

MINUTES OF THE SENATE COMMITTEE ON JUDICIARY

The meeting was called to order by Senator Jeanne Hoferer at
Chairperson

10:00 a.m./p.m. on February 14, 1985 in room 514-S of the Capitol.

~~All~~ members ~~were~~ present ~~except~~: Senators Hoferer, Burke, Feleciano, Gaines, Langworthy, Parrish, Steineger, Talkington, Winter and Yost.

Committee staff present:

Mary Torrence, Office of Revisor of Statutes
Mike Heim, Legislative Research Department
Jerry Donaldson, Legislative Research Department

Conferees appearing before the committee:

David Barclay, Department of Corrections
Ron Smith, Kansas Bar Association

Senator Hoferer chaired the committee in the absence of Senator Frey.

David Barclay, Department of Corrections, presented a request for a committee bill that would amend K.S.A. 75-6102(d) to permit the state to provide legal representation to teachers or instructors who are under contract with the Department of Corrections to provide educational or vocational training services. Following the explanation, Senator Feleciano moved to introduce the bill. Senator Parrish seconded the motion. The motion carried. See Attachment III

Senate Bill 134 - Revision of investment securities article of U.C.C.

Staff presented background information (See Attachment I).

Ron Smith, Kansas Bar Association, explained the intent of the bill and there will be a request for an interim study.

Senate Bill 103 - Inspection of records relating to juveniles and children in need of care.

Committee discussion was held on the bill.

Senate Bill 108 - Amount of docket fee to go to crime victims reparations fund.

Following committee discussion, Senator Gaines moved to report the bill favorably. Senator Burke seconded the motion. After further discussion, Senator Gaines made a substitute motion to amend the bill by increasing the docket fee two dollars. Senator Winter seconded the motion. The motion carried. Senator Gaines moved to report the bill favorably as amended. Senator Burke seconded the motion. The motion carried.

Senate Bill 109 - Kansas Uniform Transfers to Minors Act.

Following committee discussion, Senator Talkington moved to report the bill favorably. Senator Burke seconded the motion. The motion carried.

The meeting adjourned.

A copy of the guest list is attached (See Attachment II).

2-14-85

INVESTMENT SECURITIES

REVISED ARTICLE 8 OF THE UNIFORM COMMERCIAL CODE

1977 Official Text and Comments

For text of original Article 8, see page 471 et seq. in main volume.

Index to Revised Article 8

See supplement to Volume 3A following the end of the material for Article 11 of the Uniform Commercial Code.

REPORTER'S INTRODUCTORY COMMENT

This proposed revision of Article 8 of the Uniform Commercial Code is an outgrowth of the work of the Committee on Stock Certificates of the Section of Corporation, Banking and Business Law of the American Bar Association. That committee, formed in 1971 in response to the "Paperwork Crunch" in the securities markets during the late 1960's, was charged with determining what legislation, if any, would be advisable to facilitate the elimination, or reduction in the use, of stock certificates and with drafting such legislation as was proposed. The committee's report, issued on September 15, 1975, contained two principal recommendations: 1) that the Model Business Corporation Act be amended in order to permit the issuance of corporate stock in uncertificated form and 2) that Article 8 of the Uniform Commercial Code (and related sections of other Articles) be revised to provide rules to regulate the rights, duties and obligations of the issuers of, and persons dealing with, uncertificated investment securities. Appendix B of the report was a suggested revision of Article 8.

The suggested revision of Article 8 was submitted by the committee to the Permanent Editorial Board for the Uniform Commercial Code which, in turn, referred it to its 348 Committee for review and comment. The revision, with changes suggested by the 348 Committee, was subsequently reviewed by the Permanent Editorial Board and further drafts were presented before the 1976 meeting of the National Conference of Commissioners on Uniform State Laws, the Council of the American Law Institute and the 1977 Annual Meeting of the American Law Institute. At its 1977 meeting, the NCCUSL approved the substance of the revision and referred it to its Committee on Style. That committee made a number of stylistic changes in wording, punctuation and the like, and its product is presented herewith.

In this introductory comment, section references are to the revised Article unless preceded by the word "present". Detailed "Reasons for 1977 Change" follow almost every section of the revision, but the pattern is summarized in this introductory comment in the hope that it will be helpful to an understanding of the general scheme of the revision.

Scope

Perhaps the best approach to describing the scope of the revision is first to state what it does *not* do. The revision does not compel the issuance of uncertificated securities by any issuer. Furthermore, the revision does not authorize the issuance of uncertificated securities, a function of the state corporation laws. What the revision is intended to accomplish is to set forth a coherent group of rules for the issuers, buyers, sellers and other persons dealing with uncertificated securities, to the same extent that present Article 8 deals with these matters with respect to certificated securities. Although the primary focus of inquiry regarding the possible elimination of certificates has been on corporate stock, the revision is broad enough to cover uncertificated debt securities, should such be issued in the future. It might be noted that the most significant uncertificated system now in operation is that conducted by the Federal Reserve Banks for United States Government Bonds. It is possible, and, indeed, probable, that particular issues of securities may, temporarily or even permanently, be partly certificated and partly uncertificated. If such be the case, the choice of form will lie with the owner and provisions are made for exchangeability at the owner's option [8-407].

The present definition of "security" [present 8-102(1)(a)] is restated, in somewhat changed form but without intended change of substance, as the definition of "certificated security" [8-102(1)(a)]. A parallel definition of "uncertificated security" is then provided, differing in that it does not require rep-

Attch. I 2/14/85

UNIFORM COMMERCIAL CODE

resentation by an instrument and somewhat narrower in scope to eliminate the inclusion of some interests, e. g., bank accounts, that a broad construction might otherwise include [8-102(1)(b)]. It is not intended that either definition coincide with the definition of "security" for other purposes, e. g., the federal securities laws. See Comment 3 to Section 8-102.

Approach

There has been a conscious attempt to disturb present Article 8 as little as possible. First, the subject-matter content and order of the forty-one numbered sections of the present statute have been preserved. Only four sections have been added. Three of these have no application to wholly certificated systems [8-108, 8-407 & 8-408].

Secondly, with the exception of only two present sections [8-313 & 8-317] and the other new section [8-321], there has been no attempt to change the law with respect to certificated securities. In some instances, where there seemed to be compelling reasons to do so, certain wording and structure have been changed, but without any intention to change the substance. In most instances, the language of the present Article, as it applies to certificated securities, has been preserved with minor stylistic changes.

Finally, the rules governing uncertificated securities have been formulated to conform as closely as possible to the rules for certificated securities, consistent, of course, with such changes as are demanded by the absence of an indispensable instrument. For example, the rights of secured parties [8-207], the "appropriate person" to initiate requests for registration of transfer [8-308] and the assurances an issuer may require as a condition to complying with such requests [8-402] have been structured in a way to produce a minimum of disparity of results and procedures whether certificated or uncertificated securities are involved.

Transfer

The essential difference between a certificated and an uncertificated security, and that from which the principal difficulties arise, is that the former is represented by an instrument, which may be treated as the property it represents, and the latter is not. Under present Article 8, transfer of a certificated security by purchase, a term which includes all voluntary transfers whether or not for value [present 1-201(32)], is accomplished by delivery of the certificated security to the purchaser [present 8-301(1)] or by some other method deemed to constitute delivery to the purchaser [present 8-313(1)]. Obviously, when a security is uncertificated, there is no instrument to deliver.

In the revised Article, the transfer rules are collected in a single subsection [8-313(1)] and are expressly made exclusive. The basic rule for certificated securities, transfer by delivery, is restated [8-313(1)(a)] and a coordinate rule for uncertificated securities, transfer by registration, is added [8-313(1)(b)]. The present rule, that delivery to the purchaser's broker of a certificated security issued in the name of or specially indorsed to the purchaser constitutes transfer to the purchaser, is preserved [8-313(1)(c)], but is expanded to cover such delivery not only to the purchaser's broker but to any financial intermediary acting for the purchaser. A "financial intermediary" is defined to include (in addition to brokers) banks, clearing corporations and other entities which regularly maintain security accounts for their customers [8-313(4)].

The remaining subparagraphs recognize current security-holding practices and provide explicitly for the transfer of ownership of both certificated and uncertificated securities controlled by third parties. Thus, when the controlling party is a clearing corporation [8-102(3)], transfer is effected merely by book entry [8-313(1)(g)]. When the controlling party is a financial intermediary, but not a clearing corporation, transfer is effected by confirmation to the purchaser accompanied by book entry [8-313(1)(d)]. When the controlling party is not a financial intermediary, transfer is effected by acknowledgment to the purchaser [8-313(1)(e) & (f)]. Three provisions apply only to the creation and release of security interests [8-313(1)(h), (i) & (j)].

Registration of Transfer

Registration of transfer of a certificated security is requested by presenting the security itself, duly indorsed, to the issuer [8-401(1)]. With uncertificated securities that procedure is unavailable, and the request for registration of trans-

INVE

fer is made by an "instruction" [8-308(5)(a)] but which in other than written form [8-308(5)(b)] is not to be originated by an "appropriate person" [8-308(5)(c)] the registered owner or his representative.

Upon receipt of an instruction for registration [8-401(1)(2)], entitled to certain assurance [8-404(3)] in much the same manner as the transfer of a certificated security.

Within two business days of the registration of a security, the issuer must send to both the transferor [8-401(1)(2)] and the transferee [8-401(1)(3)] a statement sent to the transferor if the transfer was unauthorized or otherwise. The transferee will assure him that the transfer also serve as notice to him of the claims [8-304(2)] to which he is entitled as a transferee for value is released. The transferee is notified that he may withhold payment until he receives an appropriate statement from the issuer.

Cre

A security interest in a certificated security (pledge) of the security, due to the physical procedure is indistinguishable from the registration of transfer to the secured party.

A security interest in an uncertificated security is transferred to the secured party from those involved in any other way. A secured party will be in essence the transferee of a security who obtains the security interest.

This revision provides an alternative procedure in an uncertificated security to create a situation analogous to the registration of a security interest effected by submission of an instrument to the registered owner or his representative. The procedure for registration following the issuer is obligated to send the instrument immediately following registration. The transferee may choose to await receipt of the instrument.

Once a pledge has been registered, the rights of an owner (divided into two parts) the power to order transfer of the pledged property [8-207(3)] a person to originate a security interest is substantially the situation. The still registered owner is the pledgee's possession of the property. The registered pledgee is the debtor of his pledgee. The registered pledgee has transfer power in three ways: (a) by transfer of ownership; (b) by transfer of his security interest.

There is one area of disparity between the registered pledgee of an uncertificated security and the registered pledgee of a certificated security. The registered pledgee of a certificated security is held by a pledgee without any contribution with respect to the security. The registered pledgee of a certificated security is delivered to the registered pledgee's interest. When a registered pledgee, such additional security interest is held by the registered pledgee [8-207(6)(a)] [8-207(6)(b)]. This appears to be the case.

INVESTMENT SECURITIES

fer is made by an "instruction" [8-308(4)] which normally will be a signed writing [8-308(5)(a)] but which may, under the terms of a written agreement, be in other than written form [8-308(5)(b)]. To be effective, an instruction must be originated by an "appropriate person" who, for an unencumbered security, is the registered owner or his representative [8-308(7) & (8)].

Upon receipt of an instruction, the issuer is under a duty to effect a duly requested registration [8-401(1)], liable for delay or failure to comply [8-401(2)], entitled to certain assurances [8-402], and liable for improper registration [8-404(3)] in much the same manner applicable to requests for registration of transfer of a certificated security.

Within two business days after registration of transfer of an uncertificated security, the issuer must send a written statement confirming the registration to both the transferor [8-408(5)] and the transferee [8-408(1)]. The statement sent to the transferor will alert him to take appropriate action if the transfer was unauthorized or otherwise improper. The statement sent to the transferee will assure him that the transfer has been properly registered and will also serve as notice to him of any liens [8-103(b)], restrictions [8-204(b)] or claims [8-304(2)] to which the uncertificated security may be subject. Unless a transferee for value is relying on a third party, *e. g.*, his broker, it is anticipated that he may withhold his consideration, in escrow or otherwise, until he receives an appropriate statement from the issuer.

Creation of Security Interests

A security interest in a certificated security is normally created by delivery (pledge) of the security, duly indorsed, to the secured party (pledgee). The physical procedure is indistinguishable from an outright transfer. The pledgee may elect to leave the security registered in the name of the debtor or to cause the registration of transfer to himself or his nominee.

A security interest in an uncertificated security may be created by registration of transfer to the secured party, a procedure which involves no concepts distinct from those involved in any outright transfer of an uncertificated security. The secured party will be in essentially the same position as the pledgee of a certificated security who obtains registration of transfer to himself.

This revision provides an additional method for evidencing a security interest in an uncertificated security—registration of pledge [8-108]. This is intended to create a situation analogous to that when the pledgee of a certificated security leaves the security registered in the debtor's name. Registration of pledge is effected by submission of an instruction [8-308(4)] to the issuer, originated by the registered owner or his representative [8-308(7)(a) & (8)]. The procedure for registration follows that established for registration of transfer. The issuer is obligated to send confirmatory statements to the pledgee and owner immediately following registration [8-408(2)] and the pledgee, like the buyer, may choose to await receipt of the statement before advancing the loan.

Once a pledge has been registered, the registered owner continues to enjoy all the rights of an owner (dividends, voting rights, notices, etc.) [8-207(2)] except one—the power to order transfer. That power passes exclusively to the registered pledgee [8-207(3)] and only the pledgee or his representative is an appropriate person to originate a transfer instruction [8-308(7)(b) & (8)]. This is substantially the situation that exists when a certificated security is pledged. The still registered owner is recognized as such by the issuer [8-207(1)], but the pledgee's possession of the duly indorsed certificate achieves the dual purpose of depriving the debtor of his power to transfer and conferring that power on the pledgee. The registered pledgee of an uncertificated security may exercise his transfer power in three ways: by outright transfer free of his pledge [8-207(4)(a)]; by transfer of ownership subject to his pledge [8-207(4)(b)]; or by transfer of his security interest to another secured party [8-207(4)(c)].

There is one area of disparity between the pledge of a certificated security and the registered pledge of an uncertificated security. When a certificated security is held by a pledgee without registration of transfer, additional securities distributed with respect to the pledged security, *e. g.*, stock dividends, will necessarily be delivered to the registered owner, since the issuer is unaware of the pledgee's interest. When an uncertificated security is subject to a registered pledge, such additional securities will, if uncertificated, be registered subject to the pledge [8-207(6)(a)] or, if certificated, will be delivered to the pledgee [8-207(6)(b)]. This appears to be a desirable result which is impractical to

UNIFORM COMMERCIAL CODE

obtain under the pledge of a certificated security. Similarly, securities issued or money paid in exchange for an uncertificated security will be subject to the pledgee's control [8-207(6)].

Under the revised Article, the transfer rules are exclusive and expressly include the transfer of security interests [8-313(1)]. Thus, the creation of security interests is conditioned upon the use of an effective means of transfer [8-321(1)]. The transfer rules include the physical delivery of a certificated security [8-313(1)(a)] and the registration of either pledge or transfer of an uncertificated security [8-313(1)(b)]. They also include provisions when securities are controlled by third parties. When the controlling party is a clearing corporation [8-102(3)], transfer is effected by book entry [8-313(1)(g)]. When the controlling party is a financial intermediary [8-313(4)], but not a clearing corporation, transfer is effected by confirmation to the secured party accompanied by a book entry [8-313(1)(d)]. When the controlling party is not a financial intermediary, e. g., a prior pledgee, transfer is effected by acknowledgment to the secured party [8-313(1)(e) & (f)]. Security interests created by any of these methods are enforceable even without a written agreement signed by the debtor [8-321(2)] since they involve either possession by the secured party or the functional equivalent thereof.

In addition, three methods of transfer, applicable only to the creation of security interests, are provided [8-313(1)(h), (i) & (j)]. These methods do require a written security agreement signed by the debtor and are included to permit the continuation of practices which result in perfected non-possessory security interests under present Article 9 [present 9-304(4) & 9-305] and to document the creation of a security interest in securities already held in the debtor's account by a financial intermediary.

Perfection of Security Interests

The security interest of the pledgee of a certificated security is both created [present 9-203(1)(a)] and perfected [present 9-304(1)] by the secured party's possession. Possessory security interests are expressly exempted from the normal filing requirements of Article 9 [9-302(1)(a)]. A non-possessory security interest may be perfected by notice to a bailee [present 9-305] or, under certain conditions and for temporary periods, automatically [present 9-304(4) & (5)].

Under the revised Article, a security interest which is effectively created is also perfected [8-321(2)]. If the security interest is created under the provision which corresponds to the present provision of Article 9 for temporary automatic perfection [8-313(1)(i)], perfection expires at the end of the 21 day period unless other steps are timely taken [8-321(2)]. Security interests in securities are expressly excluded from the perfection provisions of Article 9 [9-302(1)(f), 9-304(1) & (4) and 9-305].

Termination of Security Interests

The security interest of a pledgee of a certificated security is normally released by redelivery of the security to the debtor. Similarly, the security interest in an uncertificated security created by registration of transfer to the secured party is released by registration of transfer back to the debtor. A security interest in an uncertificated security created by registration of pledge is released by registration of release [8-108]. Registration of release is effected by submission of an instruction [8-308(4)] to the issuer, originated by the registered pledgee or his representative [8-308(7)(b) & (8)]. The procedure for registration follows that established for registration of transfer or pledge. The issuer is obligated to send confirmatory statements to the pledgee and the owner immediately following registration [8-408(3)] and the owner may choose to make arrangements to withhold his repayment until he has received an appropriate statement.

A security interest in securities controlled by a third party would normally be terminated by a transfer back to the debtor under the same method employed for its creation [8-313(1)(d), (e), (f), (g) or (h)]. Unless the parties otherwise agree, any such transfer will terminate the security interest. Provision is made for temporary continuation of perfection in the case where a certificated security is redelivered to the debtor for limited purposes [8-321(4)], analogous to similar provisions in Article 9 [present 9-304(5)].

When a security is certified, evidence of the holder's right is, a similar, but distinctly different, action statement (hereinafter referred to as the "action statement") issued by the issuer of an uncertificated security. The issuer of an uncertificated security, however, is not required to release to the transferee, or the holder of certificated securities, an ITS. But unlike certificated securities, the issuer of an uncertificated security speaks only as of the time of the transfer, not as of the time of other than the addressee, and the transferee or holder must rely on what an ITS does or does not say to be bound by its legend to that effect [8-408(3)].

The purchaser of an uncertificated security is not bound by the issuer's right to a lien [8-103(3)] on transfer [8-204(b)] and is not referred to in the ITS sent to the transferee or holder. The transferee or holder, without notice, is normally entitled to assume the value of the security without notice who receives an uncertificated security referred to in the ITS. In such cases, it has been properly said that the benefit of the security has been properly completed, even though the benefit of certain warranties is not transferred to the purchaser for value without notice in the warranties he has made. The security to the issuer [8-306(1)] is not transferred to the transferee or pledgee [8-311(a)]. The transferee or pledgee performs the same function for the addresser.

Under the shelter principle, the transferee or pledgee, without knowledge of a restriction which failed to note the restriction [8-204(b)]. Any purchaser from the transferee or pledgee, relying on A's statement, however, A had knowledge of the restriction even though its existence. In that event, the transferee or pledgee from A would rise subject to the restriction. This is the case if A purchased without knowledge of the restriction. In contrast, if A had knowledge of a restriction not noted in the ITS, A would take free of the restriction.

There is a much more significant difference between the security interest of the owner and the transferee. The transferee, at the time of the transfer, exhibits an ITS showing that the security at some prior date gave rise to a restriction. If A has any rights in the security, A might have pledged, or transferred, the security. While, in some cases, the transferee's rights or on those of a third party, the transferee's rights against the issuer until he

All securities of the same issuer are fungible. Thus, when an issuer issues certificated and uncertificated securities, a transferee may perform either by delivering certificated securities to his obligee or by delivering uncertificated securities to his

INVESTMENT SECURITIES

The Initial Transaction Statement

When a security is certificated, the security itself, if genuine, is prima facie evidence of the holder's rights [8-105(3)(c)]. When a security is uncertificated, a similar, but distinctly more limited, function is served by the initial transaction statement (hereinafter "ITS"). The ITS is a signed statement sent by the issuer of an uncertificated security upon registration of transfer, pledge or release to the transferee, pledgee or owner, respectively [8-408(4)]. Like certificated securities, an ITS acts as an estoppel statement against the issuer. But unlike certificated securities, an ITS runs in favor of only the addressee and speaks only as of the time of its issuance [8-105(3)(d)]. Consequently, parties other than the addressee, particularly subsequent purchasers, cannot justifiably rely on what an ITS does or does not contain. The statute requires a warning legend to that effect [8-408(9)].

The purchaser of an uncertificated security is charged with notice of the issuer's right to a lien [8-103(b)], terms of a security [8-202(1)], restrictions on transfer [8-204(b)] and adverse claims [8-304(2)] which appear or are referred to in the ITS sent to him. Conversely, the purchaser for value without notice who receives an ITS which does not refer to defects or defenses is normally entitled to assume that none exists. Furthermore, the purchaser for value without notice who receives an ITS is generally entitled to assume that the uncertificated security referred to therein is valid [8-202(2)(a)], that, in many cases, it has been properly signed, even when it has not [8-205], that it has been properly completed, even when it has not [8-206(3)(b)] and receives the benefit of certain warranties of third party signatories [8-208(1)]. Finally, the purchaser for value without notice who receives an ITS enjoys a limitation in the warranties he has made in connection with the presentation of a certificated security to the issuer [8-306(1)] and is shielded from liability to a former owner or pledgee [8-311(a)]. In these respects, the ITS serves substantially the same function for the addressee as does a certificated security.

Under the shelter principle, the purchaser of a security acquires the rights of his transferor [8-301(1)]. If A had purchased an uncertificated security without knowledge of a restriction to which it was subject and had received an ITS which failed to note the restriction, he would take free of the restriction [8-204(b)]. Any purchaser from A would acquire the security free of the restriction and could, relying on A's rights, demand a clean ITS from the issuer. If, however, A had knowledge of the restriction when he purchased, A would be subject to the restriction even if, by error, the ITS sent to him had failed to note its existence. In that event, notwithstanding A's clean ITS, the rights of a purchaser from A would rise no higher than A's, and the purchaser would take subject to the restriction. The purchaser would take free of the restriction only if he purchased without knowledge *and* if the ITS *sent to him* failed to note the restriction. In contrast, if A had purchased a certificated security with knowledge of a restriction not noted thereon, a purchaser from A without knowledge would take free of the restriction [8-204(a)] even though A could not have.

There is a much more significant difference. A purchaser may normally assume that the holder (registered owner, indorsee or bearer) of a certificated security is the owner and entitled to transfer it. An ITS, however, merely evidences the facts at the time of its issuance [8-105(3)(d)]. The fact that A exhibits an ITS showing that A had become the owner of an uncertificated security at some prior date gives a potential purchaser absolutely no assurance that A has any rights in that security now. Since the time of the ITS's issuance, A might have pledged, otherwise encumbered or transferred the security. While, in some cases, the purchaser may be willing to rely on A's representations or on those of a third-party guarantor, he cannot justifiably rely on any rights against the issuer until he receives his own ITS.

Rights and Obligations of Buyers and Sellers

All securities of the same issue, both certificated and uncertificated, are treated as fungible. Thus, when an issue of securities is comprised of both certificated and uncertificated securities, a person obligated to transfer securities of that issue may perform either by delivering duly registered or indorsed certificated securities to his obligee or by causing the registration of transfer of equivalent uncertificated securities to his obligee [8-107(1)]. Similarly, the buyer of se-

UNIFORM COMMERCIAL CODE

curities becomes obligated to pay the price whether the securities transferred to him are certificated or uncertificated [8-107(2)].

In an exchange or brokerage transaction, the selling customer may complete his obligation by delivering certificated securities to his broker [8-314(1)(a)(i)], by causing the registration of transfer of uncertificated securities to his broker [8-314(1)(a)(ii)] or, if requested, by causing a third party to acknowledge that he holds a security for the broker [8-314(1)(a)(iii)]. In addition, the selling customer can conditionally fulfill his obligation by delivering to his broker a transfer instruction for an uncertificated security, but his obligation is not completed if the instruction is presented to the issuer within thirty days and the issuer refuses to register the requested transfer [8-314(1)(a)(iv)]. This final alternative is also available to the selling broker in fulfilling his obligation to the buying broker, with the same condition attaching [8-314(1)(b)(iii)]. In a transaction not on an exchange or through brokers, the transferor's duty is not fulfilled, even conditionally, by the delivery of an instruction [8-314(2)].

If the issuer of an uncertificated security demands proof of authority or other evidence which is necessary to obtain registration of transfer, pledge or release of the security, the transferor, pledgor or pledgee, as the case may be, is obligated to provide such evidence, but, if the transfer, pledge or release is not for value, only if he is reimbursed for any expense involved [8-316].

The performance exception to the statute of frauds includes, in addition to the acceptance of delivery of a certificated security, the acceptance of a transfer instruction and the situation where the transfer of an uncertificated security has been registered to the alleged buyer and the alleged buyer does not object in writing to the issuer within ten days after receiving the statement confirming the registration of transfer [8-319(b)].

Warranties

The person who requests an issuer to register the transfer of a certificated security, by presenting a duly indorsed certificated security, warrants to the issuer that he has the power to do so, or, in effect, that the chain of indorsements is genuine and complete [8-306(1)]. In making that warranty, the presenter, who, in the typical case, is, or acts for, the transferee, has before him, as evidence, the security, the indorsements and signature guarantees. On the other hand, the person who requests an issuer to register the transfer (or pledge or release) of an uncertificated security does so by presenting an instruction, which is not even presumptive evidence that the originator is the registered owner or pledgee of the security involved. Hence, the presenter, as such, warrants nothing to the issuer. Rather, the originator of the instruction, who is responsible for its creation, warrants to the issuer that he will be, at the time of presentation, an appropriate person to originate the instruction and entitled to the requested registration—facts which he, and perhaps no one else, knows [8-306(5)].

The transferor of a certificated security warrants to a purchaser for value the effectiveness and rightfulness of the transfer and the genuineness of the security [8-306(2)]. In effect, he undertakes that the issuer will recognize the purchaser as the owner of the intangible interest represented by the security free from any defects not noted thereon. The warranties made by the originator of an instruction to a purchaser for value are intended to produce substantially the same obligation and include, therefore, a warranty of absence of defects—a fact which the purchaser of a certificated security can himself ascertain from the security itself [8-306(7)] but of which the purchaser of an uncertificated security cannot have knowledge until he receives his initial transaction statement from the issuer.

The warranties made by secured parties who originate instructions with respect to uncertificated securities are limited [8-306(8)] consistent with similar limitations of the warranties of secured parties who deliver certificated securities they hold in pledge [8-306(4)].

Guarantees

The signature guarantee, which is an essential element of the transfer process for widely-held securities, presents a special problem. The signature guarantor of the indorsement of a certificated security warrants that the indorser is an appropriate person, *i. e.*, that he is, or acts for, the owner [8-312(1)(b)]. To make a similar undertaking with respect to the originator of an instruction to

transfer (or pledge or release) without a certificated security, the originator, if he is acting in his own name, will be known to the issuer on the instruction, there is Hence, the warranties of genuineness, capacity and owner or pledgee [8-312] that he is an appropriate person.

A special guarantee of securities, in effect, that the originator warrants [8-312(3)]. If the security is not free from defects [8-312(3)], it is antitake [8-312(7)], it is antitake in which the broker will sue. When a special guarantee is given, warranties to the guarantor.

Finally, there is a guarantee of genuineness in all respects [8-312(7)]. If the security is not free from defects [8-312(3)], it is antitake [8-312(7)], but warranties to the guarantor [8-312(7)].

The concept of bona fide purchaser of certificated securities [8-302(1)] is that a purchaser of a certificated security is charged with acting in his behalf takes of a certificated security is charged with action statement sent to him without notice takes free of defenses [8-202(1)] and may also take free of any claim is such that it would be a purchaser of an uncertificated security [8-302(1)]. Notice of liens [8-103(b)] is noted in the initial transaction statement. Only when he has received notice of adverse claims shall he enjoys bona fide purchaser.

The above-described difference between the purchaser of a certificated security and the purchaser of an uncertificated security has been noted, the purchaser of a certificated security has received anything (value) in the transaction statement. The purchaser of his seller or a third party is not bound until he receives a statement of assurance that he has, indeed, received use of wholly certificateless securities, escrow arrangements or other means to obtain satisfactory assurance.

The treatment of adverse claims of securities is different. With certificated securities the issuer is liable to the issuer [8-403(1)]. Because they can be so easily transferred without knowledge [8-302(3)], they have, been preserved [8-403(1)].

With uncertificated securities the transfer is accomplished only by the issuer and the purchaser is charged with action statement sent to him. The action statement developed for uncertificated securities is embodied in legal process in the form of a [8-403(1)(a)]. They also permit, under

INVESTMENT SECURITIES

transfer (or pledge or release) an uncertificated security, the signature guarantor, without a certificated security, prior indorsements and signature guarantees before him, would have to warrant a fact of which he has no evidence—that the originator is, or acts for, the registered owner or pledgee. That fact, however, will be known to the issuer and since the issuer is the only person who must act on the instruction, there is no need to require the signature guarantor's warranty. Hence, the warranties of the signature guarantor of an instruction are limited to genuineness, capacity and the fact that the signer is, or acts for, the *purported* owner or pledgee [8-312(2)]. The originator himself warrants to the issuer that he is an appropriate person [8-306(5)].

A special guarantee of signature is also provided by which the guarantor warrants, in effect, that the instruction will result in the requested transfer, free from defects [8-312(3)]. Although the issuer cannot require a special guarantee [8-312(7)], it is anticipated that it will be used in brokerage transactions in which the broker will specially guarantee the signature of his own customer. When a special guarantee of signature is made, the originator makes equivalent warranties to the guarantor [8-306(6)].

Finally, there is a guarantee of instruction which entails a warranty of rightfulness in all respects [8-312(6)], analogous to the guarantee of indorsement of a certificated security [8-312(5)]. This guarantee cannot be required by the issuer [8-312(7)], but when it is made, the originator makes equivalent warranties to the guarantor [8-306(7)].

Bona Fide Purchase

The concept of bona fide purchase applies to both certificated and uncertificated securities [8-302(1)]. The difference is that the purchaser of a certificated security is charged with notice only of what appears when he or a person acting in his behalf takes delivery of the security while the purchaser of an uncertificated security is charged with notice of what appears in the initial transaction statement sent to him. Thus, the purchaser of a certificated security without notice takes free of liens [8-103(a)], terms of a security which may be defenses [8-202(1)] and restrictions [8-204(a)] not noted on the security. He may also take free of any adverse claim [8-302(3)] unless the nature of the claim is such that it would be disclosed by the security itself [8-304(1)]. The purchaser of an uncertificated security without notice, however, is charged with notice of liens [8-103(b)], defenses [8-202(1)] and restrictions [8-204(b)] noted in the initial transaction statement sent to him. He is also charged with notice of adverse claims shown in the initial transaction statement [8-304(2)]. Only when he has received a clean initial transaction statement can he be sure that he enjoys bona fide purchaser status [8-302(1)(b)].

The above-described difference is of limited practical significance. As has already been noted, the purchaser of an uncertificated security cannot be sure that he has received anything (whether or not defective) until he receives his initial transaction statement. Therefore, unless he chooses to rely on the warranties of his seller or a third party guarantor, he will not release his consideration unless and until he receives a clean initial transaction statement to give him the assurance that he has, indeed, received what he bargained for. The wide-spread use of wholly certificateless systems will necessarily involve the development of escrow arrangements or other mechanisms by means of which the parties will obtain satisfactory assurances.

Adverse Claims

The treatment of adverse claims presented a very special kind of problem. With certificated securities they are communicated by mere written notification to the issuer [8-403(1)]. They do not normally constitute a serious problem because they can be so easily defeated by transfer of the security to a purchaser without knowledge [8-302(3)]. The rules for certificated securities have, therefore, been preserved [8-403(1), (2) & (3)].

With uncertificated securities, however, the rules become unworkable because transfer is accomplished only by communication with the issuer [8-313(1)(b)] and the purchaser is charged with notice of whatever appears in the initial transaction statement sent to him [8-304(2)]. Consequently, new rules have been developed for uncertificated securities. They require that a third party claim be embodied in legal process in order to make it cognizable by the issuer [8-403(4)(a)]. They also permit, under certain circumstances, the registration of trans-

UNIFORM COMMERCIAL CODE

fer or pledge subject to an adverse claim [8-403(5)]. Finally, they provide protection to a registered pledgee who attained bona fide purchaser status prior to the time that notice of a cognizable adverse claim reached the issuer [8-403(6)].

Creditors' Rights

The general rule of present Article 8, that no judicial lien on a debtor's interest in a security is valid until the security is actually seized [present 8-317(1)] is wholly inapplicable to uncertificated securities and, in the light of wide-spread nominee registration, depository systems and the like, has become inadequate even with respect to certificated securities. That rule is retained only for certificated securities in the debtor's control [8-317(1)]. Uncertificated securities registered in the debtor's name may be reached only by service upon the issuer [8-317(2)]. The interest of a debtor in either certificated or uncertificated securities under the control of secured parties or financial intermediaries is reached by service upon the controlling party [8-317(3) & (4)]. When a debtor's interest in securities controlled by a third party is subject to a judicial lien, provisions are made for the transfer of such securities, free of the lien, and the shifting of the lien to the proceeds in the hands of the third party [8-317(5)].

Nominee Registration

The increasing incidence of nominee registration in brokerage accounts, bank custody accounts, security depositories and otherwise has led to new and expanded provisions regarding the rights of creditors [8-317]. The same phenomenon has also led to a revision of the general transfer rules by substituting the broader category of "financial intermediary" [8-313(4)] where only "broker" formerly appeared [8-313(1) (c) & (d), (2) & (3)].

PART 1. SHORT TITLE GENERAL MATTER

- Section
8-101. Short Title.
8-102. Definitions and Interpretations.
8-103. Issuer's Lien.
8-104. Effect of Overissue.
8-105. Certificated Securities; Statements and Assumptions; Not Negotiable; Statements and Assumptions.
8-106. Applicability.
8-107. Securities Transferred for Price.
8-108. Registration of Pledges of Uncertificated Securities.

PART 2. ISSUE—ISSUANCE

- 8-201. "Issuer."
8-202. Issuer's Responsibilities; Defenses; Notice of Defense.
8-203. Staleness as Notice of Defense.
8-204. Effect of Issuer's Responsibility Transfer.
8-205. Effect of Unauthorized Issuance on Certificated Securities; Effect of Unauthorized Issuance on Uncertificated Securities.
8-206. Completion or Alteration of Security Transaction Statement.
8-207. Rights and Duties of Issuer and Registered Pledgee.
8-208. Effect of Signature of Issuing Trustee, Registering Trustee, or Transfer Agent.

PART 3. TRANSFER

- 8-301. Rights Acquired by Transfer.
8-302. "Bona Fide Purchaser"; "Adverse Claim"; Title by Bona Fide Purchaser.
8-303. "Broker."
8-304. Notice to Purchaser of Claims.
8-305. Staleness as Notice of Claims.
8-306. Warranties on Presentment; Transfer of Certificated Securities; Warranties of Issuer and Transferors of Instructions.

Ad

Colorado. Adopted Revised Article 8 by L.1981, p. 352, § 1 to p. 377. It did not adopt conforming amendments to other articles of the Code.

Connecticut. Adopted Revised Article 8 and amendments to other articles of the Code conforming to Revised Article 8 by L.1979, P.A.No. 79-435, effective 1, 1979.

Maine. Note that although not adopted Revised Article 8 11 M.R.S.A. § 8-321 (relating to securities subject to repurchase obligations of issuer) in the adopted the definitions of "security" and "uncertificated security" contained in section 8-102 of Article 8. For text of said 11 M.R.S.A. § 8-321, see "Additional Sections" following the material for section 8 of original Article 8, supra.

Minnesota. Adopted Revised Article 8 and amendments to other articles

DEPARTMENT OF CORRECTIONS

TOPIC: REPRESENTATION OF CONTRACT PERSONNEL

ISSUE: Should the Kansas Tort Claims Act be amended to permit the State to provide legal representation in defending a lawsuit filed by an inmate against a teacher or instructor who is under contract with the Department of Corrections to provide that service?

BACKGROUND: Current law, K.S.A. 75-6102(d), excludes independent contractors from coverage under the Kansas Tort Claims Act. This would include teachers and instructors employed by institutions under contract to the Department of Corrections to provide educational and vocational training services. Thus, if one of these individuals was sued by an inmate as a result of an action taken in fulfilling his or her contract duties, the State could not provide legal representation in defending the suit. The cost for such representation would fall upon the school or individual teacher. Such a result seems difficult to justify in a prison setting where the Department asks the teachers and instructors to enforce the rules the same as other employees. In a prison setting, this can prompt an inmate initiated lawsuit against the teacher. It is even more difficult to justify when 90 percent of such lawsuits are frivolous.

RECOMMENDATION: It is recommended that K.S.A. 75-6102(d) be amended to permit the State to provide legal representation to teachers or instructors who are under contract with the Department of Corrections to provide educational or vocational training services.

CES/pa

2/14/85

Attch. III

DEPARTMENT OF CORRECTIONS
LEGISLATIVE PROPOSAL

2-14-82

75-6102. Definitions. As used in K.S.A. 75-6101 through 75-6118, and amendments thereto, unless the context clearly requires otherwise:

(a) "State" means the state of Kansas and any department or branch of state government, or any agency, authority, institution or other instrumentality thereof.

(b) "Municipality" means any county, township, city, school district or other political or taxing subdivision of the state, or any agency, authority, institution or other instrumentality thereof.

(c) "Governmental entity" means state or municipality.

(d) "Employee" means any officer, employee, servant or member of a board, commission, committee, division, department, branch or council of a governmental entity, including elected or appointed officials and persons acting on behalf or in service of a governmental entity in any official capacity, whether with or without compensation. "Employee" does not include an independent contractor under contract with a governmental entity. Employee does include former employees for acts and omissions within the scope of their employment during their former employment with the governmental entity.

History: L. 1979, ch. 186, § 2; L. 1982, ch. 374, § 1; L. 1983, ch. 299, § 1; April 28.

Law Review and Bar Journal References:

"A Practitioner's Guide to the Kansas Tort Claims Act," Jerry R. Palmer, 48 J.B.A.K. 299, 300 (1979).

except that an employee of an independent contractor under contract to provide educational or vocational training to inmates in the custody of the secretary of corrections shall be considered an employee of the state for purposes of this act.

Attach. III