungible bulk, as in the circumstances specified in paragraphs (d)(ii) and (d)(iii) of subsection (1), the purchaser is the owner of a proportionate property interest in the fungible bulk.

(3) Notice of an adverse claim received by the [broker] financial intermediary or by the purchaser after the [broker] financial intermediary takes delivery of a certificated security as a holder for value or after the transfer, pledge, or release of an uncertificated security has been registered free of the claim to a financial intermediary who has given value is not effective either as to the [broker] financial intermediary or as to the purchaser. However, as between the [broker] financial intermediary and the purchaser the purchaser may demand [delivery] transfer of an equivalent security as to which no notice of [an] adverse claim has been received.

(4) A "financial intermediary" is a bank, broker, clearing corporation or other person (or the nominee of any of them) which in the ordinary course of its business maintains security accounts for its customers and is acting in that capacity. A financial intermediary may have a security interest in securities held in account for its customer.

§ 8–313 APPENDIX

Reasons for 1977 Change

The title of this section has been changed and its content broadened in order to identify the time when both certificated and uncertificated securities are transferred to purchasers. The content has been further extended to recognize that many transactions are conducted through financial intermediaries, a term defined in subsection (4) to include all entities, and not merely brokers, that maintain security accounts for their customers. It is one of the three sections in this revision in which it is intended to extend the coverage of Article 8 as to certificated securities. Sections 8—317 and 8—321 are the others.

Subsection (1) is expressly made applicable to limited interests, including security interests, as well as entire interests. Compare Section 8—301(2). The addition of the word "only" in the first sentence is intended to provide that the methods of transfer listed are exclusive and that compliance with one of them is essential to a valid transfer. Transfers by operation of law are excepted because they are not transfers to a "purchaser".

The rules of the present statute as they apply to certificated securities are preserved in subparagraphs (a), (c), (d)(i), (e) and (g). The coverage of (c) and (d)(i), however, is extended to situations where any financial intermediary, except a clearing corporation, is involved and the coverage of (e) is limited to third persons who are not financial intermediaries.

Subparagraph (b) is the basic rule for uncertificated securities and provides that a transfer (including a pledge or release, which are transfers of security interests) occurs when it is registered. Subparagraph (f) is the analogue of (e) and applies when an uncertificated security is controlled by a third person. In both (e) and (f), acknowledgement by the third person is the critical event.

Subparagraphs (d)(ii) and (d)(iii) have no counterpart in the present statute but are considered desirable express statements in the light of modern security holding practices of both brokers and banks. The final sentence of present subsection (2) implies this result without stating it expressly. Once the "fungible bulk" principle is established, it is immaterial whether the underlying securities are certificated, uncertificated or held in a clearing corporation account.

Entire subparagraph (d) is applicable to all financial intermediaries except clearing corporations and requires, as conditions of transfer, both a confirmation to the purchaser and a book entry. In contrast, subparagraph (g) applies only to

clearing corporations and requires only the appropriate book entry. The difference results from the fact that clearing corporations will normally control only securities belonging to their customers while other financial intermediaries may themselves be the beneficial owners or pledgees of securities not held in account for their customers. In the event of the insolvency of either the financial intermediary or the customer, it appears desirable to have some objective evidence of a transfer in addition to an internal book entry. This distinction preserves the similar distinction between subparagraphs (c) and (e) of the present statute.

Under the present statute, the rules of Section 8—313(1) are neither expressly applicable to security interests nor are they expressly made exclusive. On the other hand, when value has been given and the debtor has rights in the collateral, present Section 9—203(1) permits the creation of an enforceable security interest when either the secured party has possession of the collateral *or* the debtor has signed a written security agreement. Under present Article 9, a security interest created by signed agreement, although enforceable, would, with limited exceptions, be unperfected.

Under this revision, new Section 8—321 requires a transfer under Section 8—313(1) to create an enforceable security interest and Section 9—203(1) is expressly made subject to Section 8—321. As a result, it will not be possible to create a security interest in securities by mere written agreement. It is not considered necessary to continue to provide for the creation of unperfected security interests. It is considered desirable, however, to provide for the creation of security interests, unaccompanied by possession, which can be perfected under present Article 9.

Subparagraph (h), limited to the transfer of a security interest, deals with the situation where a security interest, pursuant to written agreement, is perfected by notice to a bailee under Section 9—305. Unlike a transfer under subparagraph (d), (e) or (f) of subsection (1), Section 9—305 does not require confirmation or acknowledgment by the controlling party, but only the receipt of notice. Subparagraph (h) provides that a transfer is effective when notice is received and further identifies the party to be notified. Subparagraph (h) is applicable to both certificated and uncertificated securities and, even when certificated securities are involved, eliminates speculation as to who is the bailee and, indeed, whether there is an instrument. Unlike Section 9—305, which merely requires notification, subsection (h) requires that the notification be signed by the transferor, thereby reducing the possibility of interference by fraudu-

lent claimants. By this revision, securities are expressly excluded from the coverage of Section 9—305.

Subparagraph (i), also limited to the transfer of a security interest, deals with the situation where a security interest, pursuant to written agreement, for new value is automatically perfected for a period of 21 days under Section 9—304(4). Under subparagraph (i), such a security interest is effectively transferred when the new value is given. Section 8—321(2) provides for the expiration of perfection after 21 days. By this revision, securities are expressly excluded from the coverage of Section 9—304(4).

Subparagraph (j) is addressed to the situation where a financial intermediary holds securities in account for a customer and also acquires a security interest in those securities for its own account, *e. g.*, a margin account with a broker or a bank lending on the collateral of its borrower's custody account. In such cases, the financial intermediary's control of the securities is in a dual capacity, and a written agreement signed by the debtor was thought to be a desirable protection.

Present subsection (2) denies holder status to a broker's customer except in cases where the broker is holding a specific certificated security for the customer's account. The effect of this is to prevent the customer from becoming a bona fide purchaser when all he has is an interest in a fungible bulk of securities. Revised subsection (2) deals with the problem expressly in terms of who can or cannot become a bona fide purchaser. Note that in neither the present nor the revised statute can the purchaser who becomes such by acknowledgment by a third party bailee or agent attain bona fide purchaser status. Subsection (2) should be compared with Section 8—302(1)(c).

Subsection (3) states the principle that once a financial intermediary has become a bona fide purchaser subsequent notice of claims to either him or his customer are ineffective, and extends the coverage to uncertificated securities. The final sentence, now applicable to all financial intermediaries, gives the customer the right to obtain a "clean" security from his broker or bank.

New subsection (4) defines the term "financial intermediary" as an entity which maintains security accounts for its customers. Note that the definition applies only when the entity is acting in that capacity. Thus, a bank is a financial intermediary in transactions involving its custody accounts but is not a financial intermediary with respect to securities it holds as a pledgee or for its own account.

§ 8—314. Duty to [Deliver] Transfer, When Completed

(1) Unless otherwise agreed, [where] if a sale of a security is made on an exchange or otherwise through brokers:

(a) the selling customer fulfills his duty to [deliver when] transfer at the time he:

(i) [he] places [such] a certificated security in the possession of the selling broker or of a person designated by the broker; [or if requested causes an acknowledgment to be made to the selling broker that it is held for him; and]

(ii) causes an uncertificated security to be registered in the name of the selling broker or a person designated by the broker;

(iii) if requested, causes an acknowledgment to be made to the selling broker that [it] a certificated or uncertificated security is held for [him; and] the broker; or

(iv) places in the possession of the selling broker or of a person designated by the broker a transfer instruction for an uncertificated security, providing the issuer does not refuse to register the requested transfer if the instruction is presented to the issuer for registration within 30 days thereafter; and

(b) the selling broker, including a correspondent broker acting for a selling customer, fulfills his duty to [deliver] transfer at the time he:

(i) [by placing the] places a certificated security [or a like security] in the possession of the buying broker or a person designated by [him or] the buying broker;

(ii) causes an uncertificated security to be registered in the name of the buying broker or a person designated by the buying broker;

(iii) places in the possession of the buying broker or of a person designated by the buying broker a transfer instruction for an uncertificated security, providing the issuer does not refuse to register the requested transfer if the instruction is presented to the issuer for registration within 30 days thereafter; or

(iv) [by effecting] effects clearance of the sale in accordance with the rules of the exchange on which the transaction took place.

(2) Except as [otherwise] provided in this section and unless otherwise agreed, a transferor's duty to [deliver] transfer a security under a contract of purchase is not fulfilled until he:

(a) [he] places [the] a certificated security in form to be negotiated by the purchaser in the possession of the purchaser or of a person designated by the purchaser; [him or at the purchaser's request causes an acknowledgment to be made to the purchaser that it is held for him.]

(b) causes an uncertificated security to be registered in the name of the purchaser or a person designated by the purchaser; or

(c) [at the purchaser's request] if the purchaser requests, causes an acknowledgment to be made to the purchaser that [it] a certificated or uncertificated security is held for [him] the purchaser.

(3) Unless made on an exchange, a sale to a broker purchasing for his own account is within [this] subsection (2) and not within subsection (1).

Reasons for 1977 Change

This section presently provides that a transferor's duty is fulfilled by physical delivery of a certificated security. This rule is preserved in subparagraphs (1)(a)(i), (1)(b)(i) and (2)(a). New subparagraphs (1)(a)(ii), (1)(b)(ii) and (2)(b) permit the transferor also to perform by causing the registration of transfer of an uncertificated security to the transferee or his designee. Another alternative, causing a third party holder to acknowledge that he holds for the transferee if the transferee so requests, is provided in the present section and is explicitly stated in new subparagraphs (1)(a)(iii) and (2)(c). A selling broker may also fulfill his duty by effecting clearance pursuant to exchange rules. This is stated in new subparagraph (i)(b)(iv).

In brokerage transactions only, subparagraphs (1)(a)(iv) and (1)(b)(iii) permit yet another alternative. Under these, the transferor may conditionally satisfy his duty by the delivery of an instruction. Such delivery does not constitute complete performance if the instruction is timely presented for registration and the issuer refuses to comply with its request. The burden of timely presentment is placed on the recipient of the instruction and it is not intended that instruc-

tions so given will circulate in the manner in which certificated securities now commonly circulate by indorsement. It is contemplated that this method of performance will be commonly employed in transactions settled through brokers, with, in many cases, the selling broker specially guaranteeing the signature of the originator of the instruction pursuant to Section 8—312(3).

§ 8—315. Action Against [Purchaser] Transferee Based Upon Wrongful Transfer

(1) Any person against whom the transfer of a security is wrongful for any reason, including his incapacity, [may] as against anyone except a bona fide purchaser, may:

(a) reclaim possession of the certificated security wrongfully transferred; [or]

(b) obtain possession of any new certificated security [evidencing] representing all or part of the same rights; [or]

(c) compel the origination of an instruction to transfer to him or a person designated by him an uncertificated security constituting all or part of the same rights; or

(d) have damages.

(2) If the transfer is wrongful because of an unauthorized indorsement of a certificated security, the owner may also reclaim or obtain possession of the security or a new certificated security, even from a bona fide purchaser, if the ineffectiveness of the purported indorsement can be asserted against him under the provisions of this Article on unauthorized indorsements (Section 8—311).

(3) The right to obtain or reclaim possession of a certificated security or to compel the origination of a transfer instruction may be specifically enforced and [its] the transfer of a certificated or uncertificated security enjoined and [the] a certificated security impounded pending the litigation.

Reasons for 1977 Change

The coverage of this section is broadened to include remedies for the wrongful transfer of both certificated and uncertificated securities. Subparagraph (c) is added to subsection (1) to establish the alternative remedy of compelling the origination of an instruction to transfer an equivalent uncertificated security which is the functional equivalent of subparagraph (b).

Subsection (2) is applicable only to certificated securities and language is added to make that clear. The right to specific enforcement provided in subsection (3) is extended to the origination of a transfer instruction and the right to enjoin transfer is made applicable to both certificated and uncertificated securities.

§ 8—316. Purchaser's Right to Requisites for Registration of Transfer, Pledge, or Release on Books

Unless otherwise agreed, the transferor of a certificated security or the transferor, pledgor, or pledgee of an uncertificated security [must] on due demand must supply his purchaser with any proof of his authority to transfer, pledge, or release or with any other requisite [which may be] necessary to obtain registration of the transfer, pledge, or release of the security; but if the transfer, pledge, or release is not for value, a transferor, pledgor, or pledgee need not do so unless the purchaser furnishes the necessary expenses. Failure within a reasonable time to comply with a demand made [within a reasonable time] gives the purchaser the right to reject or rescind the transfer, pledge, or release.

Reasons for 1977 Change

Language has been added to this section in order to broaden its coverage to both certificated and uncertificated securities. Because uncertificated securities are not only transferred, but also can be pledged and released by registration, language has been added to include such transactions.

§ 8—317. [Attachment or Levy Upon Security] Creditors' Rights

(1) Subject to the exceptions in subsections (3) and (4), no attachment or levy upon a certificated security or any share or other interest [evidenced] represented thereby which is outstanding [shall be] is valid until the security is actually seized by the officer making the attachment or levy, but a certificated security which has been surrendered to the issuer may be [attached or levied upon at the source] reached by a creditor by legal process at the issuer's chief executive office in the United States.

(2) An uncertificated security registered in the name of the debtor may not be reached by a creditor except by legal process at the issuer's chief executive office in the United States.

(3) The interest of a debtor in a certificated security that is in the possession of a secured party not a financial intermediary or in an uncertificated security registered in the name of a secured party not a financial intermediary (or in the name of a nominee of the secured party) may be reached by a creditor by legal process upon the secured party.

(4) The interest of a debtor in a certificated security that is in the possession of or registered in the name of a financial intermediary or in an uncertificated security registered in the name of a financial intermediary may be reached by a creditor by legal process upon the financial intermediary on whose books the interest of the debtor appears.

(5) Unless otherwise provided by law, a creditor's lien upon the interest of a debtor in a security obtained pursuant to subsection (3) or (4) is not a restraint on the transfer of the security, free of the lien, to a third party for new value; but in the event of a transfer, the lien applies to the proceeds of the transfer in the hands of the secured party or financial intermediary, subject to any claims having priority.

(6) [(2)] A creditor whose debtor is the owner of a security [shall be] is entitled to [such] aid from courts of appropriate jurisdiction, by injunction or otherwise, in reaching [such] the security or in satisfying the claim by means [thereof as is] allowed at law or in equity in regard to property [which] that cannot readily be [attached or levied upon] reached by ordinary legal process.

Reasons for 1977 Change

This section has been substantially rewritten and expanded, not only to provide for the rights of creditors of the owners of uncertificated securities, but also to provide expressly for remedies against the interest of debtors in certificated securities which are not within the debtor's control. It is one of the three sections in this revision in which it is intended to extend the coverage of Article 8 as to certificated securities. Sections 8—313 and 8—321 are the others.

Subsection (1) states the rule of the present statute for certificated securities which provides that a creditor's lien upon a certificated security is not valid until actual seizure. The chief justification for this rule is the protection of purchasers from the debtor. The rule is entirely appropriate when the security is within the debtor's control. When the debtor does not have such control, the rule has no function.

The present statute recognizes a single exception to the rule where the security has been surrendered to the issuer. New subsection (1) includes this exception and expressly provides that such a security can be reached by serving the issuer at its chief executive office, replacing the cryptic phrase "at the source." The most logical place to serve the issuer would be the place where the transfer records are maintained, but that location might be difficult to identify, especially when the separate elements of a computer network might be situated in different places. The chief executive office is selected as the appropriate place by analogy to Section 9—103(3)(d).

Subsection (2) provides that process upon the issuer is the only method for a creditor to reach an uncertificated security registered in the name of the debtor. This conclusion was reached with some reluctance since it requires a creditor to institute legal action and/or a debtor to defend that action in a jurisdiction which may have no relationship to either of the parties or the dispute other than the happenstance that the debtor owns a security of the particular issuer. Nevertheless, attempts to formulate a procedure by which even a judgment creditor could effectively reach his debtor's uncertificated securities without such legal action resulted in what seemed to be an intolerable burden for issuers.

Subsection (3) provides a second exception to the seizure rule when a certificated security is in the possession of a secured party. In such a case, an effective lien can be established by service on the secured party without depriving him of his possession. This section does not attempt to provide for rights as between the creditor and the secured party, as, for example, whether or when the secured party must liquidate the security. For essentially the same reasons, subsection (3) also covers the case where an uncertificated security has been transferred into the name of a secured party either at the inception of the loan or thereafter.

Subsection (4) recognizes that certificated securities are frequently held in account for customers by banks or brokers and that such securities may be registered not only in the name of the debtor but, more commonly, in street or other nominee name. Additionally, in such cases, the securities may have been commingled, repledged or deposited so that no particular security could be identified as that of the debtor. The subsection provides that the debtor's account can be reached by process upon the entity upon whose books the interest of the debtor appears. This appears to be the most effective way of preventing the transfer of the debtor's interest and thus protecting the creditor. It is only that entity that is aware of the debtor's interest, irrespective of where the se-

curities are located or in what name they happen to be registered. For the same reason, subsection (4) also covers the case where uncertificated securities are registered in street name.

Subsection (5) expressly provides that securities in which the debtor's interest is reached pursuant to subsections (3) or (4) may be transferred for new value, free of the creditor's lien, but, when and if they are, that the lien will be transferred to the proceeds. Nothing in subsection (5) is intended to validate any transfer that would otherwise constitute a fraudulent conveyance. Furthermore, subsection (5) is expressly subject to the procedural laws of the states and no attempt has been made to prescribe the consequences of obtaining such a lien or the procedures for its enforcement.

Particular terms to describe creditor's process have been avoided in this section. This section is not intended to have any effect on the availability of garnishment or similar third-party process as a pre-judgment or post-judgment remedy. Such matters are a proper concern of the procedural rules of the states, subject, of course, to constitutional limitations.

§ 8—318. No Conversion by Good Faith [Delivery] Conduct

An agent or bailee who in good faith (including observance of reasonable commercial standards if he is in the business of buying, selling, or otherwise dealing with securities) has received certificated securities and sold, pledged, or delivered them or has sold or caused the transfer or pledge of uncertificated securities over which he had control according to the instructions of his principal, is not liable for conversion or for participation in breach of fiduciary duty although the principal [has] had no right [to dispose of them] so to deal with the securities.

Reasons for 1977 Change

The section which exonerates the agent or bailee who has made a good faith sale, pledge or delivery of certificated securities has been broadened to provide similar protection for similar parties engaging in similar activities with respect to uncertificated securities.

§ 8—319. Statute of Frauds

A contract for the sale of securities is not enforceable by way of action or defense unless:

(a) there is some writing signed by the party against whom enforcement is sought or by his authorized agent or broker, sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price; [or]

(b) delivery of [the] a certificated security or transfer instruction has been accepted, or transfer of an uncertificated security has been registered and the transferee has failed to send written objection to the issuer within 10 days after receipt of the initial transaction statement confirming the registration, or payment has been made, but the contract is enforceable under this provision only to the extent of [such] the delivery, registration, or payment; [or]

(c) within a reasonable time a writing in confirmation of the sale or purchase and sufficient against the sender under paragraph (a) has been received by the party against whom enforcement is sought and he has failed to send written objection to its contents within [ten] 10 days after its receipt; or

(d) the party against whom enforcement is sought admits in his pleading, testimony, or otherwise in court that a contract was made for the sale of a stated quantity of described securities at a defined or stated price.

Reasons for 1977 Change

This section extends the coverage of the statute of frauds to contracts for the sale of both certificated and uncertificated securities. The performance exceptions of paragraph (b) now include the acceptance of a transfer instruction by the alleged transferee and the registration of transfer of an uncertificated security to which registration the alleged transferee has not objected in writing within ten days after receiving the initial transaction statement confirming such registration. These additions, while necessary to enforcement against the alleged transferee, are unnecessary with respect to the transferor since each will almost certainly involve a writing signed by the transferor and thus will be within paragraph (a).

§ 8—320. Transfer or Pledge Within [a] Central Depository System

(1) In addition to other methods, a transfer, pledge, or release of a security or any interest therein may be effected by the making of appropriate entries on the books of a clearing corporation reducing the account of the transferor, pledgor, or pledgee and increasing the account of the transferee, pledgee, or pledgor by the amount of the obligation, or the number of shares or rights transferred, pledged, or released, if the security is shown on the account of a transferor, pledgor, or pledgee on the books of the clearing corporation; is subject to the control of the clearing corporation; and

(a) [(1)] if [a security] certificated,

(i) [(a)] is in the custody of [a] the clearing corpotion, another clearing corporation, [or of] a custodian bank or a nominee of [either subject to the instructions of the clearing corporation] any of them; and

(ii) [(b)] is in bearer form or indorsed in blank by an appropriate person or registered in the name of the clearing corporation, [or] a custodian bank, or a nominee of [either] any of them; or [and]

(b) if uncertificated, is registered in the name of the clearing corporation, another clearing corporation, a custodian bank, or a nominee of any of them;

[(c) is shown on the account of a transferor or pledgor on the books of the clearing corporation;

then, in addition to other methods, a transfer or pledge of the security or any interest therein may be effected by the making of appropriate entries on the books of the clearing corporation reducing the account of the transferor or pledgor and increasing the account of the transferee or pledgee by the amount of the obligation or the number of shares or rights transferred or pledged.]

(2) Under this section entries may be made with respect to like securities or interests therein as a part of a fungible bulk and may refer merely to a quantity of a particular security without reference to the name of the registered owner, certificate or bond number, or the like, and, in appropriate cases, may be on a net basis taking into account other transfers, [or] pledges, or releases of the same security.

(3) A transfer [or pledge] under this section [has the effect of a delivery of a security in bearer form or duly indorsed in blank (Section 8—301) representing the amount of the obligation or the number of shares or rights transferred or pledged] is effective (Section 8—313) and the purchaser acquires the rights of the transferor (Section 8—301). A pledge or release under this section is the transfer of a limited interest. If a pledge or the creation of a security interest is intended, [the making of entries has the effect of a taking of delivery by the pledgee or a secured party (Sections 9—304 and 9—305)] the security interest is perfected at the time when both value is given by the pledgee and the appropriate entries are made (Section 8—321). A transferee or pledgee under this section [is a holder] may be a bona fide purchaser (Section 8—302).

(4) A transfer or pledge under this section [does] is not [constitute] a registration of transfer under Part 4 [of this Article].

(5) That entries made on the books of the clearing corporation as provided in subsection (1) are not appropriate does not affect the validity or effect of the entries [nor] or the liabilities or obligations of the clearing corporation to any person adversely affected thereby.

Reasons for 1977 Change

Changes have been made in this section to make it applicable to certificated and uncertificated securities. This will affect the operation of securities depositories in three ways. First, it will enable participants to add to their accounts with the depository by the registration of transfer of uncertificated securities to the depository or its nominee in addition to the current method of delivering certificated securities in negotiable form. Secondly, it will permit the depository to maintain its holdings of securities in uncertificated form, thus reducing custodial problems. Finally, it will permit the depository to transfer uncertificated securities out to its participants by causing the registration of transfer, as an alternative to the current method of maintaining an inventory of certificated securities for that purpose.

Subsection (1) has been restructured to make it clear that it covers securities that clearing corporation A may control through its account in clearing corporation B. The growing system of interfacing depositories makes such clarification desirable.

Subsection (3) has been rewritten to address certain consequences directly, rather than merely by analogy to the physical delivery of certificated securities.

§ 8—321. Enforceability, Attachment, Perfection and Termination of Security Interests

(1) A security interest in a security is enforceable and can attach only if it is transferred to the secured party or a person designated by him pursuant to a provision of Section 8—313(1).

(2) A security interest so transferred pursuant to agreement by a transferor who has rights in the security to a transferee who has given value is a perfected security interest, but a security interest that has been transferred solely under paragraph (i) of Section 8—313(1) becomes unperfected after 21 days unless, within that time, the requirements for transfer under any other provision of Section 8—313(1) are satisfied.

(3) A security interest in a security is subject to the provisions of Article 9, but:

(a) no filing is required to perfect the security interest; and

(b) no written security agreement signed by the debtor is necessary to make the security interest enforceable, except as otherwise provided in paragraph (h), (i), or (j) of Section 8—313(1).

The secured party has the rights and duties provided under Section 9—207, to the extent they are applicable, whether or not the security is certificated, and, if certificated, whether or not it is in his possession.

(4) Unless otherwise agreed, a security interest in a security is terminated by transfer to the debtor or a person designated by him pursuant to a provision of Section 8—313(1). If a security is thus transferred, the security interest, if not terminated, becomes unperfected unless the security is certificated and is delivered to the debtor for the purpose of ultimate sale or exchange or presentation, collection, renewal, or registration of transfer. In that case, the security interest becomes unperfected after 21 days unless, within that time, the security (or securities for which it has been exchanged) is transferred to the secured party or a person designated by him pursuant to a provision of Section 8—313(1).

Reasons for 1977 Change

This is an entirely new section and is intended to govern the creation, perfection and termination of security interests in all securities, certificated and uncertificated. It is one of three sections in this revision in which it is intended to ex-

tend to coverage of Article 8 as to certificated securities. Sections 8—313 and 8—317 are the others. Several sections of Article 9 are made subject to or are affected by this section.

Subsection (1) provides that an effective transfer under Section 8—313(1) is an essential element to the creation of an enforceable security interest. Under present Section 9—203 (1), an enforceable security interest can be created without possession if there is a written security agreement signed by the debtor. Under this revision, Section 9—203(1) is expressly made subject to this section.

Subsection (2) provides that when value has been given and the debtor has rights in the collateral, an appropriate transfer will result not only in an enforceable security interest but also in one that is perfected. Under this revision, an unperfected security interest in a security cannot be created. A security interest created by transfer under Section 8—313 (1)(i), however, may become unperfected if, within 21 days, the requirements of another method of effective transfer are not satisfied. This produces the same result as present Section 9—304(4). Securities are expressly excluded from the coverage of Section 9—304(4).

Subsection (3) expressly makes a security interest in securities subject to the provisions of Article 9 except those provisions dealing with the creation and perfection of security interests. Those matters are governed by this section. In addition, the provisions of Section 9—207, which govern the rights and duties of the pledgee of a certificated security, are extended, to the extent they are applicable, to all secured parties, whether or not the possession of a certificated security is involved. Thus, in the absence of agreement to the contrary, the secured party, who might be the registered owner of an uncertificated security, would have the duty to remit dividends he received to the debtor or to apply them in reduction of the obligation under Section 9—207(2)(c).

Subsection (4) provides that a security interest is terminated by re-transfer to the debtor unless the parties otherwise agree. Even when the parties agree that the security interest is to continue, it will become unperfected unless there is delivery of a certificated security for the limited purposes described in the second sentence. This provision is intended to produce the same result as present Section 9—304(5) from the coverage of which securities are expressly excluded. The final sentence limits the continued perfection to a 21 day period, as does Section 9—304(5), and requires re-transfer to the secured party, in a manner analogous to Section 9—304 (6), as a condition of continued or renewed perfection.

PART 4

REGISTRATION

§ 8—401. Duty of Issuer to Register Transfer, Pledge, or Release

(1) [Where] If a certificated security in registered form is presented to the issuer with a request to register transfer[,] or an instruction is presented to the issuer with a request to register transfer, pledge, or release, the issuer [is under a duty to] shall register the transfer, pledge, or release as requested if:

(a) the security is indorsed or the instruction was originated by the appropriate person or persons (Section 8—308); [and]
(b) reasonable assurance is given that those indorsements or instructions are genuine and effective (Section 8—402); [and]
(c) the issuer has no duty [to inquire into] as to adverse claims or has discharged [any such] the duty (Section 8—403); [and]
(d) any applicable law relating to the collection of taxes has been complied with; and
(e) the transfer, pledge, or release is in fact rightful or is to a bona fide purchaser.

(2) [Where] If an issuer is under a duty to register a transfer, pledge, or release of a security, the issuer is also liable to the person presenting a certificated security or an instruction [it] for registration or his principal for loss resulting from any unreasonable delay in registration or from failure or refusal to register the transfer, pledge, or release.

Reasons for 1977 Change

Subsection (1) states the duty of the issuer to honor instructions to register the transfer, pledge or release of uncertificated securities in the same terms and with the same conditions that the present statute imposes with respect to the registration of transfer of certificated securities.

The issuer's liability under subsection (2) is extended to cover losses resulting from failure to take timely action with respect to instructions to transfer, pledge or release uncertificated securities.

§ 8—402. Assurance that Indorsements and Instructions Are Effective

(1) The issuer may require the following assurance that each necessary indorsement of a certificated security or each instruction (Section 8—308) is genuine and effective:

(a) in all cases, a guarantee of the signature ([subsection (1) of] Section 8—312(1) or (2)) of the person indorsing a certificated security or originating an instruction including, in the case of an instruction, a warranty of the taxpayer identification number or, in the absence thereof, other reasonable assurance of identity; [and]

(b) [where] if the indorsement is made or the instruction is originated by an agent, appropriate assurance of authority to sign;

(c) [where] if the indorsement is made or the instruction is originated by a fiduciary, appropriate evidence of appointment or incumbency;

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

(e) [where] if the indorsement is made or the instruction is originated by a person not covered by any of the foregoing, assurance appropriate to the case corresponding as nearly as may be to the foregoing.

(2) A "guarantee of the signature" in subsection (1) means a guarantee signed by or on behalf of a person reasonably believed by the issuer to be responsible. The issuer may adopt standards with respect to responsibility [provided such standards] if they are not manifestly unreasonable.

(3) "Appropriate evidence of appointment or incumbency" in subsection (1) means:

(a) in the case of a fiduciary appointed or qualified by a court, a certificate issued by or under the direction or supervision of that court or an officer thereof and dated within [sixty] 60 days before the date of presentation for transfer, pledge, or release; or

(b) in any other case, a copy of a document showing the appointment or a certificate issued by or on behalf of a person reasonably believed by the issuer to be responsible or, in the absence of [such a] that document or certificate, other evidence reasonably deemed by the

issuer to be appropriate. The issuer may adopt standards with respect to [such] the evidence [provided such standards] if they are not manifestly unreasonable. The issuer is not charged with notice of the contents of any document obtained pursuant to this paragraph (b) except to the extent that the contents relate directly to the appointment or incumbency.

(4) The issuer may elect to require reasonable assurance beyond that specified in this section, but if it does so and, for a purpose other than that specified in subsection (3)(b), both requires and obtains a copy of a will, trust, indenture, articles of co-partnership, by-laws, or other controlling instrument, it is charged with notice of all matters contained therein affecting the transfer, pledge, or release.

Reasons for 1977 Change

This section has been modified so as to permit the issuer to require, as a condition of honoring an instruction, precisely the same assurances and supplementary documentation as the present section permits the issuer to require as a condition of registering the transfer of a certificated security. In addition, under the last phrase of subparagraph (1)(a) the issuer may require either a warranty of the taxpayer identification number on an instruction as provided in Section 8—312(2)(d) or other evidence of identity.

§ 8—403. [Limited Duty of Inquiry] Issuer's Duty as to Adverse Claims

(1) An issuer to whom a certificated security is presented for registration [is under a duty to] shall inquire into adverse claims if:

(a) a written notification of an adverse claim is received at a time and in a manner [which affords] affording the issuer a reasonable opportunity to act on it prior to the issuance of a new, reissued, or re-registered certificated security, and the notification identifies the claimant, the registered owner, and the issue of which the security is a part, and provides an address for communications directed to the claimant; or

(b) the issuer is charged with notice of an adverse claim from a controlling instrument [which] it has elected to require under [subsection (4) of] Section 8—402(4).

(2) The issuer may discharge any duty of inquiry by any reasonable means, including notifying an adverse claimant by registered or certified mail at the address furnished by him or, if there be no such address, at his residence or regular place of business that the certificated security has been presented for registration of transfer by a named person, and that the transfer will be registered unless within [thirty] 30 days from the date of mailing the notification, either:

(a) an appropriate restraining order, injunction, or other process issues from a court of competent jurisdiction; or

(b) there is filed with the issuer an indemnity bond, sufficient in the issuer's judgment to protect the issuer and any transfer agent, registrar, or other agent of the issuer involved[,] from any loss [which] it or they may suffer by complying with the adverse claim [is filed with the issuer].

(3) Unless an issuer is charged with notice of an adverse claim from a controlling instrument which it has elected to require under [subsection (4) of] Section 8—402(4) or receives notification of an adverse claim under subsection (1) [of this section, where], if a certificated security presented for registration is indorsed by the appropriate person or persons the issuer is under no duty to inquire into adverse claims. In particular:

(a) an issuer registering a certificated security in the name of a person who is a fiduciary or who is described as a fiduciary is not bound to inquire into the existence, extent, or correct description of the fiduciary relationship; and thereafter the issuer may assume without inquiry that the newly registered owner continues to be the fiduciary until the issuer receives written notice that the fiduciary is no longer acting as such with respect to the particular security;

(b) an issuer registering transfer on an indorsement by a fiduciary is not bound to inquire whether the transfer is made in compliance with a controlling instrument or with the law of the state having jurisdiction of the fiduciary relationship, including any law requiring the fiduciary to obtain court approval of the transfer; and

(c) the issuer is not charged with notice of the contents of any court record or file or other recorded or unrecorded document even though the document is in its

possession and even though the transfer is made on the indorsement of a fiduciary to the fiduciary himself or to his nominee.

(4) An issuer is under no duty as to adverse claims with respect to an uncertificated security except:

(a) claims embodied in a restraining order, injunction, or other legal process served upon the issuer if the process was served at a time and in a manner affording the issuer a reasonable opportunity to act on it in accordance with the requirements of subsection (5);

(b) claims of which the issuer has received a written notification from the registered owner or the registered pledgee if the notification was received at a time and in a manner affording the issuer a reasonable opportunity to act on it in accordance with the requirements of subsection (5);

(c) claims (including restrictions on transfer not imposed by the issuer) to which the registration of transfer to the present registered owner was subject and were so noted in the initial transaction statement sent to him; and

(d) claims as to which an issuer is charged with notice from a controlling instrument it has elected to require under Section 8—402(4).

(5) If the issuer of an uncertificated security is under a duty as to an adverse claim, he discharges that duty by:

(a) including a notation of the claim in any statements sent with respect to the security under Sections 8—408(3), (6), and (7); and

(b) refusing to register the transfer or pledge of the security unless the nature of the claim does not preclude transfer or pledge subject thereto.

(6) If the transfer or pledge of the security is registered subject to an adverse claim, a notation of the claim must be included in the initial transaction statement and all subsequent statements sent to the transferee and pledgee under Section 8—408.

(7) Notwithstanding subsections (4) and (5), if an uncertificated security was subject to a registered pledge at the time the issuer first came under a duty as to a particular adverse claim, the issuer has no duty as to that claim if transfer of the

security is requested by the registered pledgee or an appropriate person acting for the registered pledgee unless:

(a) the claim was embodied in legal process which expressly provides otherwise;

(b) the claim was asserted in a written notification from the registered pledgee;

(c) the claim was one as to which the issuer was charged with notice from a controlling instrument it required under Section 8—402(4) in connection with the pledgee's request for transfer; or

(d) the transfer requested is to the registered owner.

Reasons for 1977 Change

The present law permits an adverse claimant to delay the registration of transfer of a certificated security by thirty days merely by sending a timely written notification to the issuer identifying the claimant, registered owner and issue and giving an address for communications. This rather loose procedure has not constituted a serious problem for two reasons. First, the transfer of a certificated security is effected by delivery and the rights of the parties are established before the security is presented to the issuer for registration. More significantly, the bona fide purchaser of a security takes free of adverse claims and claims known to the issuer need not be known to him.

The present system enables the claimant to assert his rights in court before the issuer lets a new certificated security loose which might find its way into the hands of a bona fide purchaser. He can effectively do so, of course, only when the rights of a bona fide purchaser have not already intervened, but, in that minority of instances, he does receive protection. Conversely, the ease with which a claimant can register his claim with the issuer is not a great burden on the owner since the clean certificate in his hands gives him the power to transfer to a bona fide purchaser free of the adverse claim. Thus, the present statute requires no notice to the owner when a claim is filed with the issuer and the claim has no effect on transactions until the certificate is presented for registration of transfer. By then, the effect is usually limited to mere delay.

With uncertificated securities, however, transfer does not take place until registration so that any mandated delay seriously impairs an owner's ability to sell or pledge his security. Since a prudent purchaser may not pay until he re-

ceives a clean initial transaction statement, the effect of a mere letter notifying the issuer of an adverse claim, however frivolous, would be disastrous. Because of this important difference, the rules of the present section, in subsections (1), (2) and (3) have been restated, unchanged, but limited to situations involving only certificated securities. New rules, applying only to uncertificated securities, are set forth in subsections (4), (5) and (6) and are intended to accommodate the interests of owners, purchasers, issuers and adverse claimants.

Subsection (4) states that an issuer has no duty as to adverse claims except in four described situations. Mere written notifications result in a duty only when they come from existing owners and pledgees and are analogous to stop payment orders on checks. There is a duty as to claims to which the security was subject when it was purchased by the present owner, a situation with which the owner is already familiar. There is a duty as to claims arising from the issuer's request for documentation under Section 8—402.

The significant difference is that claims asserted by third parties, in order to impose a duty on the issuer, must be supported by legal process. This will constitute assurance that the claim is not merely frivolous and that its assertion is more than harassment. In most cases the owner will have been notified and have had the opportunity to be heard. While claims thus asserted may ultimately be adjudged invalid, the owner will not be tied up by a bare written communication from the claimant. On the other hand, while a more substantial burden is imposed on the claimant, there is a channel through which he can assert his claim before the rights of a bona fide purchaser intervene.

Once it is established that the claim imposes a duty on the issuer, notations of the claim must be contained in all statements sent with respect to the security and registration of transfer or pledge must be refused unless the nature of the claim is consistent with transfer or pledge subject to the claim. When transfer or pledge is registered subject to the claim, the final sentence of subsection (5) requires that the claim be noted in all statements sent to the transferee or pledgee.

Subsection (7) deals with the situation where an uncertificated security is already subject to a registered pledge when the issuer first learns of an adverse claim as to which he has a duty. In that event, the registered pledgee who became such without notice of the claim may be a bona fide purchaser with the right to transfer the security free of the claim. That right cannot be curtailed by the claim of a third party (in-

cluding the registered owner) unless legal process embodying the claim expressly deals with the pledgee's interest. There is obviously no curtailment of the pledgee's right when the claim is asserted by the pledgee himself. It should be curtailed if the pledgee's right to obtain registration of transfer is called into question by a controlling instrument which the issuer elects to require before acting on the pledgee's request. Since the transfer to the registered owner is the equivalent of a release of the pledge, such a transfer should not terminate the issuer's duty as to the claim.

§ 8—404. Liability and Non-Liability for Registration

(1) Except as [otherwise] provided in any law relating to the collection of taxes, the issuer is not liable to the owner, pledgee, or any other person suffering loss as a result of the registration of a transfer, pledge, or release of a security if:

(a) there were on or with [the] a certificated security the necessary indorsements or the issuer had received an instruction originated by an appropriate person (Section 8—308); and

(b) the issuer had no duty [to inquire into] as to adverse claims or has discharged [any such] the duty (Section 8—403).

(2) [Where] If an issuer has registered a transfer of a certificated security to a person not entitled to it, the issuer on demand [must] shall deliver a like security to the true owner unless:

(a) the registration was pursuant to subsection (1); [or]

(b) the owner is precluded from asserting any claim for registering the transfer under [subsection (1) of the following section] Section 8—405(1); or

(c) [such] the delivery would result in overissue, in which case the issuer's liability is governed by Section 8—104.

(3) If an issuer has improperly registered a transfer, pledge, or release of an uncertificated security, the issuer on demand from the injured party shall restore the records as to the injured party to the condition that would have obtained if the improper registration had not been made unless:

(a) the registration was pursuant to subsection (1); or

(b) the registration would result in overissue, in which case the issuer's liability is governed by Section 8—104.

Reasons for 1977 Change

Subsection (1) exonerates the issuer from liability to any person arising from registration of transfer, pledge or re-

lease of an uncertificated security under the same conditions that the present statute provides with respect to the registration of transfer of a certificated security.

The remedy for improper registration under subsection (2), i. e., the delivery of a like security to the true owner, is inapplicable to uncertificated securities. Thus, subsection (3) provides an analogous remedy for uncertificated securities, the restoration of the records to their proper condition. The same exception is made in the event of overissue. The exception of paragraph (2)(b) is inapplicable to uncertificated securities which, by definition, cannot be lost, destroyed or stolen, and is omitted from subsection (3).

§ 8—405. Lost, Destroyed, and Stolen Certificated Securities

(1) [Where] If a certificated security has been lost, apparently destroyed, or wrongfully taken, and the owner fails to notify the issuer of that fact within a reasonable time after he has notice of it and the issuer registers a transfer of the security before receiving [such a] notification, the owner is precluded from asserting against the issuer any claim for registering the transfer under [the preceding section] Section 8—404 or any claim to a new security under this section.

(2) [Where] If the owner of [the] a certificated security claims that the security has been lost, destroyed, or wrongfully taken, the issuer [must] shall issue a new certificated security or, at the option of the issuer, an equivalent uncertificated security in place of the original security if the owner:

(a) so requests before the issuer has notice that the security has been acquired by a bona fide purchaser; [and]

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

(c) satisfies any other reasonable requirements imposed by the issuer.

(3) If, after the issue of [the] a new certificated or uncertificated security, a bona fide purchaser of the original certificated security presents it for registration of transfer, the issuer [must] shall register the transfer unless registration would result in overissue, in which event the issuer's liability is governed by Section 8—104. In addition to any rights on the indemnity bond, the issuer may recover the new certificated security from the person to whom it was issued or any person taking under him

except a bona fide purchaser or may cancel the uncertificated security unless a bona fide purchaser or any person taking under a bona fide purchaser is then the registered owner or registered pledgee thereof.

Reasons for 1977 Change

Subsection (1) is applicable only to certificated securities, since only they can be lost, destroyed or stolen.

Subsection (2) permits the issuer to satisfy his obligation to replace a lost, destroyed or stolen certificated security by issuing a replacement in either certificated or uncertificated form. Such alternatives exist only when the particular issue is partly certificated and partly uncertificated. In that event, the owner may have the privilege of exchanging one for the other under Section 8—407, thus placing the ultimate option with him. Compare explanation of changes under Section 8—104.

§ 8—406. Duty of Authenticating Trustee, Transfer Agent, or Registrar

(1) [Where] If a person acts as authenticating trustee, transfer agent, registrar, or other agent for an issuer in the registration of transfers of its certificated securities or in the registration of transfers, pledges, and releases of its uncertificated securities, [or] in the issue of new securities, or in the cancellation of surrendered securities:

(a) he is under a duty to the issuer to exercise good faith and due diligence in performing his functions; and

(b) [he has] with regard to the particular functions he performs, he has the same obligation to the holder or owner of [the] a certificated security or to the owner or pledgee of an uncertificated security and has the same rights and privileges as the issuer has in regard to those functions.

(2) Notice to an authenticating trustee, transfer agent, registrar or other [such] agent is notice to the issuer with respect to the functions performed by the agent.

Reasons for 1977 Change

The coverage of this section is broadened to include the agents of the issuers of both certificated and uncertificated securities.

§ 8—407. Exchangeability of Securities

(1) No issuer is subject to the requirements of this section unless it regularly maintains a system for issuing the class of securities involved under which both certificated and uncertificated securities are regularly issued to the category of owners, which includes the person in whose name the new security is to be registered.

(2) Upon surrender of a certificated security with all necessary indorsements and presentation of a written request by the person surrendering the security, the issuer, if he has no duty as to adverse claims or has discharged the duty (Section 8—403), shall issue to the person or a person designated by him an equivalent uncertificated security subject to all liens, restrictions, and claims that were noted on the certificated security.

(3) Upon receipt of a transfer instruction originated by an appropriate person who so requests, the issuer of an uncertificated security shall cancel the uncertificated security and issue an equivalent certificated security on which must be noted conspicuously any liens and restrictions of the issuer and any adverse claims (as to which the issuer has a duty under Section 8—403(4)) to which the uncertificated security was subject. The certificated security shall be registered in the name of and delivered to:

(a) the registered owner, if the uncertificated security was not subject to a registered pledge; or
(b) the registered pledgee, if the uncertificated security was subject to a registered pledge.

Reasons for 1977 Change

This is an entirely new section which deals with the right of the holder of a certificated security to exchange it for an equivalent uncertificated security and the right of the registered owner or registered pledgee of an uncertificated security to obtain a certificated security in exchange for it. This section is applicable only in those situations where both certificated and uncertificated securities exist within the same issue and either form is available to the particular owner. Subsection (1) so limits its applicability.

Neither this nor any other section of this Article is intended to mandate the establishment or continuance of a dual system of registration. It is contemplated that some issuers may provide for both forms of securities on a more or less indefinite basis. Issuers of existing issues which are neces-

sarily wholly certificated may make uncertificated securities available with the intention to phase out the certificated securities over a period of time. Some issuers, if permitted by relevant law, may restrict the availability of uncertificated securities to particular categories of owners, e. g., brokers, banks and institutions.

Subsections (2) and (3) establish the mechanism for exchange. When a certificated security is surrendered for exchange and the issuer has a duty as to adverse claims, that duty must be discharged before an equivalent uncertificated security can be issued. When an instruction requests the issuance of a certificated security in exchange for an uncertificated security, adverse claims as to which the issuer has a duty are to be noted conspicuously thereon. In either case, the existence of the issuer's duty is determined by the provisions of Section 8—403.

§ 8—408. Statements of Uncertificated Securities

(1) Within 2 business days after the transfer of an uncertificated security has been registered, the issuer shall send to the new registered owner and, if the security has been transferred subject to a registered pledge, to the registered pledgee a written statement containing:

(a) a description of the issue of which the uncertificated security is a part;

(b) the number of shares or units transferred;

(c) the name and address and any taxpayer identification number of the new registered owner and, if the security has been transferred subject to a registered pledge, the name and address and any taxpayer identification number of the registered pledgee;

(d) a notation of any liens and restrictions of the issuer and any adverse claims (as to which the issuer has a duty under Section 8—403(4)) to which the uncertificated security is or may be subject at the time of registration or a statement that there are none of those liens, restrictions, or adverse claims; and

(e) the date the transfer was registered.

(2) Within 2 business days after the pledge of an uncertificated security has been registered, the issuer shall send to the

registered owner and the registered pledgee a written statement containing:

(a) a description of the issue of which the uncertificated security is a part;

(b) the number of shares or units pledged;

(c) the name and address and any taxpayer identification number of the registered owner and the registered pledgee;

(d) a notation of any liens and restrictions of the issuer and any adverse claims (as to which the issuer has a duty under Section 8—403(4)) to which the uncertificated security is or may be subject at the time of registration or a statement that there are none of those liens, restrictions, or adverse claims; and

(e) the date the pledge was registered.

(3) Within 2 business days after the release from pledge of an uncertificated security has been registered, the issuer shall send to the registered owner and the pledgee whose interest was released a written statement containing:

(a) a description of the issue of which the uncertificated security is a part;

(b) the number of shares or units released from pledge;

(c) the name and address and any taxpayer identification number of the registered owner and the pledgee whose interest was released;

(d) a notation of any liens and restrictions of the issuer and any adverse claims (as to which the issuer has a duty under Section 8—403(4)) to which the uncertificated security is or may be subject at the time of registration or a statement that there are none of those liens, restrictions or adverse claims; and

(e) the date the release was registered.

(4) An "initial transaction statement" is the statement sent to:

(a) the new registered owner and, if applicable, to the registered pledgee pursuant to subsection (1);

(b) the registered pledgee pursuant to subsection (2); or

(c) the registered owner pursuant to subsection (3).

Each initial transaction statement shall be signed by or on behalf of the issuer and must be identified as "Initial Transaction Statement".

(5) Within 2 business days after the transfer of an uncertificated security has been registered, the issuer shall send to the former registered owner and the former registered pledgee, if any, a written statement containing:

(a) a description of the issue of which the uncertificated security is a part;

(b) the number of shares or units transferred;

(c) the name and address and any taxpayer identification number of the former registered owner and of any former registered pledgee; and

(d) the date the transfer was registered.

(6) At periodic intervals no less frequent than annually and at any time upon the reasonable written request of the registered owner, the issuer shall send to the registered owner of each uncertificated security a dated written statement containing:

(a) a description of the issue of which the uncertificated security is a part;

(b) the name and address and any taxpayer identification number of the registered owner;

(c) the number of shares or units of the uncertificated security registered in the name of the registered owner on the date of the statement;

(d) the name and address and any taxpayer identification number of any registered pledgee and the number of shares or units subject to the pledge; and

(e) a notation of any liens and restrictions of the issuer and any adverse claims (as to which the issuer has a duty under Section 8—403(4)) to which the uncertificated security is or may be subject or a statement that there are none of those liens, restrictions, or adverse claims.

(7) At periodic intervals no less frequent than annually and at any time upon the reasonable written request of the registered pledgee, the issuer shall send to the registered pledgee of each uncertificated security a dated written statement containing:

(a) a description of the issue of which the uncertificated security is a part;

(b) the name and address and any taxpayer identification number of the registered owner;

(c) the name and address and any taxpayer identification number of the registered pledgee;

(d) the number of shares or units subject to the pledge; and

(e) a notation of any liens and restrictions of the issuer and any adverse claims (as to which the issuer has a duty under Section 8—403(4)) to which the uncertificated security is or may be subject or a statement that there are none of those liens, restrictions, or adverse claims.

(8) If the issuer sends the statements described in subsections (6) and (7) at periodic intervals no less frequent than quarterly, the issuer is not obliged to send additional statements upon request unless the owner or pledgee requesting them pays to the issuer the reasonable cost of furnishing them.

(9) Each statement sent pursuant to this section must bear a conspicuous legend reading substantially as follows: "This statement is merely a record of the rights of the addressee as of the time of its issuance. Delivery of this statement, of itself, confers no rights on the recipient. This statement is neither a negotiable instrument nor a security."

Reasons for 1977 Change

This is an entirely new section which obliges the issuer of uncertificated securities to send certain statements. The required statements are of two types. Transaction statements, required by subsections (1), (2), (3) and (5), are analogous to debit and credit advices and the periodic statements can be reconciled from them. Periodic statements, required by subsections (6) and (7) are analogous to bank statements and will advise owners and pledgees of their positions at given points in time.

The transaction statements, which are mandated upon the registration of transfer, pledge or release, must be sent within two days after the relevant registration, but it is contemplated that such statements will be prepared virtually simultaneously with the actual registration and sent immediately thereafter.

The transaction statements are intended to serve two functions. They are notice to the transferor (the owner in the case of a transfer or pledge or the pledgee in the case of a release or the transfer of a security subject to a pledge) that his interest has been reduced. In the event of fraudulent, unauthorized or otherwise improper registration, the transaction statement will serve as notice that timely action should be taken.

More importantly, these statements are notice to the transferee (new owner in the case of a transfer, pledgee in the case of a pledge, present owner in the case of a release) that the increase of his interest has, in fact, been registered. Furthermore, since all statements except those required by subsection (5) must include a notation of defects or an express statement that there are none, these statements will give the transferee the assurance equivalent to that afforded by a "clean" certificated security and create an estoppel against the issuer.

It is contemplated that transferees will and should be able to rely on these statements and, in many cases, will not part with their consideration until they receive them. In order that they will have the desired effect of establishing rights for the transferee against the issuer, subsection (4) requires that the copy of each transaction statement sent to the transferee, called an "initial transaction statement," be signed. Note that Section 1—201(39) does not require a manual signature for compliance with this requirement. Compare also Sections 8—103(b), 8—105(3)(d), 8—202, 8—204(b), 8—205, 8—206, 8—208, 8—304 and 8—313(3) for the effects of initial transaction statements.

The frequency of one year, with which periodic statements must be sent to owners and pledgees, is intended to be a minimum requirement for all issuers, including closely held corporations. Owners and pledgees are entitled to request additional statements of position at any time. It is contemplated, however, that publicly held issuers will adopt the practice of sending quarterly statements conforming to the common practice of sending quarterly reports and dividend checks. For those that do, subsection (8) eliminates the obligation to furnish additional statements of position on request unless the issuer is reimbursed for the additional cost.

Subsection (9) requires a conspicuous legend to be borne by each statement as a protection against unjustified reliance on statements of uncertificated securities by persons who might deal with them. Other than the aforesaid legend, the form of the statements required by this section is not prescribed. Perhaps the forms now used by the transfer agents of mutual funds to confirm acquisitions, dispositions, reinvestment of dividends, periodic liquidations and statements of position might serve as a model.

Amendments to Article 9 (1972 Official Text)

§ 9—103. Perfection of Security Interests in Multiple State Transactions

* * *

(3) Accounts, general intangibles and mobile goods.

(a) This subsection applies to accounts (other than an account described in subsection (5) on minerals) and general intangibles (other than uncertificated securities) and to goods. . . .

* * *

(6) Uncertificated securities.

The law (including the conflict of laws rules) of the jurisdiction of organization of the issuer governs the perfection and the effect of perfection or non-perfection of a security interest in uncertificated securities.

Reasons for 1977 Change

Uncertificated securities are included in the definition of "General intangibles" under Section 9—106. Since the perfection of a security interest in an uncertificated security is normally accomplished by registration of pledge or transfer under Article 8, uncertificated securities are excluded from the coverage of subsection (3) under which the location of the debtor would govern. New subsection (6) prescribes the law of the issuer's jurisdiction of organization as the governing law, consistent with Section 8—106.

§ 9—105. Definitions and Index of Definitions

(1) In this Article unless the context otherwise requires:

* * *

(i) "Instrument" means a negotiable instrument (defined in Section 3—104), or a certificated security (defined in Section 8—102) or . . .

* * *

Reasons for 1977 Change

Because Section 8—102 now defines "security" as either a certificated or an uncertificated security, the word "certificated" is inserted to limit the definition only to those securities which are represented by instruments.

§ 9—203. Attachment and Enforceability of Security Interest; Proceeds; Formal Requisites

(1) Subject to the provisions of Section 4—208 on the security interest of a collecting bank, Section 8—321 on security interests in securities and Section 9—113 on a security interest arising under the Article on Sales, a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless:

(a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned; [and]

(b) value has been given; and

(c) the debtor has rights in the collateral.

* * *

Reasons for 1977 Change

The added language in subsection (1) expressly makes this section subject to Section 8—321. Section 8—321(1) provides that an enforceable security interest in a security can be created only by a transfer which complies with Section 8—313(1).

It should be noted that both subsection (1) of this section and Section 8—321(2) contain the requirements that value be given and that the debtor have rights in the collateral. Subparagraph (1)(a) of this section, however, requires either possession by the secured party or a security agreement signed by the debtor. Of the various provisions of Section 8—313(1), some require possession by the secured party, some require a signed security agreement and the rest require procedures which are functionally equivalent to possession.

It is intended that compliance with some provision of Section 8—313(1) is essential to the creation of an enforceable security interest in a security and, conversely, that compliance with the requirements of subsection (1) of this section will not, of itself, suffice.

§ 9—302. When Filing is Required to Perfect Security Interest; Security Interests to Which Filing Provisions of This Article Do Not Apply

(1) A financing statement must be filed to perfect all security interest[s] except the following:

* * *

(f) a security interest of a collecting bank (Section 4—208) or in securities (Section 8—321) or arising under the Article on Sales (see Section 9—113) or covered in subsection (3) of this section;

* * *

Reasons for 1977 Change

Section 8—321(2) provides that security interests in securities created in accordance with its provisions are perfected. Since none of its provisions, including the provisions of Section 8—313(1) incorporated therein, require filing, security interests in securities are excepted from the normal filing requirements of Article 9 by the language added to subparagraph (1)(f) of this section. Note that most of the requirements of Section 8—313(1) involve either possession or its functional equivalent.

§ 9—304. Perfection of Security Interest in Instruments, Documents, and Goods Covered by Documents; Perfection by Permissive Filing; Temporary Perfection Without Filing or Transfer of Possession

(1) A security interest in chattel paper or negotiable documents may be perfected by filing. A security interest in money or instruments (other than certificated securities or instruments which constitute part of chattel paper) can be perfected only by the secured party's taking possession, except as provided in subsections (4) and (5) of this section and subsections (2) and (3) of Section 9—306 on proceeds.

* * *

(4) A security interest in instruments (other than certificated securities) or negotiable documents is perfected without filing or the taking of possession for a period of 21 days from the time it attaches to the extent that it arises for new value given under a written security agreement.

(5) A security interest remains perfected for a period of 21 days without filing where a secured party having a perfected security interest in an instrument (other than a certificated security), a negotiable document or goods in possession of a bailee other than one who has issued a negotiable document therefor:

* * *

(b) delivers the instrument to the debtor for the purpose of ultimate sale or exchange or of presentation, collection, renewal, or registration of transfer.

(6) After the 21 day period in subsections (4) and (5) perfection depends upon compliance with applicable provisions of this Article.

Reasons for 1977 Change

The definition of "instrument" in Section 9—105(1)(i) includes a certificated security and the perfection of security interests in all securities is governed by Section 8—321. Hence, certificated securities are expressly excluded from this section.

Note that a perfected security interest under Section 8—321 must be created by a transfer under Section 8—313(1) which, when certificated securities are involved, requires possession or a functional equivalent thereof. The 21 day initial grace period of subsection (4) is reflected in Section 8—313(1)(i) and the reference thereto in Section 8—321(2). The 21 day grace period of subsection (5) is reflected in Section 8—321 (4).

§ 9—305. When Possession by Secured Party Perfects Security Interest Without Filing

A security interest in letters of credit and advices of credit (subsection (2)(a) of Section 5—116), goods, instruments (other than certificated securities), money, negotiable documents, or chattel paper may be perfected by the secured party's taking possession of the collateral. If such collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest. A security interest is perfected by possession from the time possession is taken without relation back and continues only so long as possession is retained, unless otherwise specified in this Article. The security interest may be otherwise perfected as provided in this Article before or after the period of possession by the secured party.

Reasons for 1977 Change

The definition of "instrument" in Section 9—105(1)(i) includes a certificated security and the perfection of security interests in all securities is governed by Section 8—321. Hence, certificated securities are expressly excluded from this section.

The typical pledge of a certificated security is unaffected by this change since Section 8—313(1)(a) provides for transfer by delivery and Section 8—321(2) provides that a security interest thus transferred is perfected. Section 9—305 has been relied on to perfect security interests in securities in the hands of third parties (first pledgees, brokers, custodian banks, etc.) by notifying such third parties and assuming that they are bailees of certificated securities. When certificated securities have been repledged, held in nominee name or deposited in a securities depository, there is some doubt as to the identity of the bailee or, indeed, whether there is even an instrument that can be identified as the subject matter of the security interest.

The transfer rules of Section 8—313(1), which are incorporated in Section 8—321, are intended to settle such questions with respect to both certificated securities and uncertificated securities, which, by definition, cannot be "possessed." Note that Section 8—313(1)(h) deals explicitly with the problem of perfection by notice, provides that the notice be signed by the debtor-transferor and identifies the proper party to be notified.

§ 9—309. Protection of Purchasers of Instruments [and], Documents and Securities

Nothing in this Article limits the rights of a holder in due course of a negotiable instrument (Section 3—302) or a holder to whom negotiable document of title has been duly negotiated (Section 7—501) or a bona fide purchaser of a security (Section [8—301] 8—302) and such holders or purchasers take priority over an earlier security interest even though perfected. Filing under this Article does not constitute notice of the security interest to such holders or purchasers.

Reasons for 1977 Change

This section presently resolves the conflict which may result when a financial intermediary or secured party wrongfully transfers a certificated security he controls. Since the term "security" now includes, under revised Section 8—

102, uncertificated securities, this section will also cover the situation where a financial intermediary or secured party who is the registered owner or registered pledgee of an uncertificated security wrongfully causes the registration of transfer or pledge. In either case, a bona fide purchaser (including a pledgee) from the financial intermediary or secured party will prevail over a secured creditor of the beneficial owner who has created and perfected his security interest by notice to or acknowledgment from the wrongful transferor under Section 8—321.

§ 9—312. Priorities Among Conflicting Security Interests in the Same Collateral

* * *

(7) If future advances are made while a security interest is perfected by filing [or], the taking of possession, or under Section 8—321 on securities, the security interest has the same priority for the purposes of subsection (5) with respect to the future advances as it does with respect to the first advance. If a commitment is made before or while the security interest is so perfected, the security interest has the same priority with respect to advances made pursuant thereto. In other cases a perfected security interest has priority from the date the advance is made.

* * *

Reasons for 1977 Change

The insertion in subsection (7) protects the future advances of a secured party who has perfected his security interest in securities under Section 8—321 even if the method did not involve his taking possession of the collateral.

Changes in Articles 1 and 5

§ 1—201. General Definitions

Subject to additional definitions contained in the subsequent Articles of this Act which are applicable to specific Articles or Parts thereof, and unless the context otherwise requires, in this Act:

* * *

(5) "Bearer" means the person in possession of an instrument, document of title, or certificated security payable to bearer or indorsed in blank.

* * *

(14) "Delivery" with respect to instruments, documents of title, chattel paper, or certificated securities means voluntary transfer of possession.

* * *

(20) "Holder" means a person who is in possession of a document of title or an instrument or [an] a certificated investment security drawn, issued, or indorsed to him or his order or to bearer or in blank.

* * *

§ 5—114. Issuer's Duty and Privilege to Honor; Right to Reimbursement

* * *

(2) Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (Section 7—507) or of a certificated security (Section 8—306) or is forged or fraudulent or there is fraud in the transaction:

(a) the issuer must honor the draft on demand for payment if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course (Section 3—302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (Section 7—502) or a bona fide purchaser of a certificated security (Section 8—302); and

* * *

Reasons for 1977 Change

The foregoing insertions of the word "certificated" in two sections of Articles other than Articles 8 and 9 are made in order to conform to the new definitions in Section 8—102. Without modification, the term "security" would include uncertificated securities as well as certificated securities.

REPORTER'S INTRODUCTORY COMMENT

This proposed revision of Article 8 of the Uniform Commercial Code is an outgrowth of the work of the Committee on Stock Certificates of the Section of Corporation, Banking and Business Law of the American Bar Association. That committee, formed in 1971 in response to the "Paperwork Crunch" in the securities markets during the late 1960's, was charged with determining what legislation, if any, would be advisable to facilitate the elimination, or reduction in the use, of stock certificates and with drafting such legislation as was proposed. The committee's report, issued on September 15, 1975, contained two principal recommendations: 1) that the Model Business Corporation Act be amended in order to permit the issuance of corporate stock in uncertificated form and 2) that Article 8 of the Uniform Commercial Code (and related sections of other Articles) be revised to provide rules to regulate the rights, duties and obligations of the issuers of, and persons dealing with, uncertificated investment securities. Appendix B of the report was a suggested revision of Article 8.

The suggested revision of Article 8 was submitted by the committee to the Permanent Editorial Board for the Uniform Commercial Code which, in turn, referred it to its 348 Committee for review and comment. The revision, with changes suggested by the 348 Committee, was subsequently reviewed by the Permanent Editorial Board and further drafts were presented before the 1976 meeting of the National Conference of Commissioners on Uniform State Laws, the Council of the American Law Institute and the 1977 Annual Meeting of the American Law Institute. At its 1977 meeting, the NCCUSL approved the substance of the revision and referred it to its Committee on Style. That committee made a number of stylistic changes in wording, punctuation and the like, and its product is presented herewith.

In this introductory comment, section references are to the revised Article unless preceded by the word "present". Detailed "Reasons for 1977 Change" follow almost every section of the revision, but the pattern is summarized in this introductory comment in the hope that it will be helpful to an understanding of the general scheme of the revision.

APPENDIX

Scope

Perhaps the best approach to describing the scope of the revision is first to state what it does *not* do. The revision does not compel the issuance of uncertificated securities by any issuer. Furthermore, the revision does not authorize the issuance of uncertificated securities, a function of the state corporation laws. What the revision is intended to accomplish is to set forth a coherent group of rules for the issuers, buyers, sellers and other persons dealing with uncertificated securities, to the same extent that present Article 8 deals with these matters with respect to certificated securities. Although the primary focus of inquiry regarding the possible elimination of certificates has been on corporate stock, the revision is broad enough to cover uncertificated debt securities, should such be issued in the future. It might be noted that the most significant uncertificated system now in operation is that conducted by the Federal Reserve Banks for United States Government Bonds. It is possible, and, indeed, probable, that particular issues of securities may, temporarily or even permanently, be partly certificated and partly uncertificated. If such be the case, the choice of form will lie with the owner and provisions are made for exchangeability at the owner's option [8—407].

The present definition of "security" [present 8—102(1)(a)] is restated, in somewhat changed form but without intended change of substance, as the definition of "certificated security" [8—102(1)(a)]. A parallel definition of "uncertificated security" is then provided, differing in that it does not require representation by an instrument and somewhat narrower in scope to eliminate the inclusion of some interests, *e. g.*, bank accounts, that a broad construction might otherwise include [8—102(1)(b)]. It is not intended that either definition coincide with the definition of "security" for other purposes, *e. g.*, the federal securities laws. See Comment 3 to Section 8—102.

Approach

There has been a conscious attempt to disturb present Article 8 as little as possible. First, the subject-matter content and order of the forty-one numbered sections of the present statute have been preserved. Only four sections have been added. Three of these have no application to wholly certificated systems [8—108, 8—407 & 8—408].

Secondly, with the exception of only two present sections [8—313 & 8—317] and the other new section [8—321], there has been no attempt to change the law with respect to certificated securities. In some instances, where there seemed to be compelling reasons to do so, certain wording and structure have been changed, but without any intention to change the substance. In most instances, the language of the present Article, as it applies to certificated securities, has been preserved with minor stylistic changes.

1977 AMENDMENTS

Finally, the rules governing uncertificated securities have been formulated to conform as closely as possible to the rules for certificated securities, consistent, of course, with such changes as are demanded by the absence of an indispensable instrument. For example, the rights of secured parties [8—207], the "appropriate person" to initiate requests for registration of transfer [8—308] and the assurances an issuer may require as a condition to complying with such requests [8—402] have been structured in a way to produce a minimum of disparity of results and procedures whether certificated or uncertificated securities are involved.

Transfer

The essential difference between a certificated and an uncertificated security, and that from which the principal difficulties arise, is that the former is represented by an instrument, which may be treated as the property it represents, and the latter is not. Under present Article 8, transfer of a certificated security by purchase, a term which includes all voluntary transfers whether or not for value [present 1—201(32)], is accomplished by delivery of the certificated security to the purchaser [present 8—301 (1)] or by some other method deemed to constitute delivery to the purchaser [present 8—313(1)]. Obviously, when a security is uncertificated, there is no instrument to deliver.

In the revised Article, the transfer rules are collected in a single subsection [8—313(1)] and are expressly made exclusive. The basic rule for certificated securities, transfer by delivery, is restated [8—313(1)(a)] and a coordinate rule for uncertificated securities, transfer by registration, is added [8—313(1)(b)]. The present rule, that delivery to the purchaser's broker of a certificated security issued in the name of or specially indorsed to the purchaser constitutes transfer to the purchaser, is preserved [8—313(1)(c)], but is expanded to cover such delivery not only to the purchaser's broker but to any financial intermediary acting for the purchaser. A "financial intermediary" is defined to include (in addition to brokers) banks, clearing corporations and other entities which regularly maintain security accounts for their customers [8—313(4)].

The remaining subparagraphs recognize current security-holding practices and provide explicitly for the transfer of ownership of both certificated and uncertificated securities controlled by third parties. Thus, when the controlling party is a clearing corporation [8—102(3)], transfer is effected merely by book entry [8—313(1)(g)]. When the controlling party is a financial intermediary, but not a clearing corporation, transfer is effected by confirmation to the purchaser accompanied by book entry [8—313(1)(d)]. When the controlling party is not a financial intermediary, transfer is effected by acknowledgment to the purchaser [8—313(1)(e) & (f)]. Three provisions apply only to the creation and release of security interests [8—313(1)(h), (i) & (j)].

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Registration of Transfer

Registration of transfer of a certificated security is requested by presenting the security itself, duly indorsed, to the issuer [8—401(1)]. With uncertificated securities that procedure is unavailable, and the request for registration of transfer is made by an "instruction" [8—308(4)] which normally will be a signed writing [8—308(5)(a)] but which may, under the terms of a written agreement, be in other than written form [8—308(5)(b)]. To be effective, an instruction must be originated by an "appropriate person" who, for an unencumbered security, is the registered owner or his representative [8—308(7)(a) & (8)].

Upon receipt of an instruction, the issuer is under a duty to effect a duly requested registration [8—401(1)], liable for delay or failure to comply [8—401(2)], entitled to certain assurances [8—402], and liable for improper registration [8—404(3)] in much the same manner applicable to requests for registration of transfer of a certificated security.

Within two business days after registration of transfer of an uncertificated security, the issuer must send a written statement confirming the registration to both the transferor [8—408(5)] and the transferee [8—408(1)]. The statement sent to the transferor will alert him to take appropriate action if the transfer was unauthorized or otherwise improper. The statement sent to the transferee will assure him that the transfer has been properly registered and will also serve as notice to him of any liens [8—103(b)], restrictions [8—204(b)] or claims [8—304(2)] to which the uncertificated security may be subject. Unless a transferee for value is relying on a third party, *e. g.*, his broker, it is anticipated that he may withhold his consideration, in escrow or otherwise, until he receives an appropriate statement from the issuer.

Creation of Security Interests

A security interest in a certificated security is normally created by delivery (pledge) of the security, duly indorsed, to the secured party (pledgee). The physical procedure is indistinguishable from an outright transfer. The pledgee may elect to leave the security registered in the name of the debtor or to cause the registration of transfer to himself or his nominee.

A security interest in an uncertificated security may be created by registration of transfer to the secured party, a procedure which involves no concepts distinct from those involved in any outright transfer of an uncertificated security. The secured party will be in essentially the same position as the pledgee of a certificated security who obtains registration of transfer to himself.

This revision provides an additional method for evidencing a security interest in an uncertificated security—registration of pledge [8—108]. This is intended to create a situation analogous to that when the pledgee of a certificated security leaves

the security registered in the debtor's name. Registration of pledge is effected by submission of an instruction [8—308(4)] to the issuer, originated by the registered owner or his representative [8—308(7)(a) & (8)]. The procedure for registration follows that established for registration of transfer. The issuer is obligated to send confirmatory statements to the pledgee and owner immediately following registration [8—408(2)] and the pledgee, like the buyer, may choose to await receipt of the statement before advancing the loan.

Once a pledge has been registered, the registered owner continues to enjoy all the rights of an owner (dividends, voting rights, notices, etc.) [8—207(2)] except one—the power to order transfer. That power passes exclusively to the registered pledgee [8—207(3)] and only the pledgee or his representative is an appropriate person to originate a transfer instruction [8—308(7)(b) & (8)]. This is substantially the situation that exists when a certificated security is pledged. The still registered owner is recognized as such by the issuer [8—207(1)], but the pledgee's possession of the duly indorsed certificate achieves the dual purpose of depriving the debtor of his power to transfer and conferring that power on the pledgee. The registered pledgee of an uncertificated security may exercise his transfer power in three ways: by outright transfer free of his pledge [8—207(4)(a)]; by transfer of ownership subject to his pledge [8—207(4)(b)]; or by transfer of his security interest to another secured party [8—207(4)(c)].

There is one area of disparity between the pledge of a certificated security and the registered pledge of an uncertificated security. When a certificated security is held by a pledgee without registration of transfer, additional securities distributed with respect to the pledged security, *e. g.*, stock dividends, will necessarily be delivered to the registered owner, since the issuer is unaware of the pledgee's interest. When an uncertificated security is subject to a registered pledge, such additional securities will, if uncertificated, be registered subject to the pledge [8—207(6)(a)] or, if certificated, will be delivered to the pledgee [8—207(6)(b)]. This appears to be a desirable result which is impractical to obtain under the pledge of a certificated security. Similarly, securities issued or money paid in exchange for an uncertificated security will be subject to the pledgee's control [8—207(6)].

Under the revised Article, the transfer rules are exclusive and expressly include the transfer of security interests [8—313(1)]. Thus, the creation of security interests is conditioned upon the use of an effective means of transfer [8—321(1)]. The transfer rules include the physical delivery of a certificated security [8—313(1)(a)] and the registration of either pledge or transfer of an uncertificated security [8—313(1)(b)]. They also include provisions when securities are controlled by third parties. When the controlling party is a clearing corporation [8—102(3)], transfer is effected by book entry [8—313(1)(g)]. When the controlling party is a financial intermediary [8—313(4)], but

not a clearing corporation, transfer is effected by confirmation to the secured party accompanied by a book entry [8—313(1)(d)]. When the controlling party is not a financial intermediary, *e. g.*, a prior pledgee, transfer is effected by acknowledgment to the secured party [8—313(1)(e) & (f)]. Security interests created by any of these methods are enforceable even without a written agreement signed by the debtor [8—321(2)] since they involve either possession by the secured party or the functional equivalent thereof.

In addition, three methods of transfer, applicable only to the creation of security interests, are provided [8—313(1)(h), (i) & (j)]. These methods do require a written security agreement signed by the debtor and are included to permit the continuation of practices which result in perfected non-possessory security interests under present Article 9 [present 9—304(4) & 9—305] and to document the creation of a security interest in securities already held in the debtor's account by a financial intermediary.

Perfection of Security Interests

The security interest of the pledgee of a certificated security is both created [present 9—203(1)(a)] and perfected [present 9—304(1)] by the secured party's possession. Possessory security interests are expressly exempted from the normal filing requirements of Article 9 [9—302(1)(a)]. A non-possessory security interest may be perfected by notice to a bailee [present 9—305] or, under certain conditions and for temporary periods, automatically [present 9—304(4) & (5)].

Under the revised Article, a security interest which is effectively created is also perfected [8—321(2)]. If the security interest is created under the provision which corresponds to the present provision of Article 9 for temporary automatic perfection [8—313(1)(i)], perfection expires at the end of the 21 day period unless other steps are timely taken [8—321(2)]. Security interests in securities are expressly excluded from the perfection provisions of Article 9 [9—302(1)(f), 9—304(1) & (4) and 9—305].

Termination of Security Interests

The security interest of a pledgee of a certificated security is normally released by redelivery of the security to the debtor. Similarly, the security interest in an uncertificated security created by registration of transfer to the secured party is released by registration of transfer back to the debtor. A security interest in an uncertificated security created by registration of pledge is released by registration of release [8—108]. Registration of release is effected by submission of an instruction [8—308(4)] to the issuer, originated by the registered pledgee or his representative [8—308(7)(b) & (8)]. The procedure for registration follows that established for registration of transfer or pledge. The issuer is obligated to send confirmatory statements to the pledgee and the owner immediately following registration [8—408(3)] and the owner may choose to make arrangements to

withhold his repayment until he has received an appropriate statement.

A security interest in securities controlled by a third party would normally be terminated by a transfer back to the debtor under the same method employed for its creation [8—313(1)(d), (e), (f), (g) or (h)]. Unless the parties otherwise agree, any such transfer will terminate the security interest. Provision is made for temporary continuation of perfection in the case where a certificated security is redelivered to the debtor for limited purposes [8—321(4)], analogous to similar provisions in Article 9 [present 9—304(5)].

The Initial Transaction Statement

When a security is certificated, the security itself, if genuine, is prima facie evidence of the holder's rights [8—105(3)(c)]. When a security is uncertificated, a similar, but distinctly more limited, function is served by the initial transaction statement (hereinafter "ITS"). The ITS is a signed statement sent by the issuer of an uncertificated security upon registration of transfer, pledge or release to the transferee, pledgee or owner, respectively [8—408(4)]. Like certificated securities, an ITS acts as an estoppel statement against the issuer. But unlike certificated securities, an ITS runs in favor of only the addressee and speaks only as of the time of its issuance [8—105(3)(d)]. Consequently, parties other than the addressee, particularly subsequent purchasers, cannot justifiably rely on what an ITS does or does not contain. The statute requires a warning legend to that effect [8—408(9)].

The purchaser of an uncertificated security is charged with notice of the issuer's right to a lien [8—103(b)], terms of a security [8—202(1)], restrictions on transfer [8—204(b)] and adverse claims [8—304(2)] which appear or are referred to in the ITS sent to him. Conversely, the purchaser for value without notice who receives an ITS which does not refer to defects or defenses is normally entitled to assume that none exists. Furthermore, the purchaser for value without notice who receives an ITS is generally entitled to assume that the uncertificated security referred to therein is valid [8—202(2)(a)], that, in many cases, it has been properly signed, even when it has not [8—205], that it has been properly completed, even when it has not [8—206(3)(b)] and receives the benefit of certain warranties of third party signatories [8—208(1)]. Finally, the purchaser for value without notice who receives an ITS enjoys a limitation in the warranties he has made in connection with the presentation of a certificated security to the issuer [8—306(1)] and is shielded from liability to a former owner or pledgee [8—311(a)]. In these respects, the ITS serves substantially the same function for the addressee as does a certificated security.

Under the shelter principle, the purchaser of a security acquires the rights of his transferor [8—301(1)]. If *A* had purchased an uncertificated security without knowledge of a restriction to which it was subject and had received an ITS which failed

to note the restriction, he would take free of the restriction [8—204(b)]. Any purchaser from *A* would acquire the security free of the restriction and could, relying on *A*'s rights, demand a clean ITS from the issuer. If, however, *A* had knowledge of the restriction when he purchased, *A* would be subject to the restriction even if, by error, the ITS sent to him had failed to note its existence. In that event, notwithstanding *A*'s clean ITS, the rights of a purchaser from *A* would rise no higher than *A*'s, and the purchaser would take subject to the restriction. The purchaser would take free of the restriction only if he purchased without knowledge *and* if the ITS *sent to him* failed to note the restriction. In contrast, if *A* had purchased a certificated security with knowledge of a restriction not noted thereon, a purchaser from *A* without knowledge would take free of the restriction [8—204(a)] even though *A* could not have.

There is a much more significant difference. A purchaser may normally assume that the holder (registered owner, indorsee or bearer) of a certificated security is the owner and entitled to transfer it. An ITS, however, merely evidences the facts at the time of its issuance [8—105(3)(d)]. The fact that *A* exhibits an ITS showing that *A* had become the owner of an uncertificated security at some prior date gives a potential purchaser absolutely no assurance that *A* has any rights in that security now. Since the time of the ITS's issuance, *A* might have pledged, otherwise encumbered or transferred the security. While, in some cases, the purchaser may be willing to rely on *A*'s representations or on those of a third-party guarantor, he cannot justifiably rely on any rights against the issuer until he receives his own ITS.

Rights and Obligations of Buyers and Sellers

All securities of the same issue, both certificated and uncertificated, are treated as fungible. Thus, when an issue of securities is comprised of both certificated and uncertificated securities, a person obligated to transfer securities of that issue may perform either by delivering duly registered or indorsed certificated securities to his obligee or by causing the registration of transfer of equivalent uncertificated securities to his obligee [8—107(1)]. Similarly, the buyer of securities becomes obligated to pay the price whether the securities transferred to him are certificated or uncertificated [8—107(2)].

In an exchange or brokerage transaction, the selling customer may complete his obligation by delivering certificated securities to his broker [8—314(1)(a)(i)], by causing the registration of transfer of uncertificated securities to his broker [8—314(1)(a)(ii)] or, if requested, by causing a third party to acknowledge that he holds a security for the broker [8—314(1)(a)(iii)]. In addition, the selling customer can conditionally fulfill his obligation by delivering to his broker a transfer instruction for an uncertificated security, but his obligation is not completed if the instruction is presented to the issuer within thirty days *and* the issuer refuses to register the requested transfer [8—314(1)(a)(iv)]. This final alternative is also available to the selling

broker in fulfilling his obligation to the buying broker, with the same condition attaching [8—314(1)(b)(iii)]. In a transaction not on an exchange or through brokers, the transferor's duty is not fulfilled, even conditionally, by the delivery of an instruction [8—314(2)].

If the issuer of an uncertificated security demands proof of authority or other evidence which is necessary to obtain registration of transfer, pledge or release of the security, the transferor, pledgor or pledgee, as the case may be, is obligated to provide such evidence, but, if the transfer, pledge or release is not for value, only if he is reimbursed for any expense involved [8—316].

The performance exception to the statute of frauds includes, in addition to the acceptance of delivery of a certificated security, the acceptance of a transfer instruction and the situation where the transfer of an uncertificated security has been registered to the alleged buyer and the alleged buyer does not object in writing to the issuer within ten days after receiving the statement confirming the registration of transfer [8—319(b)].

Warranties

The person who requests an issuer to register the transfer of a certificated security, by presenting a duly indorsed certificated security, warrants to the issuer that he has the power to do so, or, in effect, that the chain of indorsements is genuine and complete [8—306(1)]. In making that warranty, the presenter, who, in the typical case, is, or acts for, the transferee, has before him, as evidence, the security, the indorsements and signature guarantees. On the other hand, the person who requests an issuer to register the transfer (or pledge or release) of an uncertificated security does so by presenting an instruction, which is not even presumptive evidence that the originator is the registered owner or pledgee of the security involved. Hence, the presenter, as such, warrants nothing to the issuer. Rather, the originator of the instruction, who is responsible for its creation, warrants to the issuer that he will be, at the time of presentation, an appropriate person to originate the instruction and entitled to the requested registration—facts which he, and perhaps no one else, knows [8—306(5)].

The transferor of a certificated security warrants to a purchaser for value the effectiveness and rightfulness of the transfer and the genuineness of the security [8—306(2)]. In effect, he undertakes that the issuer will recognize the purchaser as the owner of the intangible interest represented by the security free from any defects not noted thereon. The warranties made by the originator of an instruction to a purchaser for value are intended to produce substantially the same obligation and include, therefore, a warranty of absence of defects—a fact which the purchaser of a certificated security can himself ascertain from the security itself [8—306(7)] but of which the purchaser of an uncertificated security cannot have knowledge until he receives his initial transaction statement from the issuer.

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The warranties made by secured parties who originate instructions with respect to uncertificated securities are limited [8—306 (8)] consistent with similar limitations of the warranties of secured parties who deliver certificated securities they hold in pledge [8—306(4)].

Guarantees

The signature guarantee, which is an essential element of the transfer process for widely-held securities, presents a special problem. The signature guarantor of the indorsement of a certificated security warrants that the indorser is an appropriate person, *i. e.*, that he is, or acts for, the owner [8—312(1)(b)]. To make a similar undertaking with respect to the originator of an instruction to transfer (or pledge or release) an uncertificated security, the signature guarantor, without a certificated security, prior indorsements and signature guarantees before him, would have to warrant a fact of which he has no evidence—that the originator is, or acts for, the registered owner or pledgee. That fact, however, will be known to the issuer and since the issuer is the only person who must act on the instruction, there is no need to require the signature guarantor's warranty. Hence, the warranties of the signature guarantor of an instruction are limited to genuineness, capacity and the fact that the signer is, or acts for, the *purported* owner or pledgee [8—312(2)]. The originator himself warrants to the issuer that he is an appropriate person [8—306(5)].

A special guarantee of signature is also provided by which the guarantor warrants, in effect, that the instruction will result in the requested transfer, free from defects [8—312(3)]. Although the issuer cannot require a special guarantee [8—312(7)], it is anticipated that it will be used in brokerage transactions in which the broker will specially guarantee the signature of his own customer. When a special guarantee of signature is made, the originator makes equivalent warranties to the guarantor [8—306 (6)].

Finally, there is a guarantee of instruction which entails a warranty of rightfulness in all respects [8—312(6)], analogous to the guarantee of indorsement of a certificated security [8—312 (5)]. This guarantee cannot be required by the issuer [8—312 (7)], but when it is made, the originator makes equivalent warranties to the guarantor [8—306(7)].

Bona Fide Purchase

The concept of bona fide purchase applies to both certificated and uncertificated securities [8—302(1)]. The difference is that the purchaser of a certificated security is charged with notice only of what appears when he or a person acting in his behalf takes delivery of the security while the purchaser of an uncertificated security is charged with notice of what appears in the initial transaction statement sent to him. Thus, the purchaser of a certificated security without notice takes free of liens [8—103(a)], terms of a security which may be defenses [8—202(1)]

and restrictions [8—204(a)] not noted on the security. He may also take free of any adverse claim [8—302(3)] unless the nature of the claim is such that it would be disclosed by the security itself [8—304(1)]. The purchaser of an uncertificated security without notice, however, is charged with notice of liens [8—103 (b)], defenses [8—202(1)] and restrictions [8—204(b)] noted in the initial transaction statement sent to him. He is also charged with notice of adverse claims shown in the initial transaction statement [8—304(2)]. Only when he has received a clean initial transaction statement can he be sure that he enjoys bona fide purchaser status [8—302(1)(b)].

The above-described difference is of limited practical significance. As has already been noted, the purchaser of an uncertificated security cannot be sure that he has received anything (whether or not defective) until he receives his initial transaction statement. Therefore, unless he chooses to rely on the warranties of his seller or a third party guarantor, he will not release his consideration unless and until he receives a clean initial transaction statement to give him the assurance that he has, indeed, received what he bargained for. The wide-spread use of wholly certificateless systems will necessarily involve the development of escrow arrangements or other mechanisms by means of which the parties will obtain satisfactory assurances.

Adverse Claims

The treatment of adverse claims presented a very special kind of problem. With certificated securities they are communicated by mere written notification to the issuer [8—403(1)]. They do not normally constitute a serious problem because they can be so easily defeated by transfer of the security to a purchaser without knowledge [8—302(3)]. The rules for certificated securities have, therefore, been preserved [8—403(1), (2) & (3)].

With uncertificated securities, however, the rules become unworkable because transfer is accomplished only by communication with the issuer [8—313(1)(b)] and the purchaser is charged with notice of whatever appears in the initial transaction statement sent to him [8—304(2)]. Consequently, new rules have been developed for uncertificated securities. They require that a third party claim be embodied in legal process in order to make it cognizable by the issuer [8—403(4)(a)]. They also permit, under certain circumstances, the registration of transfer or pledge subject to an adverse claim [8—403(5)]. Finally, they provide protection to a registered pledgee who attained bona fide purchaser status prior to the time that notice of a cognizable adverse claim reached the issuer [8—403(6)].

Creditors' Rights

The general rule of present Article 8, that no judicial lien on a debtor's interest in a security is valid until the security is actually seized [present 8—317(1)] is wholly inapplicable to uncertificated securities and, in the light of wide-spread nominee registration, depository systems and the like, has become inade-

quate even with respect to certificated securities. That rule is retained only for certificated securities in the debtor's control [8—317(1)]. Uncertificated securities registered in the debtor's name may be reached only by service upon the issuer [8—317 (2)]. The interest of a debtor in either certificated or uncertificated securities under the control of secured parties or financial intermediaries is reached by service upon the controlling party [8—317(3) & (4)]. When a debtor's interest in securities controlled by a third party is subject to a judicial lien, provisions are made for the transfer of such securities, free of the lien, and the shifting of the lien to the proceeds in the hands of the third party [8—317(5)].

Nominee Registration

The increasing incidence of nominee registration in brokerage accounts, bank custody accounts, security depositories and otherwise has led to new and expanded provisions regarding the rights of creditors [8—317]. The same phenomenon has also led to a revision of the general transfer rules by substituting the broader category of "financial intermediary" [8—313(4)] where only "broker" formerly appeared [8—313(1)(c) & (d), (2) & (3)].