SOME PROBLEMS UNDER ARTICLE 8 OF THE UNIFORM COMMERCIAL CODE

ERNEST L. FOLK, III*

Article 8 of the Uniform Commercial Code[1] is a unique effort to state legal rules uniformly applicable to the transfer of all forms of investment securities. Thus, when enacted in any state, it automatically replaces the usual patchwork of statutes governing securities transfer. Ordinarily, two statutes are affected: the Uniform Stock Transfer Act, an excellent (although now somewhat outmoded) enactment so far as it goes, but applicable only to stock; and the Uniform Negotiable Instruments Law,[2] which presents serious conceptual and practical problems to the ready transfer of bonds, debentures, and similar forms of creditor securities. Enactment of the Code does not repeal the Uniform Act for the Simplification of Fiduciary Security Transfers,[3] which foreshadowed and, indeed, shaped the structure and content of Article 8, but which is limited, as its title indicates, to transfers by and to fiduciaries, although so far as it goes it covers all forms of investment securities. The theory of Article 8 is that all types of investment securities, whether creditor or equity interests, are sufficiently similar that a single enactment can adequately regulate their transfer and registration and state the same rules of "negotiability."

The last sentence roughly defines the coverage of Article 8. It is not concerned with the issue of securities, or with their public distribution, as are corporation and securities statutes. Article 8's overriding objective is to assure full negotiability to all investment securities.

The term "negotiability" embraces several concepts.[4] It may refer either (1) to ease and facility of transfer by specified procedures, *e.g.*, delivery of a bearer-form security or delivery plus indorsement of a registered form security; (2) to the right of the then holder to

---

* Associate Professor of Law, University of North Carolina. Portions of this article reflect the author's study of Article 8 for the South Carolina General Assembly's Committee to Study the Uniform Commercial Code.

[1] The UNIFORM COMMERCIAL CODE is cited hereinafter as "Code" with section numbers, *e.g.*, § 8-104.

[2] The UNIFORM NEGOTIABLE INSTRUMENTS LAW, sometimes referred to as "NIL," appears as ARIZ. REV. STAT. ANN. §§ 44-401 -595 (1956).

[3] The UNIFORM ACT FOR THE SIMPLIFICATION OF FIDUCIARY SECURITY TRANSFERS is referred to as SIMPLIFICATION ACT. It appears as ARIZ. REV. STAT. ANN. §§ 14-1121 -1130 (Supp. 1962).

[4] See Aigler, *Recognition of New Types of Negotiable Instruments*, 24 COLUM. L. REV. 563 (1924).

enforce the security rather than sue in his transferor's name;[5] and (3) to the possibility that a transferee may acquire better rights than his transferor.[6] In all three respects, Article 8 confers "negotiability" on investment securities. Section 8-105 specifically declares all such securities to be "negotiable instruments," and the whole of Article 8 fleshes out the meaning of this statement. Given several possible policy objectives on a given point, Article 8's tendency is to resolve the competing policies in favor of full negotiability, subordinating the other interest (usually that of the original owner or some other "adverse claim").

The utility of Article 8 can be summarized in several propositions. First, since the transfer and registration of all investment securities can be treated alike, adoption of Article 8 automatically simplifies the law, taking the place of other statutes and widely scattered case law. Second, Article 8 goes beyond prior enactments in assuring the full negotiability of investment securities. Thirdly, Article 8 covers areas of financial and investment practice not previously subject to any uniform act, and only subject to an occasional enactment in a few states. Illustrating this are the rules of Part 4 for registering transfer of securities in "registered form," including both stocks and many bonds. Fourthly, Article 8 dispels dark shadows cast by the NIL on the negotiability of important classes of investment paper. Stated otherwise, it recognizes that many rules appropriate for *commercial* paper wreak havoc with *investment* paper; and accordingly the Code strictly separates these two categories of instruments, for separate and mutually exclusive treatment.[7]

It is not always recognized how far the NIL impairs the negotiability of many investment securities. From this standpoint, the basic error in drafting the NIL was its too broad coverage at a time when the case-law was too sparse, at least in the field of investment securities, to justify codification. The English Bill of Exchange Act,[8] in part the NIL model, confined itself to bills, notes, and checks, thus excluding bonds and debentures which developed on their own through judicial decisions. The NIL definition of negotiability[9] was sufficiently broad to cover bonds and debentures, and at the same time sufficiently restrictive to destroy the negotiability of many standard

---

[5] This is assumed throughout Article 8, but in particular see Code § 8-105(2) (presumptions applicable to any action on a security).

[6] This is the hallmark of the bona fide purchaser, Code §§ 8-301(2) and -302.

[7] Code §§ 8-102(1)(b). See also Code § 2-105(1) ("securities" excluded from definition of "goods" covered by Article 2 — Sales), and Code § 3-103(1) (Article 3 — Commercial Paper "does not apply to . . . investment securities").

[8] BILLS OF EXCHANGE ACT, 1882, 45 & 46 Vict. c. 61.

[9] UNIFORM NEGOTIABLE INSTRUMENTS LAW § 1, ARIZ. REV. STAT. ANN. § 44-401 (1956).

forms of investment securities.[10] Among the chief barriers to negotiability — or at least the certainty of negotiability — were the following.

(1) It has long been customary to issue bonds or debentures with elaborate provisions in an indenture. These provisions normally relate to rights under the mortgage or other security for the loan, dividend or other financial limitations, limitations on the right to sue, and so on. The technical difficulty was that such provisions might run contrary to the NIL requirement of an "unconditional promise" to pay a sum certain in money, especially the typical "no action" clauses limiting or denying bondholder rights to sue, and vesting such rights in the indenture trustee.[11] *Enoch v. Brandon*[12] partly resolved the problem under the NIL on the theory that the doubtful or restrictive provisions governed only the security behind the bond or debenture, but did not qualify the bond's fundamental promise to pay. But even this formulation may not be wholly adequate, since it at least implies that one must search the indenture for assurance that no indenture clause qualifies the promise to pay. The Code, however, does not require an "unconditional" promise to pay as a prerequisite of negotiability. Indeed, the Code, unlike the NIL, does not contain requirements going to the substance or content of the security. Besides this negative assurance, Code Section 8-201(1) specifically authorizes incorporatiton by reference of terms in an indenture or other side instrument; the sole restriction is against terms contradictory or inconsistent with those in the security itself. Thus, an income bond, clearly not negotiable under the NIL because its promise of payment is conditional, would be valid under the Code; but a security would not be valid under the Code if the bond itself declared an unconditional payment obligation while the indenture conditioned payment upon income, for then the two instruments would be inconsistent.

(2) A second NIL threat to negotiability also derives from the required unconditional promise to pay. Thus, municipal or state bonds payable only out of a special fund, such as the revenues of a municipal electrical utility system, or out of a special tax or assessment are non-negotiable under the NIL. Similarly affected were equipment trust obligations payable out of special funds, *e.g.*, rentals from equipment leases. So too with income bonds. Many such instruments, especially municipal bonds, have been made negotiable by special statute, thus by-passing the NIL limitation. The Code avoids this problem by not specifying any requirements as to the nature of the promise to pay.

[10] For a thorough discussion, see Justice Cardozo's classic decision in President & Directors of the Manhattan Co. v. Morgan, 242 N.Y. 38, 150 N.E. 594 (1926).

[11] UNIFORM NEGOTIABLE INSTRUMENTS LAW § 1(2); ARIZ. REV. STAT. ANN. § 44-401(2) (1956).

[12] 249 N.Y. 263, 164 N.E. 45 (1928).

(3) Of less significance, though still illustrative of the problem, are instruments not payable in money. The famous *Morgan*[13] cases in New York involved an interim certificate contracting to deliver certain foreign bonds when, as and if issued. Besides no unconditional promise to pay, the instrument was not payable in money,[14] but in something else, namely bonds. Reluctantly, the New York court held that the NIL preempted the field and destroyed the negotiability of the interim certificates, thereby denying protection to a bona fide purchaser from a thief.

(4) Although bearer bonds seemingly raise no special NIL problems,[15] the case as to registered bonds is more troublesome. When an important instrument is either fully registered or in bearer form registerable at the holder's option, it is arguable under the NIL that the issuer's obligation runs only to the single registered holder, since customarily words such as "to order" are not included in the security.[16] Indeed, this is the issuer's intent: to limit its obligation only to the registered owner and to no one else unless transfer of the bond has been registered into his name on the issuer's books.[17] Arguably, the specified transfer method — "on the books of the corporation" — contravenes the transfer forms prescribed by the NIL itself. The issue seems not to have been definitely settled, although certainly the investment community assumes the full negotiability of registered bonds and debentures. But since uncertainty is a major evil in this field, it is important to ensure that registered-form creditor instruments are fully negotiable; and Article 8 accomplishes just that. Moreover, it makes clear that the so-called transfer "on the books" of the issuer is not, strictly speaking, a part of the transfer but is simply a *regis-*

---

[13] President & Directors of the Manhattan Co. v. Morgan, 242 N.Y. 38, 150 N.E. 594 (1926).

[14] UNIFORM NEGOTIABLE INSTRUMENTS LAW § 1(2); ARIZ. REV. STAT. ANN. § 44-401(2) (1956).

[15] As long ago as 1934, a leading authority could say that bearer bonds are governed by the NIL, and that even the presence of an option to register the bond did not impair negotiability. Steffen & Russell, *Registered Bonds and Negotiability,* 47 HARV. L. REV. 741, 746 n.16, 744 n.11 (1934).

[16] Steffen & Russell, *supra* note 15 at 744, 759, 768, recognized that a "to order" clause in a registered bond might eliminate uncertainty as to the full negotiability of registered bonds; but apparently the idea never caught on. As indicated later, *infra* at note 62, a "to order" bond or debenture would not be a "security" within the meaning of Article 8's definition of the term.

[17] Thus Code § 8-207(1) specifically states that the issuer may treat the registered owner of a registered-form security, *e.g.,* stock and many bonds, "as the person exclusively entitled to vote, receive notifications and otherwise to exercise all the rights and powers of any owner." This accords with typical corporation law provisions, *e.g.,* ABA-ALI MODEL BUS. CORP. ACT § 2(g) (1953) (defining "shareholder" as "one who is a holder of record of shares in a corporation"), § 27 ("each shareholder of record" is entitled to notice of a shareholders' meeting). See also the comparable provision in UNIFORM STOCK TRANSFER ACT § 5; ARIZ. REV. STAT. ANN. § 10-233 (1956).

tration of a transfer already made, much as recording a deed signifies a transfer of realty but is not the transfer itself.[18]

In many ways, Article 8 is a difficult statute to grasp, especially the logical connection of its parts and sections. Closely studied, it emerges as a superbly drafted statute, elaborately intertwined, and closely hanging together. Although this article is not a section-by-section analysis of Article 8, but highlights some significant provisions and criticizes others, it is useful to outline it briefly.

Part I, dealing with "General Matters," defines the all-important term "security"[19] which determines the coverage of the Act; states the effect of an "overissue" of securities;[20] declares the negotiability of all securities meeting the definition of the term;[21] and states a rule for the price of certain securities.[22] Part 2 defines the relationship between the issuer and the holders of securities, defining the term "issuer,"[23] stating when issuer defenses are lost so that the security is "validated" when held by an innocent purchaser;[24] permitting the issuer to recognize only the registered owner of the security.[25] Part 3 deals in detail with the relationship among claimants to the same security, and posits two important distinctions. The first is a distinction between a "purchaser" and a "bona fide purchaser."[26] "Purchasers" include all takers of securities, since "purchase" is not limited to a transfer for consideration.[27] Bona fide purchasers are a favored sub-class of purchasers who not only give consideration for their security and are ignorant of adverse claims but also have taken it by a formally perfect transfer, *e.g.*, by delivery of a bearer-form instrument, or delivery plus indorsement of a registered-form instrument.[28] "Bona fide purchasers" may alone extinguish the claims of others,[29] thus completing the analogy to a NIL holder in due course.

---

[18] See generally Article 8, Part 4.

[19] Code § 8-102(1).

[20] Code § 8-104.

[21] Code § 8-105(1).

[22] Code § 8-107(2).

[23] Code § 8-201.

[24] Code § 8-202. There are statutory rules on imputing notice of defenses, *e.g.*, § 8-203, and of issuer-imposed transfer restrictions, § 8-204.

[25] Code § 8-207. In addition, there are rules regarding the effect of unauthorized signatures, § 8-205, and the effect of incomplete or altered instruments, § 8-206.

[26] Code §§ 8-301, 302.

[27] Code § 8-301(1), § 1-201(32), (33).

[28] Code § 8-302.

[29] Code § 8-301(2). Any purchaser acquires the rights his transferor had or had authority to convey, and an innocent purchaser (as distinguished from a bona fide purchaser, as defined in Code § 8-302) takes free of defenses of the issuer. But only a bona fide purchaser may extinguish adverse claims, Code § 8-301(2), that is, claims "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," Code § 8-301(1).

A second distinction is between (1) an "unauthorized" indorsement,[30] *e.g.*, a forgery or other signature made without actual or apparent authority,[31] and (2) a merely "wrongful" transfer, *e.g.*, one in breach of trust. Even a bona fide purchaser cannot overcome the adverse claims of others if he takes under an "unauthorized indorsement," at least until he actually receives a "new, reissued or re-registered security on registration of transfer" into his name.[32] But as to a merely "wrongful" transfer, the bona fide purchaser is protected and prevails over other claims.[33] Without elaborating the twenty sections of Part 3, these can be subdivided into classes. Two sections deal with notice of adverse claims;[34] most important is the rule that no transferee need inquire into the rightfulness of transfer although taking a security from a known fiduciary.[35] Six sections deal with the forms and effect of indorsing securities, and detail the consequences of a deficiency either as to indorsement or delivery, and the permissible types of guarantee of signatures or indorsements.[36] Two provisions deal with the events constituting delivery of securities.[37] A remaining group of sections deal, *inter alia*, with rights and liabilities of purchasers,[38] attachment and levy,[39] and the Statute of Frauds.[40]

Part 4 is the most novel portion of Article 8, for it sets forth, for the first time in a statute of general application, legal requirements for registering transfer of securities. Its purpose is to simplify a process too often cumbersome, involved, expensive, and delayed, as issuers sought to avoid any possible liability to adverse claimants for registering transfer of a security into a new name. This was especially

---

[30] See Code § 8-315 for the distinction and some of its consequences; see also Code § 8-311.

[31] This is, in substance, the definition of "unauthorized" in Code § 8-201(43).

[32] Code §§ 8-311(a), and 8-315(2).

[33] Code § 8-315(1).

[34] Code §§ 8-304 (notice from a restrictive indorsement on the security) and 8-305 (notice from "staleness," *i.e.*, the fact that the security is still circulating after maturity or default).

[35] Code § 8-304(2). An inquiry duty does arise if the purchaser knows that the proceeds are used or the transaction is for the fiduciary's personal benefit, or if he knows that the transfer is otherwise in breach of trust.

[36] Code §§ 8-307 (delivery without indorsement), 8-308 (forms of indorsement), 8-309 (indorsement without delivery), 8-310 (indorsement of bearer form security), 8-311 (effect of unauthorized indorsement), and 8-312 (effect of guaranteeing signature or indorsement.

[37] Code §§ 8-313 (events constituting delivery) and 8-314 (when the duty of delivery is complete).

[38] Code §§ 8-315, 8-316.

[39] Code § 8-317.

[40] Code § 8-319.

acute in the case of fiduciary transfers where issuers sought iron-clad assurances that the transfer was rightful in every respect, and no possible claimant might prevail. Under Part 4, the issuer has a specifically enforceable duty to register transfer if certain requirements are met,[41] and is liable for breach of this duty.[42] Issuers are protected because they may (1) demand certain assurances that the transfer is not unauthorized,[43] and (2) have only a limited duty to inquire into adverse claims, usually only on receipt of a "stop transfer" order.[44] If satisfied, the issuer must register transfer, and is exonerated from liability.[45] Concluding provisions specify interesting new rules for lost, destroyed or stolen securities.[46]

II. The Definition of Security

The most striking features of the Code definition of security are its breadth, and its primary reliance upon form. What is left out of the definition is especially significant. Thus, it is no part of the definition that there be an unconditional promise to pay money, or any promise for that matter, as with stock. Indeed, it would be impossible to draft a definition of "security" covering both creditor and equity interests which looked to substantive matters.

The object of the definition is to encompass all currently accepted investment media. At the least, it embraces all sorts of shares of stock, bonds and debentures, whether a fixed or contingent obligation, voting trust certificates, stock options and warrants, and scrip. The term is not limited to corporate securities, but includes interests in limited partnerships, oil and gas fractional interests, state and municipal bonds, and so on, at least so long as they meet the Code requirements of a "security."

It is instructive to contrast the Code concept of "security" with counterpart definitions in federal and state securities-regulation statutes. Here the definition of "security" is a long enumeration of various sorts of possible investment media,[47] typically ending with a phrase such as "in general, any interest or instrument commonly known as a 'security.'" The concern here is to encompass, so far as a general definition can, all possible interests in which a gullible public might be induced to invest. Hence, the effort to reach unusual

41 Code § 8-401(1).

42 Code § 8-401(2).

43 Code § 8-402, keying in with § 8-401(1)(b).

44 Code § 8-403, keying in with § 8-401(1)(c).

45 Code § 8-404.

46 Code § 8-405.

47 See § 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b (1958); § 401(7) of the Uniform Securities Act.

"securities." Many of them are such because they reflect odd human fads, but many are efforts to avoid the statutes on the supposition that unique or unusual form would by-pass state or federal regulatory requirements. Thus, because securities regulation statutes are police measures against fraud, a useful definition must apply to unusual instruments, contracts for investment, or the like, including many "securities" not traded in the organized markets and not usually regarded as investment media.

In contrast, the Code objective is to confer negotiability upon accepted forms of investment securities, and this very different policy objective shapes the definition of the term. As expressed by Carlos Israels, "uniqueness of form must logically militate against inclusion in the category [of securities, since] [c]ommercial justification for negotiability requires not uniqueness but familiarity."[48] Hence, the emphasis upon form in the four subparts of the Code definition.[49]

1. *The Recognized-Investment-Medium Requirement*

The Code declares that a security must be "an instrument which . . . 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 medium for investment. . . ."[50] Several points deserve separate comment.

(A) A security meets the requirement if it is "*of a type* commonly dealt in" on the organized markets. This does not mean that the particular security must in fact be listed on a stock exchange[51] or traded on a market. Indeed, because of transfer restrictions, it may never leave the hands of the original owners, as in a closely held corporation. Despite the fact that the security may be surrounded by transfer restrictions and purchase options, a close cor-

---

[48] Israels, *Investment Securities as Negotiable Paper—Article 8 of the Uniform Commercial Code,* 13 Bus. Law. 676, 678 (1958). This is an excellent article, perhaps the best single exposition of Article 8 of the Code.

[49] These four parts are not discussed in the order in which they appear in the definition of "security."

[50] Code § 8-102(1)(a)(ii).

[51] The term "securities exchanges" in this provision is sufficiently clear, and would cover regional as well as national exchanges. But since "security exchanges" are different animals from commodity exchanges, instruments such as commodity investment contracts would apparently not be covered by this definition, since they are traded, not on securities exchanges, but on commodity exchanges. Even the definitions in statutes regulating sale of scurities are not susceptible to such a reading. *Cf.* Section 3(a)(1) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(1) (1958), defining "exchange" as an organization which affords a "market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood."

The term "markets" in Code Section 8-102(1)(a)(ii) must also be read as modified by the term "securities," so that it refers to the over-the-counter markets maintained by brokers and dealers in securities.

poration common stock (for example) is nonetheless "of a type" which could be traded should the corporation elect to "go public." Thus, the test is whether the security could be publicly traded, not whether it is, again revealing the emphasis upon form. This portion of the definition thus embraces, at the least, common and preferred shares, warrants (rights), debentures, and perhaps a few variants of all these, since these are the typical securities traded in the organized markets. Other types of securities are "commonly dealt in" through over-the-counter markets, such as American depository receipts, shares of mutual funds, as well as the usual types of equity and creditor securities.

(B) Since many recognized investment media are not traded in the organized markets, the Code definition of "security" would be too restrictive if it did not recognize securities "of a type . . . commonly recognized in any area in which it is issued or dealt in as a medium for investment." This presents four possible combinations:

(I) The security is a recognized investment medium both where it is issued and where it is dealt in. This presents no special problem.

(II) The security is *not* a recognized investment medium in either place. This also presents no Code problem, since it will not be recognized under the definition of a "security."

(III) The security is a recognized investment medium in the place of issue but not so in the place of dealing. The Code definition would apparently apply, at least so long as there is no violation of public policy in the place of dealing. Thus, bearer stock is "commonly recognized" in continental Europe as a proper "medium for investment" but it is not issued in the United States. Although there is probably no real public policy against it in this country, the corporation statutory scheme does not provide for it, and it has never interested the investment community. But so far as the Code is concerned, European bearer stock would be a "security," and negotiable (assuming other Code requirements are met). Similarly, a fractional interest in an oil well would certainly be recognized in Texas as a proper and customary "medium for investment." Although perhaps not dealt in in another state, its negotiability under the Code would not be impaired. But in most instances, there will likely be a custom or practice in the United States or at least in some states as to dealing in the security.

(IV) The security is not a recognized investment medium in the place of issue but is so regarded in the area where it is dealt in. This situation is so unlikely as not to warrant exploring the conceptual problems it might raise of conferring negotiability in the state of dealing when it is not so recognized in the place of issue.

2. *The Requirement of Bearer or Registered Form:*[52]

A second element of the Code definition is that the security "is an instrument which is issued in bearer or registered form" as is true of most investment securities. A security is in "registered form" if it "specifies a person entitled to the security or to the rights it evidences and when its transfer may be registered upon the books maintained for that purpose by or on behalf of an issuer . . ."[53] As noted earlier,[54] the fact that a security names the owner without further words such as "to order," could be read to destroy negotiability; but the Code definition forecloses that argument. Shares of stock are invariably in registered form. Bonds and debentures may be fully registered (that is, as to both principal and interest) or registered only as to principal (the interest being payable to the bearer of the coupon), or they may be in bearer form.[55] The Code, of course, recognizes that transfer books for registered-form securities may be kept either by the issuer or by its transfer agent or registrar, as is common in large corporations.[56]

A security is also in "registered form" if "the security so states." Some securities are in registered form, but still are transferred by delivery. Although this is a valid *inter partes* transfer,[57] eventually the holder will have it registered to enforce rights available only to a registered owner, *e.g.*, interest on a fully registered bond. So, too, a security may state that it is in coupon form, but the holder has the privilege of registration.

A security is in "bearer form" if "it runs to bearer according to its terms and not by reason of any indorsement."[58] This means that

---

[52] Code § 8-102(1)(a)(i).

[53] Code § 8-102(1)(c).

[54] See notes 16-18 *supra.*

[55] A recent Wall Street Journal article, "Coupon Clipping May Be on the Way Out as Registered-Bond Proposals Gain Favor," notes that when one large bond issue gave bondholders the option of bearer or registered bonds, 80% of the buyers chose the latter. Apparently, institutional investors in a "private placement" of bonds favor a single registered security over coupon bonds. Efficiency and cost savings are suggested as the reasons that both issuers and banks are backing the trend to registered bonds. Although currently registered bonds sell at a slight discount from coupon bonds, apparently reflecting the view that registered bonds are "less negotiable," one prominent figure predicts that this will soon be reversed. Wall Street Journal, July 9, 1963.

[56] Compare the definition in Code § 8-201(3) of "issuer," applicable only to the registration of transfer provisions, as "a person on whose behalf transfer books are maintained."

[57] See Code § 8-307 (effect of delivery without indorsement of a security in registered form). More generally, see Code § 8-301(1) ("Upon delivery of a security the purchaser acquires the rights in the security which his transferor had or had actual authority to convey. . . .").

[58] Code § 8-102(1)(d).

the security is properly transferred by delivery from hand to hand, as with unregistered bonds and, of course, bond coupons presented for the interest payment. So, too, in Europe the holder of bearer-form shares may vote at shareholder meetings or receive the current dividend on presentation of his shares or some other instrument. Because an instrument is in bearer form only if it so states, the presence of an indorsement on the security does not preclude further transfer by delivery without indorsement, and certainly indorsement does not convert it into a registered-form security.[59] Thus, there is no inconsistency between the definition of a bearer-form security and the facts of the market place, that many registered-form securities are transferred by delivery only. Finally, a purported indorsement to bearer on a registered-form security does not convert it into a bearer-form instrument.[60] Although it may continue to pass by delivery, the issuer is not bound by what the indorser did, and need not recognize the holder who obtained the security by delivery after a bearer indorsement but who cannot show the necessary indorsements.[61]

The Code definition, by confining itself to bearer-form and registered-form securities, would exclude certain long-term instruments, regarded as investment media, which are made to order, *e.g.*, a 50 year note for $10 million issued by X Corporation to Y Insurance Co. This presently presents no significant problem. So long as the note meets the Code requirements for commercial paper, it is negotiable under Article 3. If, however, it were an income note to order, it would not be negotiable commercial paper (because not for a sum certain or unconditionally payable) nor an investment security (because not in registered or bearer form). But this problem can be solved by making the income note payable to bearer or putting it in registered form. Apart from its relatively infrequent use, it is not clear why the Code should have excluded securities payable to order although not in bearer or registered form.

3. *The Class or Series Requirement:*[62]

A third formal requisite of a "security" is that it be "either one of a class or series, or by its terms is divisible into a class or series of instruments," ordinarily a simple and almost wholly formal requirement. Thus, a complex corporation financial structure may include

[59] See Code § 8-310 (indorsement of security in bearer form) and Official Comment to that section.

[60] Because a security is in bearer form only if "it runs to bearer according to its terms and not by reason of any indorsement." Code § 8-102(1)(d).

[61] See Code § 8-207(1) (issuer need recognize only the registered owner). But under Code § 8-307, the transferee by delivery only has a "specifically enforceable right to have any necessary indorsement supplied." See also Code § 8-306 (purchaser's right to requisites for registration of transfer on books of the issuer).

[62] Code § 8-102(1)(a)(iii).

Series A, B, C, etc., of First Mortgage Bonds, Series L and M of Subordinated Debentures, Class A of First Preferred Stock (of which Series T, U, and V have been issued and are outstanding), and the Common Stock. Or a close corporation may issue Class A Common Stock with voting rights, and Class B Common with no vote.

However, the class or series requirement may occasionally impose limitations. For example, warrants for purchase of new stock, especially if issued generally to the outstanding shareholders, would be a "class" of security and a particular warrant would be "one of a class." But a stock option to a single individual, perhaps incidental to an employment contract, would apparently not be "one of a class," so that its unique character would remove it from the definition of a "security."[63] Presumably, an employee stock-option plan, with options to 100 key employees, would be a "class." Even if they were not technically such, this would probably present no serious problem, since ordinarily such options are personal and non-transferable by their terms. Again, the earlier example of a 50-year $10 million note would arguably not be a security because not "one of a class." Evidently, then, as a minimum compliance with this provision, there must be at least two instruments in a given class or series, since the security must be "*one* of a class or series." A formal recital in the instrument is probably a sufficient compliance with the class or series requirement.

4. *Evidence of a Share or Obligation:*[64]

The fourth definitional requirement is that the security "evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer." This terminology embraces all sorts of equity and creditor interests. A mutual fund share would be "a share . . . in property" owned by the fund; an American Depository Receipt would be an "interest in property" belonging to the holder of the shares. It is doubtful whether pre-incorporation stock subscriptions are covered, since they do not, as of that time, represent any interest in property or in an enterprise, but are only an agreement to become a shareholder if the corporation is formed.

Having analyzed the elements of the definition of a "security," two general comments are in order. First, the Code definition completes the process, begun especially with the Uniform Stock Transfer Act, of integrating the property interest with the instrument itself, so that transfer of the instrument is a transfer of the interest it "evidences." Indeed, a security "is an instrument which" meets the Code requirements. "Instrument" is an undefined term in the Code, but at the least it connotes a writing, as almost all securities are. Accord-

---

[63] Of course, the underlying security (the stock) would satisfy one class or series requirement.

[64] Code § 8-102(1)(a)(iv).

ingly, Article 8 would not cover close corporation share interests, occassionally issued without a certificate and transferred other than by standard procedures.[65] This result is appropriate, for an interest not represented by a formal writing is uncertain in every respect and can scarcely be traded with facility.

Secondly, a much more serious problem, but one common to all codes, is the possible freezing of new developments in the law, responding to new customs and practices in the area controlled by the Code. Thus the NIL prematurely codified the law as to bonds and debentures, incidentally creating confusion which it was supposed to end. The codifier's dilemma may be acute. On the one hand, non-codification allows flexibility but tends to destroy certainty; its advantage is allowing new situations to acquire legal recognition, unhindered by the strait jacket of statutory language.[66] On the other hand, codification tends to assure certainty; flexibility is not necessarily lost if the statute is well drafted; but there is greater chance of confining practice and custom within traditional boundaries.

The definition of "security" in Article 8 does not escape this problem, especially the provision that the security must be "*of a type*" commonly dealt in on the organized markets or recognized as an investment medium. But a new type of security cannot be "of a type commonly dealt in . . . or commonly recognized" until sufficient time has elapsed for a custom to arise. Growth of a custom recognizing a new type of security not within the Code definition is retarded: without statutory recognition its negotiability is uncertain, and corporate managers are understandably hesitant to risk it. The tendency, although not an inescapable consequence, is that prudent issuers will stick to accepted forms of securities, and will not venture into new areas.

President and Directors of the Manhattan Co. v. Morgan[67] illustrates the possible stultifying effect of codification, in that case the NIL. There Justice Cardozo reluctantly held that the temporary certificates issued by underwriters to furnish bonds in definitive form were not negotiable because not in compliance with the NIL's formal requisites for negotiability. Practice and custom were regarded as immaterial to establishing negotiability, since, after the NIL had pre-

---

[65] This is significant because under some corporation statutes, including the Model Business Corporation Act, a stock certificate may not be issued until the consideration is fully paid up. ABA-ALI Model Bus. Corp. Act § 21, last paragraph (1953). This is a great barrier to the abuse of paying little or no consideration on stock, obtaining a certificate, and then transferring it for a much larger consideration. Of course, since technically the certificate only evidences the interest, it might be transferred absent a certificate, but as a practical matter this becomes impossible.

[66] Of course, case-law may impose its own strait jackets, requiring a statute to undo the restrictions.

[67] 242 N.Y. 38, 150 N.E. 594 (1926).

empted the field, only a statute could confer negotiability.

In contrast, a line of English cases illustrates the gradual recognition by courts, unimpeded by statute, of a mercantile custom of recognizing new forms of investment securities as negotiable. Earlier commercial paper had gained legal recognition by courts looking to mercantile custom or what today we would probably call the practices of the financial community. The issue in such cases was the fact of a custom according negotiability to the instrument, and once established by decisional law contrary evidence was inadmissible to disprove negotiability, *viz.*, it became a rule of law. In the mid- and late-19th Century, English cases held negotiable non-English government bonds actively traded in England,[68] scrip entitling the holder to definitive bonds of the issuers,[69] scrip entitling the bearer to become a registered shareholder in an English corporation,[70] and English[71] and non-English[72] debenture bonds. Even in the United States, in areas not covered by the NIL, sometimes the same sort of development has occurred. Thus, mortgage participation certificates, which a New York court in 1938 held were "not freely bought and sold in the market place and do not pass from hand to hand like certificates of stock," would today probably be regarded as a recognized medium for investment, and thus a "security" under the Code.[73] But if the Code definition had been in effect in 1938, it is doubtful whether investors would buy such certificates, so that no custom would arise on which to predicate a rule of law. The order bond also illustrates the problem. Although not used today, it is impossible to say that it may never be used or that no needs will ever arise which would be better served by order bonds than by registered or bearer instruments. But under the Code definition, such an instrument is not a "security" and thus not entitled to the benefits of the Code.

There is no simple answer to this problem. Although new forms of securities are infrequent, this is no answer; bills of exchange and notes are only two forms of paper which were once new, but they are the basis of many commercial transactions today. Legislation can

---

[68] Gorgier v. Mileville, 3 B. & C. 45, 107 Eng. Rep. 651, (K.B. 1824); Attorney-General v. Bouwens, 4 M. & W. 171, 150 Eng. Rep. 1390 (Ex. 1838); Heseltine v. Siggers, 1 Exch. 856, 154 Eng. Rep. 365 (Ex. 1848).

[69] Goodwin v. Robarts, [1875] L.R. 10 Ex. 337, *aff'd.*, [1876] 1 App. Cas. 476.

[70] Rumball v. Metropolitan Bank, [1877] 2 Q.B.D. 194.

[71] Bechuanaland Exploration Co. v. London Trading Bank, Ltd., [1898] 2 Q.B. 658; Edelstein v. Schuler & Co., [1902] 2 K.B. 144.

[72] London Joint Stock Bank v. Simmons, [1892] A.C. 201. See also Bentinck v. London Joint Stock Bank, [1893] 2 Ch. 120.

[73] Oppenheim v. Title Guarantee & Trust Co., 253 App. Div. 356, 2 N.Y.S.2d 181 (1st Dept. 1938). Compare the recent SEC litigation regarding a related type of "security" in Los Angeles Trust Deed & Mortgage Exch. v. SEC, 285 F.2d 162 (9th Cir. 1960).

cure these problems as they arise, although usually this is a late, if not a last, resort. And the real problem is not whether legislation can meet the deficiency — it can. Rather the problem is whether a restrictive definition in the basic statute will diminish the likelihood that new forms of securities will be fashioned and traded to meet new needs. Even so, absent a statutory definition, the road to full negotiability is a rocky one, since courts are reluctant to accord negotiability until a custom of ready transfer is proven, and not always then.

The best solution rests in (1) the continuing interest of the academic and practicing lawyers in developments in these areas, and (2) the fact that the Uniform Commercial Code is subject to the continuing oversight of the Permanent Editorial Board which presumably will be alert to seek out new developments and keep the Code in harmony with changing financial practices.[74]

VALIDATION AND OVERISSUE

The prime objective of Article 8 is to make investment securities fully negotiable. To ensure that innocent purchasers obtain a clear title to the securities they purchase, unshadowed by issuer defenses or claims by other owners ("adverse claims"), the Code has many provisions which "validate" securities in the hands of such purchasers. For example, Section 8-202 extinguishes almost all issuer defenses when the security is in the hands of a "purchaser for value and without notice" of defenses or defects in the issue.[75] Section 8-301(2) enables a "bona fide purchaser" to take the security free not only of issuer defenses, but also of adverse claims of third parties, so that he is entitled to have the security registered in his name (if it is a registered-form instrument). Hence, the possibility that the issuer may be compelled to recognize both the bona fide purchaser and the original "true owner"[76] of the security, if the issuer fails to perform certain duties in connection with registration.[77] Thus, the issuer may have to recognize 100 shares of its stock owned by a bona fide purchaser, and the 100 shares of the original owner who, by hypothesis, was wrongfully deprived of his stock. In consequence, where there were originally only 100 shares owned by A, the issuer may now have

---

[74] See the agreement between the American Law Institute and the National Conference of Commissioners on Uniform State Laws establishing the Permanent Editorial Board, reprinted in the 1962 Official Text of the UNIFORM COMMERCIAL CODE at p. xi.

[75] Code § 8-202(2)(a). If the defect involves a violation of a constitutitonal provision, the security is validated only when held by a subsequent purchaser, that is one "who takes other than by original issue," Code § 8-102(2). Special rules are stated for validating defective or iregular governmental issues of securities in Code § 8-202(2)(b).

[76] See Code §§ 8-404(2) and 8-405.

[77] These duties are stated in Code §§ 8-401 and 8-404(1).

to recognize 200 shares, 100 of them owned by A and 100 by B (the bona fide purchaser). The same situation may arise when a security is apparently lost, stolen or destroyed. Suppose that A's certificate for 100 shares is stolen. On making proper affidavits, etc., A obtains a new certificate for 100 shares which he subsequently transfers to B, a bona fide purchaser without notice of the situation. B is entitled to have his newly purchased 100 share certificate registered by the issuer. Subsequently, the original stolen certificate is transferred by the thief to C, a bona fide purchaser without notice; C is entitled to registration of his 100 shares. Thus, under the Code, the issuer must honor certificates for 200 shares.

These examples illustrate the possibility — remote as it may be — that compulsory validation of securities might result in overissue. To use the last example, suppose that before C seeks registration of his stock, all of the issuer's authorized shares are outstanding. If the issuer must thereafter register C's stock, and assuming no increase in the authorized shares, there would be an overissue of 100 shares of stock, that is, an "issue of securities in excess of the amount which the issuer has corporate power to issue."[78]

The overissue problem, as posed by this example, is more acute conceptually than practically. Practically, most corporations will have treasury shares on hand, or an excess of authorized over outstanding shares, and can meet any obligation without overissue. Conceptually, it has long been established that a corporation may not issue shares in excess of the authorized number,[79] that such an overissue is "void" and a "nullity,"[80] and that the overissued shares may not be cured even by retroactively amending the articles of incorporation,[81] although new securities may be authorized and exchanged for the void overissue.

The Code could have, but did not, require issuers to validate securities without regard to overissue, treating this as only a technical barrier to recognizing the rights of innocent purchasers and true owners. A statute adopting such an approach is, in substance, say-

[78] Code § 8-104(2). Because of the sweep of the definition of "security," Code § 8-104 apparently applies to overissue of bonds as well as of stock. The Official Comments, however, concern themselves solely with stock, as if the provision had no application beyond stock. Although it might be argued that the phrase in Code § 8-104(2) referring to "corporate power to issue" necessarily refers only to stock, this is inconclusive since such language is equally descriptive of a municipality's power to issue or not issue bonds. It is to be assumed that the provision applies to all securities, since otherwise there would be an inexplicable gap in the statutory coverage. In all events, overissue of creditor securities rarely presents the archaic though acute conceptual problems of a stock issue. At any given time, ordinarily the bond ceiling is not touched, since bonds are regularly retired in normal practice, thereby reducing the total outstanding.

[79] Railway Co. v. Allerton, 85 U.S. (18 Wall.) 233 (1873).

[80] See New York, N.H.R.R. v. Schuyler, 34 N.Y. 30 (Ct. App. 1865).

[81] Triplex Shoe Co. v. Rice & Hutchins, 17 Del. Cr. 356, 152 Atl. 342 (1930).

ing that, whatever the corporation's charter may say about the number of authorized shares, the statute authorizes any additional number needed to validate securities, without requiring shareholder action to increase the number of authorized shares. Whatever the public policy behind the rule against overissue, it is not violated by such a statutory approach which, moreover, has the merit of simplicity contrasted with the complex problems in the Code's overissue provision. True it is that compulsory "overissue" will dilute the shareholders' equity interest, but this is also true when already authorized shares are issued; this problem is not peculiar to overissue. Nor is compulsory overissue such a simple way out that issuers will be negligent in registering transfer, since there would still be liabilities for the issuer's negligent mis-registration. Certainly, in the few instances where overissue may result, the chance of manipulating the corporation's stock structure is so slight as to be non-existent, but if it did occur the guilty parties would have breached their fiduciary duties. The only area where overissue might be injurious is in a close corporation, where forced overissue may upset a carefully devised balance of control. But here transfer of shares is least likely, some form of consent to the transfer usually is required, and the facts concerning the transfer are usually known. One can only suppose that the Code's aversion to this approach has a totemic character: a ritualistic deference to ancient rules carrying a strong emotional charge.

The Code device to deal with overissue is two-fold: either the corporation must purchase and deliver "an identical security which does not constitute an overissue" if "reasonably available for purchase," or, if not, the luckless security holder may have damages.[82] These provisions contain a variety of knotty problems.

The touchstone of this provision is whether a security is "reasonably available for purchase." On the surface, this seems a simple test. Certainly, a security is "reasonably available for purchase" if it is traded on an exchange or on the over-the-counter markets, or if one or more holders are willing to sell the needed shares at a reasonable price. The question is a factual issue depending on the individual circumstances of the case.

A question on which neither the Code nor the Official Comments throw light is whether a security is "reasonably available for purchase" if, despite a supply of shares at a reasonable price, the corporation is financially unable to make the purchase which the holder of the overissued security "may compel." This financial inability may be due to the corporatiton's insolvency, or to statutory or indenture requirements of maintaining a sufficient 'cover' for preferred stock liquidation preferences, or other corporation law restrictions

[82] Code § 8-104(1).

on the accounts out of which share purchases may be made. Thus, the Model Business Corporation Act forbids purchase of shares except out of earned surplus or, with two-thirds shareholder approval, out of capital surplus, but limits this power by a solvency requirement.[83] These limitations are waived for limited categories of stock purchases,[84] but none of these is relevant to the Code problem. Although the Code provision seemingly focuses on finding someone ready, willing and able to sell the shares at a reasonable price, certainly a corporation cannot meet this if it would violate corporation law limitations on the use of its funds. Perhaps the simplest solution is for the corporation law to recognize that the normal limitations on use of corporate funds for stock purchases do not apply to obtaining shares, if available, to fulfill an obligation of validating security and avoiding overissue.[85]

The same Code provision (§ 8-104(1)(a), contains another problem. Assuming the availability of stock for purchase out of lawful funds, the Code states that the holder of the security "may compel the issuer to purchase and deliver" the security. The phrase "may compel" is ambiguous. Linguistically, it may mean that the security holder has an option to compel the issuer to purchase and deliver a new security or to pursue some other undefined remedy. The traditional remedy is a suit for damages.[86] Assuming that this remedy is not preempted by the Code under its "may compel" language, the measure of damages is uncertain. Since the security is, by hypothesis, "reasonably available for purchase," the measure of damages stated in Section 8-104(1)(b) is not applicable, since it applies only if the security is *not* "reasonably available for purchase."

It is not clear why the Code does not use language unmistakably declaring that, assuming the security is "reasonably available" for purchase, this is the exclusive remedy. Since the security holder's original intention was to obtain a security, his reasonable expectations are met if his sole remedy is to obtain "an identical security which does not constitute an overissue." Certainly, if the Code is to pursue the somewhat devious remedy it has set out, instead of the simpler procedure of compulsory overissue, it would be well to simplify matters, and make it clear that, assuming reasonable availability, (1) the issuer has a duty to purchase and deliver a new security, and (2) the security holder has a duty to accept delivery of the shares.[87]

---

[83] ABA-ALI MODEL BUS. CORP. ACT § 5 (1953).

[84] *Ibid.*

[85] Such a clause could readily be added to the third paragraph of Section 5 of the ABA-ALI MODEL BUSINESS CORPORATION ACT, although the context here would limit it to the purchase of shares, and not all "securities" as Code § 8-104 provides.

[86] See New York & N.H.R.R. v. Schuyler, 34 N.Y. 30 (Ct. App. 1865) and the Official Comment to Code § 8-104.

[87] For example, Code § 8-104(1)(a) might be revised to read somewhat as follows:

The Code provides that if a security is not reasonably available for purchase, the holder of the defective security may recover from the issuer the price which he or the last purchaser for value paid for it with interest from the date of his demand.[88] This statutory damages rule supposedly removes the case-law uncertainty as to the measure of damages and prevents speculation, although some curious results this rule may produce would likely have the opposite effect.

Suppose that *A* purchased part of a new stock issue at 20 in 1955 not knowing that the particular shares he acquired were in overissue. He learns of this defect in 1960. He demands that the corporation replace the defective shares with ones not constituting an overissue, but shares are not "reasonably available for purchase." Under Code Section 8-104(1)(b) he is entitled to "recover from the issuer the price he . . . paid for it." But at the date of his 1960 demand, identical but valid shares of the stock are worth only $3.00. If *A* may enforce his demand, he is at a real advantage relative to the other shareholders who obtained a valid issue, because he receives a windfall of $17 (the difference between his purchase price of $20 and the current value). The corporation, in effect, suffers a penalty which may be undeserved if the overissue was inadvertent or otherwise not in bad faith or in breach of duty. The tables are turned if the shares *A* purchased in 1955 at 20 are now worth $50. Under the Code rule, the corporation need only pay *A* $20 plus interest. In effect, *A* suffers a serious detriment, to the amount of $30 per share (the difference between the $20 purchase price and the current $50 value). The Code rule scarcely makes him whole, since obviously he would prefer to have shares, not his original purchase price. A similar analysis would apply under the Code's last-purchaser-for-value rule.

UNAUTHORIZED INDORSEMENTS AND WRONGFUL TRANSFERS

A. *Rights of Purchasers and True Owners:*

The Code provisions on registering transfer of securities cannot be understood apart from the distinction between (1) a transfer which is wrongful because the indorsement effecting transfer is "unauthorized," and (2) a transfer which is wrongful for reasons other than an "unauthorized" indorsement.[89] This distinction has important con-

---

"(a) if an identical security which does not constitute an overissue is reasonably available for purchase, or is otherwise available for delivery, the exclusive remedy of the person entitled to issue or validation shall be to compel the issuer to deliver, or purchase, and deliver, to him the new security against surrender of the security, if any, which he holds; . . . ."

[88] Code § 8-104(1)(b).

[89] This distinction is especially clearly drawn in Code § 8-315(1), (2).

sequences both for the transferee of the security and for the issuer who registers the transfer. Briefly capsuled, if the indorsement is "unauthorized," even a boda fide purchaser is not protected against the true owner's overriding claim;[90] and the issuer who registers transfers under such an indorsement is absolutely liable to furnish the true owner with a new security.[91] On the other hand, if the indorsement is not "unauthorized" but the transfer is otherwise wrongful, the bona fide purchaser prevails over the true owner,[92] and the issuer is not liable for registering transfer to the bona fide purchaser.[93] From this, it is evident that important rules of law turn upon the concept of the "unauthorized" indorsement.

To begin with, indorsement plus delivery is the proper method for a registered-form security to be transferred from one owner to another.[94] For instance, one indorses a share of stock when he signs the usual assignment clause on the back of the stock certificate.[95] In general an indorsement is made when an "appropriate person" signs the security.[96] Various "appropriate persons" are listed by the Code.[97] The most obvious instance is an adult registered owner of the security who is specified by the security or a special indorsement as entitled to it.[98] Not only is he an "appropriate person" to indorse, but a transfer by him is "authorized," and a bona fide purchaser of the indorsed security has the rights already indicated.

The questions are trickier when the "appropriate person" is a fiduciary.[99] Fiduciary security transfers have created serious problems, and it is the strength both of the Code and of the earlier Simplification Act to relieve these problems and make fiduciary securities more marketable than was possible under prior law and practice. Under the Code, a trustee or executor or guardian, etc., is an

---

[90] Strictly speaking, this is so; but if the bona fide purchaser has actually "received a new, reissued or re-registered security on registration of transfer," he does prevail. Code § 8-311(a). That is to say, if he has run the gauntlet of obtaining registration of transfer from an issuer who has discharged his duties of inquiry, and still does not know of the unauthorized indorsement, he may retain the security.

[91] Code §§ 8-315(2) and 8-404(2).

[92] Code § 8-315(1).

[93] Code §§ 8-404(1) and 8-403.

[94] See the definition of "bona fide purchaser" in Code § 8-302, as one who innocently and for value "takes delivery of a security in bearer form or of one in registered form issued to him or indorsed to him or in blank."

[95] He may also sign a separate document. Code § 8-308(1), which departs from UNIFORM NEGOTIABLE INSTRUMENTS LAW § 30, ARIZ. REV. STAT. ANN. § 44-431 (1956), but is consistent with UNIFORM STOCK TRANSFER ACT § 1, ARIZ. REV. STAT. ANN. § 10-231(A)(2) (1956).

[96] Code § 8-308(1).

[97] Code § 8-308(3).

[98] Code § 8-308(3)(a).

[99] Code § 8-308(3)(b) - (d).

"appropriate person" to indorse the security because he is the one "specified by the security or by special indorsement to be entitled to the security."[100] All is well and good if the trustee or executor is acting properly, that is, in accordance with a court order or the terms of the instrument creating the fiduciary relationship.

But a fiduciary who is clearly an "appropriate person" to indorse the security may be acting "wrongfully" in the sense that his action is contrary to the terms of the instrument or court order.[101] Two policies now conflict: preserving the beneficiary's interest from the fiduciary's wrongful acts, and insuring that bona fide purchasers may keep what they get. Prior law favored the beneficiary in this situation, leaving the purchaser's position uncertain — and thus infringing the ready transfer of investment securities. The Code emphatically reverses this position. First, and perhaps most important, knowledge that one acquires securities from a fiduciary creates no duty to inquire whether the fiduciary transfer is rightful, nor is it notice of adverse claihs.[102] This may seem shocking if, in a small town, one buys through personal arrangements a stock certificate representing an interest in a close corporation and specifying a fiduciary as owner; even so, there is room to argue that the innocent purchaser's interest should override the competing claims of others. But this rule is not at all shocking for public-issue corporations, whose securities are listed on an exchange or traded over-the-counter. It would be intolerable if an Arizona purchaser were to acquire a stock certificate for 1000 shares of General Motors and upon learning that the prior owner was a named fiduciary in Rhode Island was forced to inquire into the validity of the transfer or suffer the possible loss of his investment. Even more significant is the fact that the purchaser is likely never to see the certificate naming the prior owner, hence may never know of the prior owner, and thus could not have inquired had he desired to do so.[103] On a whole, if one is really committed to making invest-

[100] It is assumed in Code § 8-308(b)-)(d) that the fiduciary is a "person specified by the security or by special indorsement to be entitled to the security," thus reading the language of Code § 8-308(3)(a) into the succeeding subparagraphs of subsection (3).

[101] This is clear from Code § 8-308(7). See also Code § 8-403(3) for parallel rules when the security transferred by a fiduciary is presented to the issuer for registration of transfer.

[102] Specifically so stated in Code § 8-304(2). But if the purchaser knows that the proceeds of the fiduciary transfer are being used or the transaction is for the fiduciary's individual benefit or otherwise in breach of his duty, the purchaser is charged with notice of adverse claims, and thus cannot be a bona fide purchaser under the definition in Code § 8-302 and hence loses rights under Code § 8-301(2).

[103] In transactions on the organized markets, the purchaser rarely if ever sees the certificate of the prior owner or even knows his identity, although he can, if he wishes, usually find out. For the seller's broker may have the seller's certificate registered into his name for purposes of sale, and thus the purchaser sees only the new certificate, if, indeed, he sees any at all. (He may maintain his securities in his broker's street name.) Less often, the buyer's broker may obtain the seller's certificate and register transfer of it into the name of the buyer or the broker.

ment securities fully negotiable, this rule regarding fiduciary security transfers is desirable, and is indeed a logical consequence of the concept of negotiability.

Secondly, the bona fide purchaser of the security from the wrongdoing fiduciary is entitled to have the issuer register his ownership. Although the transfer is wrongful, the issuer must honor this demand, since the transferee is a bona fide purchaser.[104]

Thirdly, the true owner — perhaps a successor trustee, or a substitute executor, etc., or the beneficiary — has no right to recover the security from the bona fide purchaser.[105] Nor may he recover from the issuer who registered transfer, if the issuer observed his obligations.[106] The true owner's remedy is against the defaulting fiduciary or his surety, if any.

To return to the concept of the "unauthorized" indorsement. The defaulting fiduciary is clearly an "appropriate person" to indorse, since the Code standard is essentially an objective one: whether the indorser is one specified by the security and recognized by the Code rules.[107] Moreover, the indorsement is, in the special Code sense of the term, an "authorized" one, or more exactly, it is not "unauthorized."[108] Some confusion is produced by the use of this term, for in common parlance one would say that a fiduciary acting in breach of trust is doing an "unauthorized" act. But under the Code definition, a signature or indorsement is "unauthorized" only if it lacks actual, implied, or apparent authority.[109] Certainly on common law agency concepts, a trustee or other fiduciary in whose name the security is registered would have at least apparent authority to make the indorsement or signature needed to transfer the security. Thus, an indorsement is "unauthorized" only if actual, implied or apparent authority is lacking. Although the Code does not in terms lay down this general proposition, it is normally true that an indorsement by an "appropriate person" will not be "unauthorized" for Code purposes. Thus, Section 8-308(7) states that a fiduciary's failure to comply with the instrument or court order or state law "does not render his indorse ment unauthorized for purposes of this Act." And whether or not

---

[104] See Code § 8-401, especially § 8-401(1)(e).
[105] Code § 8-315(1).
[106] Code § 8-404(1).
[107] Code § 8-308(1), (3).
[108] There is some confusion on this term and other apparently synonymous terms used in Article 8. An indorsement is not "unauthorized" (see Code § 8-311 and § 8-315(2)) and is "genuine and effective" (see Code §§ 8-401(1)(b) and 8-402(1)) if the signature itself is "genuine" and the signer is an "appropriate person" to make the indorsement. The so-called "signature guarantee" (see Code § 8-312(1)) warrants this together with the signer's legal capacity to sign. An indorsement is made when "an appropriate person signs" the security (Code § 8-308(1)).
[109] Code § 1-201(43) (definition of "unauthorized").

one is an "appropriate person," is judged as of the date of signing, so that subsequent events, *e.g.*, removal of the fiduciary, do not affect the transfer.[110]

Given the broad coverage of the "authorized" indorsement, when will an indorsement be "unauthorized"? The most obvious example is a forgery,[111] *e.g.*, of the name of an individual owner or of a fiduciary. For example, *A's* certificate for 100 IBM shares is stolen and the thief forges *A's* name. The shares are sold through a broker, and purchased by *B*, a bona fide purchaser without notice of the theft. Clearly, the indorsement is "unauthorized" because it is a forgery, and *A* may claim the shares over *B*. But if *B* has presented the certificate for registration and has in good faith received a new security,"[112] *i.e.*, a new stock certificate for 100 IBM registered in his name, he will prevail over *A's* claim. Other "unauthorized" indorsements would include an unauthorized corporation officer (*e.g.*, the secretary or treasurer indorsing a security owned by the corporation), or perhaps a limited partner indorsing a stock certificate owned by the firm, and so on. As the above example indicates, the innocent purchaser who actually received a "new, reissued, or re-registered security" is in the most favored position of all, since he may acquire good title to a security even under a forged or otherwise unauthorized indorsement.

B. *Registration of Transfers: Issuer's Liabilities and Duties.*

The distinction between "unauthorized indorsements" and otherwise wrongful transfers brings the registration provisions of the Act into proper focus. Speaking generally, if the indorsement is unauthorized, the issuer is absolutely liable to give the true owner an identical security,[113] but the issuer does have certain rights over to ease its absolute liability.[114] If the transfer is wrongful for a reason other than an unauthorized indorsement, the issuer will not be liable at all to the true owner for registering transfer into another's name if it meets certain requirements;[115] and, indeed, it may have a duty to register the transfer to a bona fide purchaser even though the transfer was wrongful.[116]

---

[110] Code § 8-308(6).

[111] "'Unauthorized' signature or indorsement . . . includes a forgery." Code § 1-201(43).

[112] Code § 8-311(a).

[113] Code § 8-404(2).

[114] See text accompanying notes 144-151 *infra*.

[115] Code § 8-404(1). These requirements are (1) the security carries the necessary indorsements, and (2) the issuer has discharged its duty of inquiry or had no such duty.

[116] Code § 8-401, especially § 8-401(1)(e).

Before elaborating these ideas, it is well to see where the Code concepts stand in the spectrum of possible legal rules on the subject.

One possible approach is to hold that the issuer (who registers transfer of securities) is not liable at all for registration of securities, whether under an "unauthorized" indorsement (in the Code sense) or pursuant to an otherwise wrongful transfer. Apparently, no cases ever took so extreme a view, which would exonerate the issuer from all duties in this area.[117]

Prior to the Code and the Simplification Act, the prevailing view was that the issuer had extensive duties to inquire into the validity of a transfer before registering transfer, and that the issuer would be liable to the true owner for registering a wrongful transfer.[118] The case law largely involved fiduciary security transfers, and the only safe thing for the issuer was to make absolutely certain that the transfer was in every respect rightful, *viz.*, proper indorsement by an incumbent fiduciary whose transfer of the securities was authorized by the instrument or court order, with all sorts of assurances (such as guaranties and sureties) that the fiduciary had such authority, that the controlling instrument was valid and effective, that the court order was within its jurisdiction, and so on. The upshot of this was that fiduciary security transfers became very lengthy, involved, and expensive — the very antithesis of the ready marketability which is a prime element of the "negotiability" concept.

Several ideas lies behind the prior law. First, the issuer was thought to have an actual role in the transfer itself. Probably all stock, and many bonds, recite that they may be transferred "only on the books of the corporation." This implied, and the theory came to be, that until the corporation's books were changed to reflect the new owner, the transfer was incomplete. The stock had been "assigned" but it had not as yet been "transferred," to use the old terminology still current among transfer agents and also used in the Simplification Act (but not in the Code.)[119] On this theory, "transfer

[117] The issuer had no duty of inquiry into the rightfulness of a particular transfer under the pre-1848 American view, *e.g.*, Bank of Virginia v. Craig, 6 Leigh (50 Va.) 399 (1835), and the English case-law, *e.g.*, Hartga v. Bank of Eng., 3 Ves. Jr. 56, 30 Eng. Rep. 891 (Ch. 1796), and under current English statutes, Companies Act, 1948, 11 and 12 Geo. 6, c. 38, § 117 (which forbids the English equivalent of the stock transfer books to carry any notice of "any trust, express, implied or constructive.") See also Sections 73-85. In England, however, the issuer is liable for registering transfer on forged instruments. See note 151 *infra.*

[118] For authority for this general proposition, see, *e.g.*, Braucher, *Security Transfer by Fiduciaries*, 43 Minn. L. Rev. 193 (1958); Conard, *A New Deal for Fiduciaries' Stock Transfer*, 56 Mich. L. Rev. 843 (1958); Uniform Commercial Code § 8-402, Official Comment.

[119] The Simplification Act speaks of "assigning" the security, Simplification Act § 1(a), Ariz. Rev. Stat. Ann. § 14-1121(7) (Supp. 1962), and "transferring" it, Simplification Act § 1(g), Ariz. Rev. Stat. Ann. § 14-1121(7) (Supp. 1962). Under the Code, a security is "transferred" when it is delivered, and its transfer

on the books" meant more than just registration; it was an integral part of making over title to the security. The fact is that, while the old terminology persisted and fiduciary security transfers were scrutinized with surgical and hence costly thoroughness, the meanings changed. Certainly since the Uniform Stock Transfer Act, a transfer of the stock certificate transferred the entire interest which was subsumed into the instrument itself, and the transfer was effective whether or not the new owner registered himself on the corporation's books. But, of course, one will wish to do so, since the corporation need only look to the registered owner to pay dividends or interest, mail out proxies, etc. The long-run tendency of corporate practice is to treat transfer "on the books of the corporation" as a registration procedure. Logically, this is what it is, and transfer "on the books" should have nothing more to do with the actual transfer than recording a deed has to do with the validity of the transfer of land, probably less.

Secondly, because of the old idea that the issuer somehow perfected the transfer, the doctrine rather suddenly emerged that an issuer is in a trust relationship to all persons having an interest in the issuer's stock or bonds. Thus, the root American case — *Lowry v. Commercial & Farmers' Bank*[120] — laid down the proposition that a corporation is

> the custodian of the shares of stock, and clothed with power sufficient to protect the rights of everyone interested, from unauthorized transfers; it is a trust placed in the hands of the corporation for the protection of individual interests, and like every other trustee, it is bound to execute the trust with proper diligence and care and is responsible for any injury sustained by its negligence and misconduct.[121]

This dictum spawned a line of decisions whose common thread is the trustee concept: that the corporation must guarantee the rightfulness of any security transfer when it registers transfers on the books. Perhaps the most serious problem was the corollary concept that the issuer had constructive notice of any publicly recorded document bearing on the rightfulness of transfer, *e.g.*, a will or order of court appointing a fiduciary, or documents filed with the issuer.

The Simplification Act was the major step towards working out a simple, inexpensive, easy method of transferring securities held by fiduciaries. The thrust of that Act is contained in provisions which allow the issuer to assume the rightfulness of a fiduciary security

---

is "registered" by the issuer. These terminology changes are desirable, since they more accurately reflect what takes place when securities are bought and sold, and the purchaser becomes a record owner of the security.

[120] 15 Fed. Cas. 1040 (No. 8581) (C.C.D. Md. 1848).

[121] *Id.* at 1047.

transfer,[122] absent notice ofadverse claims given in a prescribed form,[123] and which negate the issuer's liability when it acts in accord with the statute.[124] The Code generalizes the theory of the Simplification Act, and takes the important step of declaring the rules applicable to *all* security transfers, whether by fiduciaries or by others. For the first time, in any statute of general application, it declares rules for the registration of transfer, including codification of the issuer's duty to register,[125] its duty of inquiry,[126] the "assurances" of the issuer may demand,[127] and finally the scope of its liability under the Code.[128]

The key to easing the issuer's burden is to limit its duty to inquire into the validity of the transfer it is asked to register. Here the Code departs sharply from prior law by confining the inquiry duty to two specific situations, but it does not go so far as the early American rule which relieved the issuer of *all* duties of inquiry, except perhaps such as might be involved under a good faith obligation to avoid "wilful, reckless, or wantonly negligent" injury by its act.

The subject of this duty of inquiry, both under the old law and in greatly attenuated form under the Code, is the existence of claims adverse to the transferee seeking registration. Previously, the issuer could never be certain of its immunity unless it was assured that there were no valid adverse claims. This was all the more difficult since "notice" of adverse claims might be imputed to an issuer in various ways, *e.g.*, constructive notice of the contents of a probated will,[129] from a relevant document furnished to it for some other purpose,[130] from the fact that the transfer books disclosed a fiduciary interest,[131] or under common law agency rules as to the effect of an agent's knowledge or notice of the wrongfulness of a transfer. Under the Code, the inquiry duty and imputed notice are largely elim inated, leaving only two fairly specific situations calling for full

---

122 Simplification Act § 3(a), ARIZ. REV. STAT. ANN. § 14-112(1) (Supp. 1902).

123 *Id.* § 5(a), ARIZ. REV. STAT. ANN. § 14-1125(A) (Supp. 1962).

124 *Id.* § 6, ARIZ. REV. STAT. ANN. § 14-1126 (Supp. 1962).

125 Code § 8-401.

126 Code § 8-403.

127 Code § 8-402.

128 Code § 8-404.

129 Lowry v. Commercial & Farmers' Bank, 15 Fed. Cas. 1040 (No. 8581) (C.C.D. Md. 1848).

130 Browning v. Fidelity Trust Co., 250 Fed. 321 (3d Cir.), *cert. denied*, 248 U.S. 564 (1918) (notice to commercial department of bank held notice to trust department); Hazzard v. Chase Nat. Bank, 159 Misc. 57, 287 N.Y. Supp. 541, 559 (Sup. Ct. 1936) (similar situation).

131 Magwood v. Railroad Bank, 5 S.C. 379, 390-92 (1874).

inquiry.[132]

The first and most important occasion for a duty of inquiry is the issuer's receipt of a stop-transfer notice, in prescribed form, before registering transfer.[133] In that case, it may withhold registration, and notify the claimant that the security has been presented for registration. The burden is upon the claimant either to obtain an order restraining registration of transfer, or to furnish a bond protecting the issuer from any liabilities for not registering transfer of the security into the purchaser's name.[134] The Code evidently contemplates strict adherence to this procedure, since the issuer need suspend registering transfer to the new owner only if (1) it has actually received the stop-transfer notice before registration, (2) the notice sufficiently identifies the security and the adverse claimant to be keyed into the issuer's records (the "transfer books") or its business machines, and (3) the adverse claimant duly responds to the issuer's notice to it of the proposed registration of transfer. Clearly, if the claimant takes the proper steps, the issuer cannot plead lack of actual knowledge of the adverse claim. And if the claimant fails to do so, the issuer is privileged to register transfer into the new name. Thus, if, after notice from the issuer, the original owner cannot secure a restraining order, or cannot furnish the bond, the issuer is relieved of liability for registering transfer. Indeed, he may have a duty to do so.[135]

In order to make assurance doubly sure, the Code specifically declares that, absent proper notification as just outlined, the issuer is under no duty to inquire further although in a sense it "knows" that there are claims.[136] Thus the issuer need not inquire into a known fiduciary relationship, or into the rightfulness of a fiduciary transfer, or into court records or even into a relevant document in its possession.[137] The objectives of these exoneration provisions are recognitio nof the issuer as essentially a registrar, easing its potential liabilities, and making all securities more marketable by enabling the bona fide purchaser to secure prompt registration of the security into his name. These provisions largely parallel Simplification Act provisions which pursue the same policy reasons.

From all of this, it follows that the issuer is *not liable* for regis-

---

[132] One of these situations is not further discussed. It is the duty of inquiry which arises when the issuer demands copies of a will, trust, or other controlling instrument, as permitted by Code § 8-402(4), in which case it is charged with notice of whatever those documents might disclose regarding adverse claims to the security it is asked to register, Code § 8-403(1)(b).

[133] Code § 8-403(1)(a).

[134] Code § 8-403(2).

[135] See Code § 8-401(1).

[136] Code § 8-403(3).

[137] Code § 8-403(3)(a) - (c).

tering transfer, if, as assumed, (1) the security has the necessary indorsements, *i.e.*, the indorsements are not unauthorized and (2) the issuer has discharged its inquiry duty. Although the issuer is relieved of liability for registering a transfer, it may turn out that, as between the various claimants, the original owner is entitled to the security. Perhaps he is able to establish his claim under Section 8-315 by showing that, after all, the transferee was not a bona fide purchaser. But this subsequent determination does not and should not affect the issuer who had before it a duly indorsed security and discharged its inquiry duty. In short, the issuer has the privilege of registering the transfer, and is not liable under specific statutory standards. Hence, a final ruling on the competing ownership interests would not retroactively create liability on the issuer. In this situation, presumably the court, as part of the full relief, would order registration of the security back into the original owner's name.

Although the issuer has the privilege of, and hence no liability for, registering transfer to the purchaser, it does not follow that it has a duty to do so. To establish a specifically enforceable duty to register, with consequent liability for non-registration, other factors must be shown. For instance, there is a duty to register transfer if "the transfer is in fact rightful."[138] There is a duty to register transfer if "the transfer . . . is to a bona fide purchaser" even though the transfer is wrongful.[139] And if the issuer "has no notice of or duty to inquire into adverse claims," it can and it should register transfer without inquiry as to the rightfulness of a transfer.[140] In all of these instances, it is assumed that the indorsement is not "unauthorized" and that the issuer had no duty to inquire into adverse claims or, given such a duty, has discharged it. But certainly there is no duty to register transfer if the indorsement is a forgery,[141] or if the presenter refuses to give the issuer the "reasonable assurance . . . that those indorsements are genuine and effective,"[142] or if the issuer had not had time to investigate.[143] "If the security is properly indorsed but nevertheless the transfer is in fact wrongful, there is no duty *unless the transfer is to a bona fide purchaser.*"[144]

We have asserted that, if the indorsement is unauthorized, the issuer remains absolutely liable for registering transfer on such an

---

138 Code § 8-401(1)(e).

139 *Ibid.*

140 Official Comment to Code § 8-401.

141 See Code § 8-401(1)(a).

142 Code § 8-401(1)(b).

143 See Code § 8-401(1)(c).

144 Official Comment to Code § 8-401. (Emphasis added).

indorsement. This is true no matter how careful it may have been to ascertain the facts. Although superficially this may seem a harsh result, in practice the issuer has adequate protection. First, it is clearly under no *duty* to register transfer if the indorsement is unauthorized;[145] presumably this means if it has well-grounded reason for thinking so, although this cannot be categorically stated. In all events, if the presenter sues the issuer to specifically enforce registration, the issuer can raise the question in court. Second, since the issuer may demand "reasonable assurance" that the indorsement is "genuine and effective,"[146] it may, before acting, compel production of relevant documents, especially those relating to fiduciary security transfers, *e.g.*, a will, trust, etc.[147] However, the issuer is penalized for doing so, since a demand for such documents automatically puts it on notice as to all facts respecting the *rightfulness* of the transfer.[148] Seemingly, the issuer is caught between the Scylla of absolute liability for registering transfer on an unauthorized indorsement, and the Charybdis of imputed notice of all relevant facts. This apparent dilemma is resolved since the issuer may protect itself by demanding a signature guarantee, which certifies that the signature is genuine, the signer is an appropriate person to sign, and had legal capacity to sign.[149] As Carlos Israel has said, "This warranty is intended as coterminous in scope with the absolute liability of the issuer for registration of transfer on an unauthorized signature."[150] Like guaranties may be demanded when an agent or fiduciary is the indorser.[151] The issuer will still be liable if it registers transfers on an unauthorized indorsement; but it has a right over against the guarantor which is often an institution such as a bank or investment house, which in turn is likely to be protected by bonds and insurance.[152]

In contrast, on registering a merely wrongful transfer, the issuer

---

145 See Code § 8-401(1)(a).

146 Code §§ 8-401(1)(b) and 8-402(1).

147 Code § 8-402(4).

148 Code § 8-403(1)(b) and (3).

149 Code § 8-312(1), as permitted by Code §§ 8-401(1)(b) and 8-402(1)(a).

150 Israels, *Investment Securities as Negotiable Paper — Article 8 of the Uniform Commercial Code,* 13 Bus. Law. 676, 685 (1958).

151 Code § 8-402(1)(b) - (e).

152 Thus the effect is to allow the true owner to recover directly from the issuer at once, *viz.*, as promptly as the matter can be amicably adjusted or a suit adjudicated or settled out of court.

Another possible protection for the issuer is suggested by the English Forged Transfers Act, 54 and 55 Vict., c. 43 (1891), which authorizes corporations to make cash payments out of their funds for any loss arising from registering transfers on a forged instrument. In order to build up a fund to meet such obligations, the issuer may impose a fee of up to 1 shilling per £100 transferred, and may impose other reasonable restrictions to protect itself against forged transfers.

is not absolutely liable. Its liability is a function of its own fault: failure to perform its limited duty of inquiry. Like all fault-based liabilities, presumably the issuer can avoid doing wrong. Since the issuer's liability does not depend upon the rightfulness of the transfer it cannot demand, as a precondition to registering transfer, an assurance that the transfer is in fact rightful (a so-called "indorsement guarantee").[153]

Article 8's treatment of lost, stolen, or destroyed securities goes well beyond the counterpart provisions of the Uniform Stock Transfer Act[154] and thereby reflects the rigorous working out of the Code policy favoring investment security negotiability. If a security is lost, stolen or destroyed, the Code expects the owner to take the usual prudent steps to protect his interest: to notify the issuer immediately of what has happened, properly in the form of a stop-transfer notice, and secure from the issuer a new security.[155] Moreover, the owner should not leave the security indorsed, for if he does, a thief or finder can easily effect delivery of the security. Since the owner's indorsement appears on the security, the indorsement is not "unauthorized," a bona fide purchaser may take all rights under it, the issuer is not liable for registering transfer (assuming the original owner gave no notice), and may have a duty to register it in the purchaser's name. The Code does not gladly suffer the fool who has not taken the simple precautions of not indorsing his security and not notifying the issuer if his security is lost, stolen or destroyed.

The issue of a new security for the one lost, etc., is a duty of the issuer if the owner (1) seeks it before the issuer has notice that a bona fide purchaser has acquired the original security, (2) gives the issuer a sufficient indemnity bond, and (3) satisfies other reasonable requirements, such as an affidavit of circumstances of the security's disappearance.[156] The old procedure of the Code abandons the Stock Transfer Act's clumsy and seldom-used procedure requiring a court

---

[153] An indorsement guarantee carries the same warranties as a signature guaranty, see text accompanying note 148 *supra* and Code § 8-312(1), but also guarantees "the rightfulness of the particular transfer in all respects." Code § 8-312(2). As noted in the text, no issuer can demand such a guaranty as a condition to registering transfer. Code § 8-312(2). But the indorsement guaranty may be "voluntarily" given to an issuer in order to speed up registration, since the issuer would presumably register transfer without extensive inquiry into the transfer if it knew that the guarantor stood behind it with a complete warranty. Thus, the indorsement's guaranty role is to eliminate the bottleneck, especially in fiduciary security transfers, of delay growing out of the issuer's privilege and duty of making even the limited inquiries provided for in Code § 8-402.

[154] Thus, UNIFORM STOCK TRANSFER ACT § 19, did not specifically cover stolen stock certificates, ARIZ. REV. STAT. ANN. § 10-247 (1956), but by its terms was limited to lost or destroyed instruments. Even so, it has been rather generally applied to stolen certificates.

[155] The owner of a lost, etc., security has a right to obtain, and the issuer a duty to furnish, a replacement security under Code § 8-405(2).

[156] Code § 8-405(2)(a) - (c).

order for a new certificate, and adopts the custom, long prevalent among corporations, of voluntarily issuing a new security on posting a sufficient bond.

The distinctive features of the Code provision arise from the fact that, unlike the situation under the Stock Transfer Act, the original security still remains effective.[157] That is to say, even after issuing a replacement security, the old security must be honored if it later turns up in the hands of a bona fide purchaser, apparently without any time limitation as to the date of its reappearance.[158] The following are some of the possible situations and their treatment under the Code.

(1) *A* loses his bond, and *Y* Corporation issues a replacement bond. The original bond is found and transferred to *B*, a bona fide purchaser. *Y* Corporation must register *B*'s bond.

(2) Same situation as (1) except that registration of *B*'s bond would result in overissue. *Y* Corporation must give *B* the rights under Section 8-104.

In both (1) and (2), *Y* Corporation may recover the replacement bond issued to *A*, and may also recover on the indemnity bond *A* gave.

(3) Same situation as (1), except that, before the original bond was found and transferred to *B*, *A* sold the replacement bond to *C*. *C* is entitled to registration as of course. When *B* acquires the original bond, *B* is also entitled to registration.

(4) Same situation as (3), except that overissue would result if *B*'s bond is registered. *B* is not entitled to registration. He may enforce his rights under Section 8-104.

(5) *A* loses his bond, and *Y* Corporation issues a replacement bond. The original bond is found and transferred to *B*, a bona fide purchaser. *Y* Corporation must register *B*'s bond. Thereafter *A* sells the replacement bond to *C*. *C* is entitled to have his bond registered.

(6) Same situation as (5), except that overissue would result if *C*'s bond is registered. *C* would presumably be relegated to rights under Section 8-104, with *B* keeping the bond itself.

CONCLUSION

Without question, Article 8 of the Uniform Commercial Code eradicates the major uncertainties and fills the principal gaps in existing law governing transfer of investment securities. But the Code

---

[157] This is a consequence of the Code's rigidly applying the concept of the security (the instrument) as the interest itself. Since the instrument is still kicking around, the interest is not cut off by the issue of a replacement security. Another example of this emphasis upon the identity of instrument and interest is the Code rule for levy or attachment of a security. Code § 8-317. As long as the instrument itself is not physically reduced to possession, no effective levy has been made. Hence, an injunction against transfer is not a levy, since the security may still be transferred to a bona fide purchaser contrary to the terms of the injunction.

[158] Code § 8-405(3).

goes beyond merely clarifying and stabilizing the law — themselves no mean virtues — and imaginatively creates a series of new and better rules. Whatever defects or uncertainties Article 8 may contain must be judged against the overall excellence both of Article 8 and of the Code as a whole. A most significant feature is the Permanent Editorial Board whose duty is to keep the Code up-to-date and to deal with deficiencies or defects which will inevitably show up in the cold hard light of litigation, and under further study and analysis. Thus, the Board has already been responsible for adding Section 8-320 prescribing rules for the transfer or pledge of securities within a central depository system, thereby facilitating the already extensive use of clearing operations to settle accounts among brokers. Considerable success has been experienced with a comparable, though less formal, technique in keeping current the ABA-ALI Model Business Corporation Act, chiefly through the continuing oversight of the Committee on Corporate Laws of the ABA Section of Corporation, Banking and Business Law. In fact, that statute has been substantially revised and altered during the years since 1950 when it was promulgated. A very recent illustration is the addition of Section 25A authorizing corporations to enact emergency by-laws for carrying on management functions following an "atomic disaster." Procedures of this sort are one of the soundest guarantees against a statute, streamlined and workable at its inception, subsequently becoming dated and even damaging to the interests it was designed to foster. Considering the deep interest in the Code and the formalized efforts to keep it as a living law, its prospects for long continued utility are very great.