MINUTES OF THE JUDICIARY COMMITTEE
March 21, 1983

The meeting of the House Judiciary Committee was called to order by Chairman Dave Brown in room 224A of the capitol building, Helena, Montana. All members were present as was Brenda Desmond, Staff Attorney for the Legislative Council.

SENATE BILL 203

SENATOR TOWE, District 34, Billings, explained that this bill has been heard by the committee previously because they had Judge Wilson here, who testified on a companion bill that Representative Addy carried. He said that this bill addresses the question of the use of judicial talent after a judge has retired by providing that a judge or justice who has retired after eight years of service may assist the supreme court, a district court, or a water court upon request of the supreme court.

There were no proponents and no opponents.

SENATOR TOWE closed.

REPRESENTATIVE KEYSER asked why they had this eight years instead of twelve years. SENATOR TOWE responded that he was not on the committee that made that choice; if a judge had been elected twice and then retired and stepped down, most likely that judge would step down before the end of that 12 years because of a medical disability or for an age reason; if he decided not to run again or if he was defeated, then he would almost always have the twelve years.

REPRESENTATIVE KEYSER noted that it doesn't say anything about a second term - it just says eight years. SENATOR TOWE replied that that is obvious, i.e., if you are appointed you have to be elected in the next election; if elected the second time, that is usually going to be less than eight years total service; if you are elected once, you serve six years and elected a second time, you are going to have a twelve-year term; you have got to be elected twice under the eight-year term; and he felt that this was the thinking of the committee.

REPRESENTATIVE SPAETH wondered if they could put in language which says "who has voluntarily retired after eight years". SENATOR TOWE replied the reason for using the term "voluntarily" in the first place is because the person who is involuntarily retired after twelve years receives pension funds; those who voluntarily retire after twelve years do not; and, therefore, if a person who is involuntarily retired could be called back to active duty; whereas the person who voluntarily decides not to run again could not; and this doesn't make any sense. He explained that this does not depend on whether or not they are receiving retirement benefits. He noted that on page 2, line 17, it says that the daily salary is reduced by the retirement allowance, if any.

REPRESENTATIVE SPAETH aksed if he saw any problem with putting back in the language "voluntarily retires". He said one of his problems is that when a judge is involuntarily retired, the people have expressed their opinion as to whether they want him to sit on the bench or not. SENATOR TOWE replied that he does not have too much problem with that; he felt that they would lose some of the effectiveness they seek by limiting the number of people to which this would apply.

REPRESENTATIVE SPAETH commented that he did not know of anyone who has been involuntarily retired other than at the polls.

REPRESENTATIVE DAILY queried how many years does a judge have to work before he is qualified for a full retirement. SENATOR TOWE said that, off hand, he thought it was 65 or 20 years, whichever is earlier, except he has to serve eight years, but he was not sure.

There were no further questions and the hearing on this bill was closed.

<u>SENATE BILL 248</u>

SENATOR TOWE stated that this bill was originally proposed by Harold Hanser, County Attorney in Yellowstone County, and he raised some questions about insanity defense. He indicated that he was aghast to learn that even though they had abolished the insanity defense, they are still, in some places, using the terms, "not guilty by reason of insanity". This bill generally revises the laws relating to a claim of mental disease or defect in criminal proceedings. He informed the committee of all the changes in this bill.

JOHN MAYNARD, Assistant Attorney General of the state of Montana, stated that the Attorney General supports this bill and he was here to answer any questions that the committee might have.

There were no further proponents and no opponents.

SENATOR TOWE closed by saying that the technical question was particularly critical; and if they don't pass that, they could have some other problems.

REPRESENTATIVE DAILY noted on page 3, line 11, wherein it says, "if the court finds that he is still unfit to proceed" and he wondered who determines if he becomes fit. SENATOR TOWE responded that the court must submit the individual to a medical examination by a professional person - a psychiatrist - who would examine the person and submit its report to the court; based on this report, the court must make a determination as to whether he is fit to proceed or not.

REPRESENTATIVE DAILY asked if he thought this was a pretty difficult thing to prove, i.e. if they had three psychiatrists, all three psychiatrists would all say something different. SENATOR TOWE replied that, in his opinion, that is exactly why they had the problems with the insanity defense; that is one of the reasons that he was not in favor of the insanity defense and supported abolishing that; there is no question but what psychiatrist can differ; if the defendant disagrees with the psychiatrist's report, the defendant can bring in another psychiatrist to try to prove something different; and that is why the court decides. He stated that he did not know of a better system.

REPRESENTATIVE DAILY asked if this bill passes, will more people be able to use the insanity defense in the state.

SENATOR TOWE replied that no, except for that technical correction on page 6, this bill does not speak to the insanity defense; they are talking about his fitness to proceed; this is different; they have to determine if the defendant is capable of participating in his own defense; and, if he is not, he cannot go to trial. He advised that this will not change the matter because by the supreme court decision, they have to do what this bill says anyway; they cannot decide that a man is not fit to proceed; send him to Warm Springs and then leave him there for the rest of his life. He continued that you have to pull him back in ninety days, have him examined again by a psychiatrist and then decide if he is really fit to proceed; if he is not fit to proceed and he is not likely to change, then he felt that it was only fair that they dismiss the criminal case; but you immediately start commitment proceedings, which will send him right back to Warm Springs, only then under the mental commitment proceedings and not under this nebulous unfit-to-proceed thing.

REPRESENTATIVE DAILY asked about the technical question on page 6, line 12, saying that he stated that a judge threw a case out of court because of a mistake that was made by the legislature, and it was codified correctly, but some sly defense counsel used it to have the decision reversed and to have the person released; and he wondered why would a judge do that. SENATOR TOWE replied that the question was not appealed, and had it been appealed, he was not sure whether the codification question would have stood or not. He noted that Harold Hanser just walked in and he was more familiar with this and requested that he be allowed to address this and also the insanity defense situation.

HAROLD HANSER, County Attorney for Yellowstone County, stated that he did not remember the exact circumstances, but there was a misprint in the statutes and this is to bring it back to where it should be.

REPRESENTATIVE DAILY commented that it does not make any sense that if everyone knew it was a mistake and yet some judge would set somebody free. MR. HANSER responded that people have to execute the laws the way they are written and that is how this was written.

REPRESENTATIVE DAILY responded that he would agree with that, but that is the problem that people have with the judicial system; that it is wrong that they do that - it is obviously wrong.

SENATOR TOWE explained that they abolished the insanity defense in 1979; if this mental defect interferes with the ability to formulate an intent, it still may be a defense to prove all the elements of the defense.

MR. HANSER indicated that there are some real problems with the insanity defense; the way it is now it is very confusing; that he would encourage them to retain the Senate amendments, but he felt that they should have a subcommittee over the interim to study this entire issue and come up with some recommendations.

There were no further questions and the hearing on this bill was closed.

SENATOR TOWE indicated that REPRESENTATIVE ADDY will carry this bill on the floor of the House.

EXECUTIVE SESSION

SENATE BILL 381

REPRESENTATIVE KEYSER moved that they table this bill. The motion was seconded by REPRESENTATIVE SPAETH.

CHAIRMAN BROWN indicated that Senator Hager asked that they table that bill, which is the grandparent's visitation rights, pending dispostion of Representative McBride's bill, which he would prefer.

The motion carried with REPRESENTATIVE KEYSER voting no.

REGULAR SESSION

SENATE BILL 138

SENATOR MAZUREK explained this bill, which is an act to generally revise Montana's codification of the Uniform

Commercial Code by substantially adopting the 1972 and 1977 changes recommended by the Uniform Law commissioners. He indicated that they got a message to Ron Wyse, the University law professor who is versed in these Uniform Commercial Code provisions and he is not here this morning, so he would try to explain the bill the best he could.

BOB MURDO, representing the Business Law Section of the State Bar of Montana, clarified some of the changes in this bill.

MIKE ZIMMERMAN, representing the Business Law Section of the State Bar of Montana, gave testimony in support of this bill.

There were no further proponents and no opponents.

REPRESENTATIVE KEYSER asked what they were saying in section 71 on pages 126 and 127. SENATOR MAZUREK replied that the law defines what a fixture is; if it is attached to the realty and cannot be removed without damage thereto that is a fixture, such as plumbing fixtures, built-in kitchen equipment, etc.

CHAIRMAN BROWN asked on page 4, lines 7 through 10, why they have that in there. SENATOR MAZUREK replied that he thought that this deals with the proceeds and the purpose is to make sure that included with the definition of proceeds would be the production of an oil or gas well. He presented to the committee an explanation of the proposed amendments to the bill prepared by Professor Ron Wyse. See EXHIBIT A.

REPRESENTATIVE HANNAH noted that theses changes were recommended in 1972 and he wondered why this bill is coming in now. SENATOR MAZUREK replied that it is a uniform law-most of the other states around us generally have adopted these changes; you have businesses that deal across state lines and they need to be playing with the same rules.

REPRESENTATIVE KEYSER contended that this is not a real uniform law as they have some changes in the law that are really different. SENATOR MAZUREK responded that this is correct to a degree and there are some changes such as the agricultural change that was proposed as an option for the states to pick one or the other; and

Montana chose one option and they are stuck with it. He emphasized that, for the most part, it is uniform and he thought that Louisiana is the only state that has not adopted the Uniform Commercial Code.

REPRESENTATIVE CURTISS asked MR. MURDO if it was his opinion that Montana was at a disadvantage because of this lack of uniformity. He responded no, he thought they have uniform law along with the other states in the United States and the things that happen are a little different in Montana versus Wyoming, Idaho, North and South Dakota; those are 1972 amendments that they are talking about and some of those states have adopted those amendments; he did not think they were disadvantaged but, if they were Louisiana and did not have this law, they would be disadvantaged.

There were no further questions and the hearing on this bill was closed.

SENATOR MAZUREK indicated that REPRESENTATIVE RAMIREZ will carry this bill on the floor of the House.

SENATE BILL 237

SENATOR HALLIGAN, District 48, Missoula, stated that this bill provides a procedure for restitution to victims of crimes by the criminal offenders and a procedure upon default in payment of restitution; restitution is not a new conviction and is not a new sentence, but the supreme court about four months ago, dealing with a case wherein restitution was involved, indicated that there are no guidelines within the state of Montana in relation to restitution; so the supreme court suggested that the legislature look at the model corrections act and develop some model language that deals with the area of restitution; and that is exactly what this bill is. He explained some important areas in the bill.

REPRESENTATIVE ASAY, District 50, Forsyth, arose in support of this bill and said that, in visiting with a judge in his district, he indicated that there was definitely a need for a provision of the payment of restitution through a court-appointed individual. He indicated that this bill will give the court the means to apply restitution and take care of many problems in the early stages.

BECKY FAIRCLOUGH, Director of the Cascade County Restitution Program, stated that she has come to realize how important the use of restitution is in the district court system. She thought that this bill was really important and she presented to the committee a letter she received from Andrea Bartelt, Director of PACE Program. See EXHIBIT A-1.

PENNY SEY, Restitution Officer for the First Judicial District, said that their most important concern is for the victim of the crime; they receive the investigative report; then they contact the victim; they assist him in filing a report; they help with filing with insurance companies; they complete the report to the court; they go with the victim to testify in behalf of the victim; and once restitution is ordered by the judge, they monitor the payments; if a defendant does not have a job, they secure employment for him or they get him into training or schooling.

CURT CHISHOLM, Deputy Director for the Department of Institutions, said that they agree in concept with the intent of the bill, but they wanted to point out that some of the language in section 5 turned up missing and they would like this amended back into the bill in order to clarify the supervision of payment and this needs to be broader than it is right now instead of just placing that responsibility on the probation officer. He also was concerned on pages 1 and 2, section 2, wherein they asked the probation officer to include in the presentence report some information that is suggested there and the reason they opposed this is because they did not think it was appropriate for the probation officer to become, in effect, insurance adjusters and have to make judgments on the amount of damage, make judgments on the ability to pay, etc. He indicated that they were hopeful that they could oversee that process, incorporate it into their presentence investigation, but not actually be responsible for making judgments on anyone's ability to pay or the amount of pecuniary loss.

JOHN MAYNARD, Assistant Attorney General for the state of Montana, testified that the Attorney General supports this bill wholeheartedly; that it is a concept whose time has come; but the problem with this bill is that it was initially drafted from a uniform act and that in justice court, they do not have probation officers, restitution officers, etc. He noted that in Great Falls the restitution officer, by mutual agreement, does service the needs of the justice court.

There were no further proponents and no opponents.

SENATOR HALLIGAN said there was a small technical amendment that should go on this bill in order to be in accord with the deferred sentencing bill, that has already passed.

REPRESENTATIVE HANNAH indicated that he would like the record to show that he was in support of this bill.

REPRESENTATIVE ADDY noted on page 6, line 2 and also section 8, page 6, that they are making it possible for a judgment to be obtained against a perpetrator in both of those sections and he wondered if that judgment is subject to the exemption against property that is claimed in bankruptcy - the kinds of property that is subject to any other judgments - things that are necessary to carry on a trade, etc. SENATOR HALLIGAN responded that the language in line 6 keys it into the other provisions of law and he thought the exemptions would apply as well.

REPRESENTATIVE JENSEN asked MS. FAIRCLOUGH if they have special funds where the funds flow in and out and those are authorized by the judge. She responded that she is employed by the district judge; her accounts are set up by the county; they have a cross-reference system so that her work can be checked.

REPRESENTATIVE JENSEN indicated that the guilty individual gives you money, it goes into the account, you write a check and then send it to the victim; and he asked how many accounts does she have right now. MS. FAIRCLOUGH replied that she has two accounts in Cascade County right now.

REPRESENTATIVE ADDY asked who would be the most appropriate official on a county-wide basis to handle this kind of program. MS. FAIRCLOUGH responded that they have the program and they are able to collect enough money that they even make a profit off that program for their county; and she would say that the best way to handle this is to have a person who is designated as a restitution officer that could handle it like a business - not a probation officer - but someone who would have time to give enough attention to this.

REPRESENTATIVE ADDY asked if she was saying that the duties of the person who handles the crime victim's compensation program would conflict a little with the duties of a restitution officer and that they would not fit hand-in-glove. He wondered why they could not put the same hat on one person. MS. FAIRCLOUGH responded that they are two different theories, i.e. the crime victims' compensation act allows for victims to be paid by a division of the Workmens' Compensation program; restitution is something totally different and they are coming out of two separate entitites. She thought that there might be conflict there.

REPRESENTATIVE CURTSS asked if she understood her to say that they were able to make a profit on this in Cascade County. MS. FAIRCLOUGH replied that they are now at that point; their program costs so much to operate; when they count their statistics for budgeting time, they count all the money they have put back into the court system; eventually when you collect contracts on court-ordered sentences, you are going to come out collecting more than the program costs the county even though all that money is not funneled directly into the judicial system of the county, it is funneled to the taxpayer of the county.

REPRESENTATIVE CURTISS asked how is that money apportioned to the victim of the crime. MS. FAIRCLOUGH replied that basically what they do is they find out what the loss is to the victim; they put that before the court; the court returns orders that the defendant pay so much to the victim; it is up to her to see that that money gets to the appropriate party and to make sure that that individual has that money coming; and they compensate 100 per cent, if possible, or whatever the court choses to order.

REPRESENTATIVE CURTISS asked if more can be actually assessed against the perpetrator of the crime than the actual damages. MS. FAIRCLOUGH replied that no, they cannot; that part of what she does is try to ascertain the amount of loss; she had a case where a truck was stolen; replacement cost of that truck was $15,000.00 - that was what the victim wanted - but you have to go by fair market value; and it was up to her to determine what fair market value was; the court chose to order only fair market value, not the assessment costs, so the victime got what his truck was worth, but he did not get a new truck. She testified that the court never orders more to a victim than is his actual loss.

REPRESENTATIVE CURTISS asked how is the funding for your department provided. MS. FAIRCLOUGH replied that she started on the Board of Crime Control for three years on a grant; then the county took over that grant and they sponsor and pay for the program out of the district court budget.

REPRESENTATIVE KEYSER asked if this bill applies mainly to felons. SENATOR HALLIGAN responded for both misdemeanors and felonies.

REPRESENTATIVE KEYSER noted on page 3, section 4, it says, "The court may not establish a payment schedule extending beyond the statutory maximum term of confinement"; and he wondered if they had a misdemeanor crime wherein the maximum would be sixty days or something like that, how would this work. SENATOR HALLIGAN replied that he will be allowed as much as two years for this restitution to be made.

REPRESENTATIVE JENSEN noted on page 1, line 20, under new section 2, it says, "condition of a deferred or suspended sentence" and he wondered if they meant deferred imposition of sentence or deferred prosecution of crime; and there are prosecutions which are deferred based on certain conditions. He asked if they should add the word, "prosecution". MR. MAYNARD responded that, as a practical matter, there may be cases in which that is the practice, but he did not know if that was authorized by current law and those are found at the conclusion of the criminal procedure code; and that is where restitution is authorized.

REPRESENTATIVE JENSEN questioned in a smaller county, who did she think should be the responsible party for the administration of these funds. MS. FAIRCLOUGH responded that probably the most logical for the collection would be the clerk of the court's office, because in a lot of cases, they are collecting money for child support and this type of thing and they are already bonded; however, they may not like to get involved in the part of determining loss and where this money goes.

REPRESENTATIVE ADDY commented that he heard Mr. Maynard say that many prosecutors do make restitution as a condition of deferred prosecution and they do it with a private agreement with the defendant rather than by an order of the court. MR. MAYNARD responded that he was not aware of any provision in law that addresses that and if they are ordering restitution, logically that would be the way that they are doing it; he was not aware of the fact that they do order restitution in deferred prosecution, but he would think that the prosecutor would say, in those instances, that he would defer prosecution on this if these things were done. He noted that there is a very elaborate deferred prosecution program in Billings and there are a number of conditions that they impose, but he didn't know if they ordered restitution.

REPRESENTATIVE ADDY commented the problem he has with that is that it seems to him that they may not have enough leverage to be able to enforce the restitution if they do not have the equivalent of a judgment from the court. He wondered if they really want to have a real active restitution program premised upon deferred prosecution. It would seem better to him to get the judgment of the court first and then deferred imposition of sentence. MR. MAYNARD replied that that is all that is addressed by this bill is deferred imposition of sentence.

REPRESENTATIVE IVERSON said that it bothered him if they are talking about restitution prior to establishing guilt.

There were no further questions and the hearing on this bill closed. Senator Halligan noted that Representative Asay will carry this bill on the floor of the House.

EXECUTIVE SESSION

SENATE BILL 394

CHAIRMAN BROWN passed out to the committee copies of a letter received from Curt Chisholm, Deputy Director of the Department of Institutions. See EXHIBIT B. He indicated that this bill was passed out of here, but he has not signed the Standing Committee Report because of this letter.

REPRESENTATIVE DAILY moved that they reconsider the action taken on this bill. REPRESENTATIVE FARRIS seconded the motion. The motion carried unanimously.

REPRESENTATIVE SPAETH moved that this bill BE CONCURRED IN. REPRESENTATIVE KEYSER seconded the motion.

REPRESENTATIVE DAILY moved that on page 8, that lines 15, 16 and 17 be stricken in their entirety. The motion was seconded by REPRESENTATIVE CURTISS.

CHAIRMAN BROWN requested Curt Chisholm to explain this a little further. MR. CHISHOLM explained the problems and then noted that if they get a license, which the Drug Enforcement Administration said they would give them if they applied for it, they would be able to do this; but they said not to tamper with the Pharmacy Practices Act; they can order these drugs directly from the manufacturer and they can keep it on hand in the event they ever need it.

The motion carried unanimously.

REPRESENTATIVE KEYSER moved that this bill BE CONCURRED IN AS AMENDED. REPRESENTATIVE CURTISS seconded the motion. The motion carried with REPRESENTATIVE DARKO and REPRESENTATIVE VELEBER voting no.

SENATE BILL 203

REPRESENTATIVE ADDY moved that this bill BE CONCURRED IN. REPRESENTATIVE JAN BROWN seconded the motion.

REPRESENTATIVE SPAETH moved to amend this bill on page 1, line 18 by inserting the word "voluntarily" between "has" and "retired". REPRESENTATIVE IVERSON seconded the motion.

REPRESENTATIVE SPAETH stated that he felt that they elect judges in this state and when they do not voluntarily re-tire, it is generally that they were defeated and the voters have expressed their desire for one reason or another that they would just as soon not have those people sitting on the bench.

REPRESENTATIVE ADDY asked if they elect water court judges. REPRESENTATIVE SPAETH responded that water judges are elected essentially at some point in time and at least in one instance had voluntarily retired. He advised that they presently have a water judge who had been involun-tarily retired, but he did not think that this applies here.

REPRESENTATIVE ADDY asked about Judge Shanstrom. REPRE-SENTATIVE SPAETH replied that he never even thought about Judge Shanstrom, but he was defeated; but he was appointed to be on the water court and never got off the water court.

REPRESENTATIVE SPAETH thought that voluntarily retired is pretty critical and when he made that motion, he did not even think of the judges that are involuntarily re-tired, but now that he thought of it, it makes even more sense.

REPRESENTATIVE ADDY commented that if they were going to limit the pool of judges to a very small number, then there would be cause for concern, but there are lots of retired judges.

REPRESENTATIVE BERGENE indicated that the thing about involuntarily is that a person could be in fairly good health and not be able to stand the strain of being a district court judge on a daily basis; and for a medical disability, you are limiting that too.

REPRESENTATIVE SPAETH commented that he thought about that too, but no one really does that; they generally serve out their term and as a practice, he does not know of anybody who is retired under that provision and thinking back over the last ten or twelve years, he does not know of any judge that is in that particular situation.

The motion carried unanimously.

REPRESENTATIVE ADDY moved that the bill BE CONCURRED IN AS AMENDED. REPRESENTATIVE JENSEN seconded the motion. The motion carried unanimously.

SENATE BILL 248

REPRESENTATIVE DAILY moved that this bill BE CONCURRED IN. REPRESENTATIVE DARKO seconded the motion.

The motion passed with REPRESENTATIVE KEYSER, REPRESENTATIVE CURTISS, REPRESENTATIVE HANNAH and REPRESENTATIVE IVERSON voting no.

REPRESENTATIVE JAN BROWN noted that Harold Hanser brought up the matter of doing a study on the commitment law and she wondered if there was a bill in on this or should they do this as a committee.

REPRESENTATIVE IVERSON said that a resolution can be introduced up to the 90th day

CHAIRMAN BROWN noted that, as far as he knew, nobody has talked about it.

REPRESENTATIVE SPAETH felt that SB 347 or HB 888 has got to be reported out in order to have any sanity on our streams this summer. CHAIRMAN BROWN indicated that they would check HB 888 out and decide what they can do with SB 347 tomorrow morning.

CHAIRMAN BROWN indicated that they have SB 391 and SB 237, which deals with restitution and he wondered if they as a committe,were comfortable with those bills, or would they like him to have David Ness come in and give them a half-hour presentation on restitution. It was agreed that they were all comfortable.

REPRESENTATIVE KEYSER moved that the meeting be adjourned at 10:26 a.m.

Dave Brown
DAVE BROWN, Chairman

Alice Omang
Alice Omang, Secretary

STANDING COMMITTEE REPORT

March 21, 19 83

MR. SPEAKER:

We, your committee on JUDICIARY

having had under consideration SENATE Bill No. 203

third reading copy (blue)
color

A BILL FOR AN ACT ENTITLED: "AN ACT AMENDING SECTION 19-5-103, MCA, TO REQUIRE A JUDGE OR JUSTICE ~~WITH 12 YEARS OR MORE OF SERVICE~~ WHO RETIRES ~~BEFORE AGE 65~~ <u>AFTER 8 YEARS OF SERVICE</u> TO ASSIST THE SUPREME COURT, A DISTRICT COURT, OR A WATER COURT UPON REQUEST OF THE SUPREME COURT OR THE CHIEF JUSTICE OF THE SUPREME COURT."

Respectfully report as follows: That SENATE Bill No. 203

BE AMENDED AS FOLLOWS:

1. Title, line 7.
Following: "RETIRES"
Insert: "VOLUNTARILY"

2. Page 1, line 18.
Following: "HAS"
Insert: "voluntarily"

<u>AND AS AMENDED</u>
<u>BE CONCURRED IN</u>

~~SB PASS~~

DAVE BROWN, Chairman.

STATE PUB. CO.
Helena, Mont.

COMMITTEE SECRETARY

STANDING COMMITTEE REPORT

March 21, 19 83

MR. SPEAKER:

We, your committee on JUDICIARY

having had under consideration SENATE Bill No. 394

third reading copy (blue)
color

"AN ACT ALLOWING A DEFENDANT SENTENCED TO DEATH TO CHOOSE BETWEEN HANGING AND A LETHAL INJECTION; PROVIDING THAT THE WARDEN OF THE STATE PRISON SHALL PROVIDE THE PLACE, PERSON, AND IMPLEMENTS TO CARRY OUT THE EXECUTION; CHANGING THE LIST OF PERSONS VIEWING THE EXECUTIONS AND EXEMPTING PERSONS ACTUALLY PERFORMING THE EXECUTION FROM PROFESSIONAL LICENSING REQUIREMENTS; AMENDING SECTIONS 37-3-103, 37-8-103, 45-3-109, 46-19-103, 46-19-202, AND 46-19-204, MCA; PROVIDING FOR APPLICATION TO DEATH SENTENCES IMPOSED BEFORE AND AFTER THE EFFECTIVE DATE OF THIS ACT; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE."

Respectfully report as follows: That SENATE Bill No. 394

BE AMENDED AS FOLLOWS:

1. Page 8, following line 14.
Strike: Subsection (6) in its entirety.

AND AS AMENDED
BE CONCURRED IN

~~DO PASS~~

STATE PUB. CO.
Helena, Mont.

DAVE BROWN, Chairman.

COMMITTEE SECRETARY

STANDING COMMITTEE REPORT

March 21, 19 83

MR. SPEAKER :

We, your committee on JUDICIARY

having had under consideration SENATE Bill No. 248

_______________ reading copy (_______)
color

"AN ACT TO GENERALLY REVISE THE LAWS RELATING TO A CLAIM OF MENTAL DISEASE OR DEFECT IN CRIMINAL PROCEEDINGS; ~~PROVIDING FOR A VERDICT OF GUILTY BUT SUFFERING FROM A MENTAL DISEASE OR DEFECT AT THE TIME OF THE OFFENSE,~~ ALLOWING A COUNTY ATTORNEY TO RAISE THE ISSUE OF A CRIMINAL DEFENDANT'S LACK OF FITNESS TO PROCEED WITH TRIAL; PROVIDING FOR THE DISPOSITION OF THOSE DEFENDANTS FOUND UNFIT TO PROCEED; CORRECTING A REFERENCE IN PRIOR LEGISLATION DESCRIBING A MENTAL DISEASE OR DEFECT; AMENDING ~~SECTIONS 46-14-201,~~ SECTION 46-14-221, ~~AND 46-14-312,~~ MCA~~,~~ ~~AMENDING~~ AND CHAPTER 713, SECTION 11, LAWS OF 1979~~,~~ ~~REPEALING SECTIONS 46-14-102 AND 46-14-301 THROUGH 46-14-304,~~ MCA."

Respectfully report as follows: That SENATE Bill No. 248

BE CONCURRED IN

XXXXXX
XXXXXXX
XXXXXX

STATE PUB. CO.
Helena, Mont.

DAVE BROWN Chairman.

COMMITTEE SECRETARY

VISITOR'S REGISTER

HOUSE JUDICIARY COMMITTEE

BILL SB 138 DATE March 21, 1983

SPONSOR SENATOR MAZUREK

NAME	RESIDENCE	REPRESENTING	SUP-PORT	OP-POSE
Bob Murdo	Helena	Business Law Section State Bar of Montana	✓	
Mike Zimmerman	Butte	Business Law Section State Bar of MT	✓	

IF YOU CARE TO WRITE COMMENTS, ASK SECRETARY FOR LONGER FORM.

WHEN TESTIFYING PLEASE LEAVE PREPARED STATEMENT WITH SECRETARY.

FORM CS-33

VISITOR'S REGISTER

HOUSE JUDICIARY COMMITTEE

BILL SENATE BILL 237 DATE March 21, 1983

SPONSOR SENATOR HALLIGAN

NAME	RESIDENCE	REPRESENTING	SUPPORT	OPPOSE
Becky Fairclough	Great Falls	Cascade County Restitution Program	X	
Penney Sey	Helena	Lewis & Clark Co. Restitution	X	
Bill ~~Bob Murdo~~	~~Helena~~	~~Business Law Section State Bar of Montana~~		

IF YOU CARE TO WRITE COMMENTS, ASK SECRETARY FOR LONGER FORM.

WHEN TESTIFYING PLEASE LEAVE PREPARED STATEMENT WITH SECRETARY.

FORM CS-33

PACE SKYLINE CENTER - 3300 Third Street NE, Great Falls, Montana 59404

March 10, 1983

Exhibit A

3-21-83

SB 237

Becky Fairclough
Restitutions Department
CASCO Building
Great Falls, MT 59401

Dear Becky:

Thank you for agreeing to be a resource speaker at our PACE Creative Problem-Solving Workshop on March 22 and 23. The workshop will be held at the Memorial Youth Center, 801 Second Avenue North. You will be working with students from 9:00 to 11:30 a.m. both days.

The topic is "Is There Justice in the Law?" and will focus on justice from the perspective of the victim, the criminal and society. Please respond to the topic from your perspective. You will first speak for five minutes as a member of a panel. Following the panel, the students will rotate to you for a series of question/answer sessions. Please interact with them in whatever way you feel will encourage the exchange of ideas.

Here is the morning schedule:

8:00 - 8:20	Registration
8:20 - 8:30	Welcome
8:30 - 8:50	Keynote Address, Judge William Coder
8:50 - 9:00	Introduction of Panel and Coaches
9:00 - 9:30	Panel: Father Gregori, moderator; Becky Fairclough; Mike Gersack; Tom McKittrick; Mike Smartt
9:30 - 9:45	Break
9:45 - 11:25	FACT FINDING: Question/Answer Sessions (five 20-minute sessions of approximately 20 students)
11:25 - 12:00	Fact Finding Summary (Teams & Coaches)
12:00 - 12:30	Lunch

Lunch will be served at noon and we invite you to join us as our guest. Please call the PACE Office, 791-2270 if you will be able to stay.

Thank you again for sharing your time and knowledge with us. You will be an integral part of the FIRST step of the Creative Problem-Solving Process.

Sincerely,

Andrea Bartelt

Andrea Bartelt, Director
PACE Program

AB:ls

Exhibit H
3/21/83
SB 138

SB138

PROPOSED AMENDMENTS TO THE MONTANA UNIFORM COMMERCIAL CODE

Prof. Ron Wyse

Montana adopted the Uniform Commercial Code (the "Code") effective January 1, 1965. Although the original version of the Code had been approved by the National Conference of Commissioners on Uniform State Laws in 1952, that version had been revised in 1962 so that the law as enacted in Montana was based on the 1962 Official Text of the Code.

In 1972, however, a new official text was promulgated which incorporated a number of changes, principally in Article 9 pertaining to Personal Property Security Interests. In 1977, further refinements were made in Article 8 which relates to Investment Securities. The present official text of the Code is referred to as the 1978 Official Text and incorporates all of the changes made subsequent to that date.

The purpose of these proposed amendments is to update the Montana version of the Code (based on the 1962 Official Text) to incorporate the changes made by the Permanent Editorial Board of the Code subsequent to the Code's adoption in Montana. The material attached hereto is reproduced with the permission of the copyright holders (the American Law Institute and the National Conference of Commissioners on Uniform State Laws) and West Publishing Company.

The attached material includes the official Reasons for Change which identifies the change as being either part of the 1972 or 1977 revisions of the Code. Eight sections (1-201, 9-103, 9-105, 9-203, 9-302, 9-304, 9-305, and 9-312) were revised in 1972 and 1977 which has resulted in some re-typing to incorporate both revisions. In addition, an amendment is proposed to section 2-702(3) that reflects a 1966 revision to the 1962 official text that has not been incorporated in the Montana statute and an amendment to section 2-207 is proposed that is not based on a revision of the official text. The Comments to the proposed amendments to those two sections have been prepared by me.

The section numbers shown on the attached material are the official numbers. The Montana version of the Code is found in Title 30, Chapters 1 through 9 and the section numbers are identical to the official text. Thus, section 1-105 of the official text is found at 30-1-105 Montana Code Annotated. Deletions from the present language are shown in brackets ([...]) and additions are underlined.

fra 1

§ 1—105. Territorial Application of the Act; Parties' Power to Choose Applicable Law

(1) Except as provided hereafter in this section, when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties. Failing such agreement this Act applies to transactions bearing an appropriate relation to this state.

(2) Where one of the following provisions of this Act specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

Rights of creditors against sold goods. Section 2—402.

Applicability of the Article on Bank Deposits and Collections. Section 4—102.

Bulk transfers subject to the Article on Bulk Transfers. Section 6—102.

Applicability of the Article on Investment Securities. Section 8—106.

[Policy and scope of the Article on Secured Transactions. Sections 9—102 and 9—103.]

<u>Perfection provisions of the Article on Secured Transactions, Section 9—103.</u>

Reasons for 1972 Change

The reference to Section 9—102 has been deleted and a change made in Section 9—102 deleting any reference therein to conflict of law problems, because there is no reason why the general principles of the present section should not be applicable to the choice of law problems within its scope. Section 9—103 continues to govern choice of law questions as to perfection of security interests and the effect of perfection and non-perfection thereof. The usual rule is that perfection is governed by the law of the jurisdiction in which the collateral is when the last event occurs on which is based the assertion that the security interest is perfected or unperfected. Section 9—103 contains special rules for the cases of intangibles which have no situs, certain types of movable goods, goods which the parties intended at the inception of the transaction to be kept in another jurisdiction, goods subject to certificate of title laws, and certain other cases. Section 9—103 also contains local law rules as to reperfection of security interests when collateral is moved from one jurisdiction to another.

§ 1—201. General Definitions

Subject to additional definitions contained in the subsequent Articles of this Act which are applicable to specific Articles or Parts thereof, and unless the context otherwise requires, in this Act:

* * *

(5) "Bearer" means the person in possession of an instrument, document of title, or <u>certificated</u> security payable to bearer or indorsed in blank.

(9) "Buyer in ordinary course of business" means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. <u>All persons who sell minerals or the like (including oil and gas) at wellhead or minehead shall be deemed to be persons in the business of selling goods of that kind.</u> "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(14) "Delivery" with respect to instruments, documents of title, chattel paper, or <u>certificated</u> securities means voluntary transfer of possession.

* * *

(20) "Holder" means a person who is in possession of a document of title or an instrument or [an] <u>a certificated</u> investment security drawn, issued, or indorsed to him or his order or to bearer or in blank.

* * *

(37) "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (Section 2—401) is limited in effect to a reservation of a "security interest". The term also includes any interest of a buyer of accounts[,] or chattel paper[, or contract rights] which is subject to Article 9. The special property interest of a buyer of goods on identification of such goods to a contract for sale under Section 2—401 is not a "security interest", but a buyer may also acquire a "security interest" by complying with Article 9. Unless a lease or consignment is intended as security, reservation of title thereunder is not a "security interest" but a consignment is in any event subject to the provisions on consignment sales (Section 2—326). Whether a lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security.

Reasons for 1972 Change of Definitions (9) and (37)

(9) The new language fits in with changes as to minerals in Section 9—103 which are explained in the references to minerals in the Reasons for Change and Comments to that section.

(37) The omission of the term "contract rights" conforms to the elimination of that term from Article 9. See Reasons for Change under Section 9—106.

§ 2—107. Goods to Be Severed From Realty: Recording

(1) A contract for the sale of [timber,] minerals or the like (including oil and gas) or a structure or its materials to be removed from realty is a contract for the sale of goods within this Article if they are to be severed by the seller but until severance a purported present sale thereof which is not effective as a transfer of an interest in land is effective only as a contract to sell.

(2) A contract for the sale apart from the land of growing crops or other things attached to realty and capable of severance without material harm thereto but not described in subsection (1) or of timber to be cut is a contract for the sale of goods within this Article whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at the time of contracting, and the parties can by identification effect a present sale before severance.

(3) The provisions of this section are subject to any third party rights provided by the law relating to realty records, and the contract for sale may be executed and recorded as a document transferring an interest in land and shall then constitute notice to third parties of the buyer's rights under the contract for sale.

Reasons for 1972 Change

Several timber-growing states have changed the 1962 Code to make timber to be cut under a contract of severance goods, regardless of the question who is to sever them. The section is revised to adopt this change. Financing of the transaction is facilitated if the timber is treated as goods instead of real estate. A similar change is made in the definition of "goods" in Section 9—105. To protect persons dealing with timberlands, filing on timber to be cut is required in Part 4 of Article 9 to be made in real estate records in a manner comparable to fixture filing.

§ 2—207. Additional Terms in Acceptance or Confirmation

(1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional or different terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

(a) the offer expressly limits acceptance to the terms of the offer;

(b) they materially alter it; or

(c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.

REASONS FOR PROPOSED CHANGE TO SECTION 2-207

Section 2-207 was a major innovation of the UCC in that it set forth rules by which transactions entered into in a commercial context are treated as the binding contracts the parties intended notwithstanding deviations from the strict common law rules of contract formation. Specifically, the section permits the formation of a binding obligation where a "definite and seasonable expression of acceptance" is sent "even though it states terms additional to or different from those offered ...," (emphasis added). The common law rule of contract required that an acceptance be the "mirror image" of the offer and would find that a purported acceptance with additional or different terms to be a counter-offer which frequently led to a finding that no contract resulted even if the parties to the transaction had reached a commercial understanding that the deal was closed.

It appears that the official text of the Code inadvertently omitted the reference to "different" terms in subsection 2. See official Comment 3 to section 2-207. While courts and commentators have disagreed on this conclusion, in this writer's opinion, cases such as Steiner v. Mobil Oil Corp., 569 P.2d 751 at 759 note 5 (Cal. 1977) represent the preferable view as to this omission of "different" terms in sub-section 2. In Steiner, the California Supreme Court noted the inclusion of both phrases ("additional or different") in official Comment 3 and observed that the distinction between the two words is ambiguous. The court found that either additional or different terms are subject to sub-section 2 of 2-207.

This proposed amendment is designed to eliminate this ambiguity in Montana. This comment written by Prof. Ronald Wyse.

30-2-702. Seller's remedies on discovery of buyer's insolvency. (1) Where the seller discovers the buyer to be insolvent he may refuse delivery except for cash including payment for all goods theretofore delivered under the contract, and stop delivery under this chapter (30-2-705).

(2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within 10 days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within 3 months before delivery the 10-day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

(3) The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser [or lien creditor] under this chapter (30-2-403). Successful reclamation of goods excludes all other remedies with respect to them.

REASONS FOR PROPOSED CHANGE TO SECTION 2-702

Section 30-2-702(3) Montana Code Annotated reflected the 1962 official text of the Code. Subsequent to Montana's adoption of this section, subsection 3 of section 2-702 was amended in 1966 by deleting the reference to "Lien Creditor," as indicated above. The rationale of the amendment in general is that section 2-702 gives an unsecured seller a right to reclaim goods delivered to an insolvent buyer if demand is made within the time period stated in the section. The section is based on the "proposition that any receipt of goods on credit by an insolvent buyer amounts to a tacit business misrepresentation of solvency and therefore, is fraudulent as against the particular seller." Official Comment Number 2 to 2-702.

This reclamation right is properly made subject to the rights of an intervening good faith purchaser but should not protect the rights of an intervening lien creditor for at least two reasons. First, giving a preference to an ordinary lien creditor (i.e., a judgment creditor levying execution on a prior debt) simply gives that creditor a windfall at the expense of our defrauded seller. It is highly unlikely that the goods being reclaimed were in possession of the debtor when the debt being enforced by the judgment creditor was created. The judgment creditor's claim may have arisen in a non-business setting and could even be based on a tort committed by the debtor. Secondly, and much more common, there will not be an <u>actual</u> intervening lien creditor but the rights of a hypothetical lien creditor will attempt to be enforced by a trustee in bankruptcy. Since the reclamation rights created by section 2-702 are keyed to the buyer's insolvency, the most usual case will be the initiation of a bankruptcy case following delivery of the goods. Most courts and commentators believed that this result was unfair to the defrauded seller and at least 15 states have amended their versions of 2-702 (as indicated above) to avoid this result. See Speidel, Summers & White, <u>Commercial and Consumer Law</u>, 2nd ed., pp. 1231-1234.

This change is recommended notwithstanding section 546(c) of the Bankruptcy Reform Act of 1978 which generally recognizes the superior right of the defrauded seller to reclaim the goods under 2-702 over the power of the bankruptcy trustee. (See the Notes of Committee on the Judiciary, U.S. Senate Report No. 95-989 which states, the "purpose of the provision [§ 546(c)] is to recognize, in part, the validity of section 2-702 of the Uniform Commercial Code, ...".) Thus, even though the new U.S. Bankruptcy Code minimizes the right of the trustee to defeat the reclamation rights of the defrauded seller, without amending section 30-2-207(3) as indicated above, an actual intervening lien creditor will still obtain an unfair advantage.

Amendment to Article 5

§ 5—114. Issuer's Duty and Privilege to Honor; Right to Reimbursement

* * *

(2) Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (Section 7—507) or of a certificated security (Section 8—306) or is forged or fraudulent or there is fraud in the transaction:

(a) the issuer must honor the draft on demand for payment if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course (Section 3—302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (Section 7—502) or a bona fide purchaser of a certificated security (Section 8—302); and

* * *

Reasons for 1977 Change

The foregoing insertions of the word "certificated" in two sections of Articles other than Articles 8 and 9 are made in order to conform to the new definitions in Section 8—102. Without modification, the term "security" would include uncertificated securities as well as certificated securities.

§ 5—116. Transfer and Assignment

(1) The right to draw under a credit can be transferred or assigned only when the credit is expressly designated as transferable or assignable.

(2) Even though the credit specifically states that it is nontransferable or nonassignable the beneficiary may before performance of the conditions of the credit assign his right to proceeds. Such an assignment is an assignment of [a contract right] an account under Article 9 on Secured Transactions and is governed by that Article except that

(a) the assignment is ineffective until the letter of credit or advice of credit is delivered to the assignee which delivery constitutes perfection of the security interest under Article 9; and

(b) the issuer may honor drafts or demands for payment drawn under the credit until it receives a notification of the assignment signed by the beneficiary which reasonably identifies the credit involved in the assignment and contains a request to pay the assignee; and

(c) after what reasonably appears to be such a notification has been received the issuer may without dishonor refuse to accept or pay even to a person otherwise entitled to honor until the letter of credit or advice of credit is exhibited to the issuer.

(3) Except where the beneficiary has effectively assigned his right to draw or his right to proceeds, nothing in this section limits his right to transfer or negotiate drafts or demands drawn under the credit.

Reasons for 1972 Change

The change conforms to the deletion of the defined term "contract right" from Article 9.

ARTICLE 8

INVESTMENT SECURITIES

PART 1

SHORT TITLE AND GENERAL MATTERS

§ 8—101. Short Title

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

Reasons for 1977 Change

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

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

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

§ 8—102. Definitions and Index of Definitions

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(iii) [is] a national securities exchange or association registered under [a statute of the United States such as the Securities Exchange Act of 1934,] the federal securities laws; and [none of whom, other than a national securities exchange or association, holds in excess of twenty per cent of the capital stock of such corporation; and]

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

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

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

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

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

Reasons for 1977 Change

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

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

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

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

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

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

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

§ 8—103. Issuer's Lien

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

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

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

Reasons for 1977 Change

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

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

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

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

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

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

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

Reasons for 1977 Change

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

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

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

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

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

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

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

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

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

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

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

Reasons for 1977 Change

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

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

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

§ 8—106. Applicability

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

(a) registration of transfer of a certificated security;

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

(c) sending of statements of uncertificated securities.

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

Reasons for 1977 Change

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

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

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

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

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

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

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

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

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

Reasons for 1977 Change

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

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

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

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

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

Reasons for 1977 Change

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

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

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

PART 2

ISSUE—ISSUER

§ 8—201. "Issuer"

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

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

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

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

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

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

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

Reasons for 1977 Change

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

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

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

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

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

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

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

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

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

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

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

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

Reasons for 1977 Change

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

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

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

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

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

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

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

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

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

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

Reasons for 1977 Change

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

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

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

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

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

Reasons for 1977 Change

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

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

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

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

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

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

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

Reasons for 1977 Change

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

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

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

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

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

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

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

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

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

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

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

Reasons for 1977 Change

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

Note that the protection of paragraph (3)(b) extends only to the addressee of the initial transaction statement. If, for example, a properly signed initial transaction statement indicated, in the space for notations of liens, the word "None", which had been incorrectly inserted, and the addressee of that statement had actual knowledge that a lien existed, a subsequent purchaser from the addressee would not take free of the lien, despite the incorrect insertion. If, however, the subsequent purchaser then received an initial transaction statement showing no liens, he would then have the protection of Section 8—103 and this section.

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

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

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

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

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

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

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

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

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

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

(a) any uncertificated securities issued in exchange for or distributed with respect to the pledged security shall be registered subject to the pledge;

(b) any certificated securities issued in exchange for or distributed with respect to the pledged security shall be delivered to the registered pledgee; and

(c) any money paid in exchange for or in redemption of part or all of the security shall be paid to the registered pledgee.

(7) [(2)] Nothing in this Article shall be construed to affect the liability of the registered owner of a security for calls, assessments, or the like.

Reasons for 1977 Change

Under present subsection (1), the issuer of a certificated security may and, in the absence of conclusive evidence that the security has been transferred, presumably will rely on the registry to establish the identity of those entitled to ownership rights. New subsection (2) establishes the same rule for the issuer of uncertificated securities, subject, however, to the rights of registered pledgees which are set forth in subsections (3), (4) and (6). It should be noted that an uncertificated security can normally be transferred only by registration of transfer.

Under subsection (3), the owner of an uncertificated security subject to a registered pledge cannot transfer his interest until the pledge has been released by the registered pledgee. Although this requirement appears to conflict with the free alienability of the debtor's interest under Section 9—311, it does so no more than the current practice of delivery of a certificated security to the pledgee, which, in effect, deprives the owner of the power to transfer an interest without the pledgee's cooperation.

The final sentence of subsection (3) makes clear that when a convertible uncertificated security is subject to a registered pledge, it is the pledgee, and not the owner, who has the exclusive power to exercise the conversion rights. Since the exercise of conversion rights for a certificated security generally requires delivery of the security to the issuer, the cooperation of the secured party is similarly required. **Note that the proceeds of the conversion are subject to the pledgee's interest or delivered to the pledgee under subsection (6).**

Subsection (4) obliges the issuer to comply with the transfer instruction of the registered pledgee of an uncertificated security, thus placing such pledgee in the same position as the pledgee of a certificated security to whom the security has been delivered with all necessary indorsements. The three subparagraphs of subsection (4) provide respectively for (a) the outright transfer of the security, free of the pledgee's interest, to a buyer or any other person, including the pledgee; (b) the transfer of the owner's equity to a third person with the pledgee's interest continuing; and (c) the substitution of a new pledgee for the existing pledgee with ownership continuing undisturbed. Subsection (5) provides for continuity of perfection for purposes of priority under Article 9, the Bankruptcy Act and other statutes.

Subsection (6) protects the pledgee's interest in the proceeds of conversion, exchange or redemption of uncertificated securities, since no instrument need be surrendered to effectuate such transactions. Subsection (6) also provides that additional securities, certificated or uncertificated, issued in connection with stock splits or stock dividends will continue under the control of the registered pledgee. This contrasts with the situation when certificated securities are pledged and dividend certificates are customarily sent to the registered owner—the only party shown on the issuer's records. In that event, the pledgee must obtain the dividend certificates from the pledgor, exposing them, in the interim, to wrongful transfer.

§ 8—208. Effect of Signature of Authenticating Trustee, Registrar, or Transfer Agent

(1) A person placing his signature upon a certificated security or an initial transaction statement as authenticating trustee, registrar, transfer agent, or the like, warrants to a purchaser for value of the certificated security or a purchaser for value of an uncertificated security to whom the initial transaction statement has been sent, if the purchaser is without notice of the particular defect, that:

(a) the certificated security or initial transaction statement is genuine; [and]

(b) his own participation in the issue or registration of the transfer, pledge, or release of the security is within his capacity and within the scope of the [authorization] authority received by him from the issuer; and

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(c) he has reasonable grounds to believe that the security is in the form and within the amount the issuer is authorized to issue.

(2) Unless otherwise agreed, a person by so placing his signature does not assume responsibility for the validity of the security in other respects.

Reasons for 1977 Change

Language has been added to this section to extend the warranties of a signing authenticating trustee, registrar, transfer agent or the like to the addressees of initial transaction statements. It should be noted that this warranty extends only to the addressee. Compare Sections 8—205 and 8—206 and the explanation of changes thereunder.

PART 3

[PURCHASE] TRANSFER

§ 8—301. Rights Acquired by Purchaser [; "Adverse Claim"; Title Acquired by Bona Fide Purchaser]

(1) Upon [delivery] transfer of a security to a purchaser (Section 8—313), the purchaser acquires the rights in the security which his transferor had or had actual authority to convey unless the purchaser's rights are limited by Section 8—302 (4). [except that a purchaser who has himself been a party to any fraud or illegality affecting the security or who as a prior holder had notice of an adverse claim cannot improve his position by taking from a later bona fide purchaser. "Adverse claim" includes a claim that a transfer was or would be wrongful or that a particular adverse person is the owner of or has an interest in the security.]

[(2) A bona fide purchaser in addition to acquiring the rights of a purchaser also acquires the security free of any adverse claim.]

(2) [(3)] A [purchaser] transferee of a limited interest acquires rights only to the extent of the interest [purchased] transferred. The creation or release of a security interest in a security is the transfer of a limited interest in that security.

Reasons for 1977 Change

Although the definition of "Purchase" in Section 1—201 (32) includes any "voluntary transaction", with or without consideration, the title of Part 3 has been changed to "Transfer" as a more natural description of the material covered therein. Similar changes have been made in the statutory text, where appropriate.

Transfers by operation of law, i. e., not to purchasers, are not intended to be covered by Part 3 of either the present or revised Article. Such transfers are effective upon the occurrence of the motivating event (death, bankuptcy or the like) and subsequent delivery and registration are merely confirmatory of what has already happened.

Subsection (1) states the basic rule of the present statute including the so-called shelter principle. The word "transfer" has been substituted for "delivery" in order that appropriate methods for the transfer of uncertificated securities can be included.

The balance of subsection (1) and all of present subsection (2) have been deleted from this Section but are now included in Section 8—302 which is intended to deal completely with the concept of bona fide purchase.

A sentence has been added to former subsection (3) to make clear that the creation and release of security interests are included in the statute's coverage.

§ 8—302. "Bona Fide Purchaser"; "Adverse Claim"; Title Acquired by Bona Fide Purchaser

(1) A "bona fide purchaser" is a purchaser for value in good faith and without notice of any adverse claim:

(a) who takes delivery of a certificated security in bearer form or [of one] in registered form, issued [to him] or indorsed to him or in blank;

(b) to whom the transfer, pledge or release of an uncertificated security is registered on the books of the issuer; or

(c) to whom a security is transferred under the provisions of paragraph (c), (d)(i), or (g) of Section 8—313(1).

(2) "Adverse claim" includes a claim that a transfer was or would be wrongful or that a particular adverse person is the owner of or has an interest in the security.

(3) A bona fide purchaser in addition to acquiring the rights of a purchaser (Section 8—301) also acquires his interest in the security free of any adverse claim.

(4) Notwithstanding Section 8—301(1), the transferee of a particular certificated security who has been a party to any fraud or illegality affecting the security, or who as a prior holder of that certificated security had notice of an adverse claim, cannot improve his position by taking from a bona fide purchaser.

Reasons for 1977 Change

The definition of bona fide purchaser of a certificated security is preserved in subparagraph (1)(a). A coordinate rule for the purchaser of an uncertificated security is stated in subparagraph (1)(b). The relevant time for testing the knowledge or constructive knowledge of a purchaser is the time of delivery in the case of a certificated security and the time of registration in the case of an uncertificated security. Note that the purchaser of an uncertificated security is charged with knowledge of adverse claims noted in the initial transaction statement sent to him as provided in Section 8—304.

In the present statute, Section 8—313 equates certain events with delivery and subsection (2) thereof provides that a purchaser who is deemed to have taken delivery through his broker under certain of the procedures in subsection (1) can be a "holder." It was thought advisable to add subparagraph (1)(c) to this section in order to identify expressly those provisions of revised Section 8—313(1) that will confer "holder" status on a purchaser and thus enable him to be a bona fide purchaser under this section.

The definition of adverse claim, the description of the title of a bona fide purchaser and the exception to the shelter principle, all of which are included in Section 8—301 of the present statute, are set forth as subsections (2), (3) and (4) respectively. Language has been added to subsection (4) to make clear that it is limited to the holder of a particular certificated security.

§ 8—303. "Broker"

"Broker" means a person engaged for all or part of his time in the business of buying and selling securities, who in the transaction concerned acts for, [or] buys a security from, or sells a security to, a customer. Nothing in this Article determines the capacity in which a person acts for purposes of any other statute or rule to which [such] the person is subject.

§ 8—304. Notice to Purchaser of Adverse Claims

(1) A purchaser (including a broker for the seller or buyer, but excluding an intermediary bank) of a certificated security is charged with notice of adverse claims if:

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

(b) the security is in bearer form and has on it an unambiguous statement that it is the property of a person other than the transferor. The mere writing of a name on a security is not such a statement.

(2) A purchaser (including a broker for the seller or buyer, but excluding an intermediary bank) to whom the transfer, pledge, or release of an uncertificated security is registered is charged with notice of adverse claims as to which the issuer has a duty under Section 8—403(4) at the time of registration and which are noted in the initial transaction statement sent to the purchaser or, if his interest is transferred to him other than by registration of transfer, pledge, or release, the initial transaction statement sent to the registered owner or the registered pledgee.

(3) [(2)] The fact that the purchaser (including a broker for the seller or buyer) of a certificated or uncertificated security has notice that the security is held for a third person or is registered in the name of or indorsed by a fiduciary does not create a duty of inquiry into the rightfulness of the transfer or constitute constructive notice of adverse claims. [If,] However, if the purchaser (excluding an intermediary bank) has knowledge that the proceeds are being used or [that] the transaction is for the individual benefit of the fiduciary or otherwise in breach of duty, the purchaser is charged with notice of adverse claims.

Reasons for 1977 Change

Subsection (1), which deals with notice arising from what appears on a certificated security is applicable only to the purchaser of a certificated security. New subsection (2) provides that the purchaser of an uncertificated security is subject to those adverse claims that are noted on the initial transaction statement sent to him (or one who "holds" for him) confirming the transfer, pledge or release which has been registered. Subsection (3) is equally applicable to the purchasers of certificated and uncertificated securities and language has been added to make that clear.

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§ 8—305. Staleness as Notice of Adverse Claims

An act or event [which] that creates a right to immediate performance of the principal obligation [evidenced] represented by [the] a certificated security or [which] sets a date on or after which [the] a certificated security is to be presented or surrendered for redemption or exchange does not [of] itself constitute any notice of adverse claims except in the case of a [purchase] transfer:

(a) after one year from any date set for [such] presentment or surrender for redemption or exchange; or

(b) after [six] 6 months from any date set for payment of money against presentation or surrender of the security if funds are available for payment on that date.

Reasons for 1977 Change

The substance of this section applies only to certificated securities for the same reasons as Section 8—203. It is not contemplated that uncertificated securities which have been called or have matured will be traded. With uncertificated securities which have become redeemable or exchangeable, effective transfer requires communication with the issuer and, therefore, presents the opportunity for the issuer to give the prospective transferee effective notice of such claims as have been lodged with it.

§ 8—306. Warranties on Presentment and Transfer of Certificated Securities; Warranties of Originators of Instructions

(1) A person who presents a certificated security for registration of transfer or for payment or exchange warrants to the issuer that he is entitled to the registration, payment, or exchange. But, a purchaser for value and without notice of adverse claims who receives a new, reissued, or re-registered certificated security on registration of transfer or receives an initial transaction statement confirming the registration of transfer of an equivalent uncertificated security to him warrants only that he has no knowledge of any unauthorized signature (Section 8—311) in a necessary indorsement.

(2) A person by transferring a certificated security to a purchaser for value warrants only that:

(a) his transfer is effective and rightful; [and]

(b) the security is genuine and has not been materially altered; and

(c) he knows of no fact which might impair the validity of the security.

(3) [Where] If a certificated security is delivered by an intermediary known to be entrusted with delivery of the security on behalf of another or with collection of a draft or other claim against [such] delivery, the intermediary by [such] delivery warrants only his own good faith and authority, even though he has purchased or made advances against the claim to be collected against the delivery.

(4) A pledgee or other holder for security who redelivers [the] a certificated security received, or after payment and on order of the debtor delivers that security to a third person, makes only the warranties of an intermediary under subsection (3).

(5) A person who originates an instruction warrants to the issuer that:

(a) he is an appropriate person to originate the instruction; and

(b) at the time the instruction is presented to the issuer he will be entitled to the registration of transfer, pledge, or release.

(6) A person who originates an instruction warrants to any person specially guaranteeing his signature (subsection 8—312 (3)) that:

(a) he is an appropriate person to originate the instruction; and

(b) at the time the instruction is presented to the issuer

(i) he will be entitled to the registration of transfer, pledge, or release; and

(ii) the transfer, pledge, or release requested in the instruction will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction.

(7) A person who originates an instruction warrants to a purchaser for value and to any person guaranteeing the instruction (Section 8—312(6)) that:

(a) he is an appropriate person to originate the instruction;

(b) the uncertificated security referred to therein is valid; and

(c) at the time the instruction is presented to the issuer

(i) the transferor will be entitled to the registration of transfer, pledge, or release;

(ii) the transfer, pledge, or release requested in the instruction will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction; and

(iii) the requested transfer, pledge, or release will be rightful.

(8) If a secured party is the registered pledgee or the registered owner of an uncertificated security, a person who originates an instruction of release or transfer to the debtor or, after payment and on order of the debtor, a transfer instruction to a third person, warrants to the debtor or the third person only that he is an appropriate person to originate the instruction and at the time the instruction is presented to the issuer, the transferor will be entitled to the registration of release or transfer. If a transfer instruction to a third person who is a purchaser for value is originated on order of the debtor, the debtor makes to the purchaser the warranties of paragraphs (b), (c)(ii) and (c)(iii) of subsection (7).

(9) A person who transfers an uncertificated security to a purchaser for value and does not originate an instruction in connection with the transfer warrants only that:

(a) his transfer is effective and rightful; and

(b) the uncertificated security is valid.

(10) [(5)] A broker gives to his customer and to the issuer and a purchaser the applicable warranties provided in this section and has the rights and privileges of a purchaser under this section. The warranties of and in favor of the broker acting as an agent are in addition to applicable warranties given by and in favor of his customer.

Reasons for 1977 Change

The substance of the present section, with respect to certificated securities, has been preserved in the first four subsections. The section title and these subsections have been changed only to make clear that application only to certificated securities is intended. Because the registration of transfer of an uncertificated security to the transferee is functionally equivalent to the delivery of a certificated security to the transferee by the issuer, language has been add-

ed to subsection (1) to equate the position of purchasers for value without notice of adverse claims whether the security they "receive" from the issuer is certificated or uncertificated.

Subsection (5) establishes the warranty made to the issuer by the originator of an instruction, which is an order to the issuer and is defined in Section 8—308(4). These warranties are designed to protect issuers who rely on instructions which may be forged, fraudulent or otherwise improper against the persons who are responsible for the creation of such instructions. If, for example, an issuer should improperly transfer shares out of the name of a shareholder on the basis of a forged instruction, and transfer those shares to a bona fide purchaser to whom a valid initial transaction statement is sent, the issuer would be subject to liability to the purported transferor under Section 8—404(3).

Subsection (6) sets forth the warranty made by the originator of an instruction to a special signature guarantor. It adds to the two warranties of subsection (5) a warranty that the instruction will result in the registration of a "clean" transfer, pledge, or release and is consistent with the warranty made by a special signature guarantor under Section 8—312(3)(b).

Subsection (7) sets forth the warranty made by the originator of an instruction to both a purchaser for value and an instruction guarantor. It adds to the warranties in subsections (5) and (6) additional warranties of rightfulness and validity and is essentially identical to the warranty of the transferor of a certificated security under subsection (2). The absolute warranty of validity, rather than the mere denial of knowledge of invalidity, is appropriate because the instruction must be communicated to the issuer in order to complete the transfer. If, upon receipt of the instruction, the issuer should dispute the validity of the security, it seems proper to place the burden of proving validity on the transferor. It is contemplated that purchasers of uncertificated securities will not normally part with their consideration unless and until they are satisfied that the transaction has been duly registered and acknowledged to be free from defects by the issuer, except when they are relying on their brokers or other third parties.

Because the guarantor of an instruction makes an absolute warranty of rightfulness under Section 8—312(6), he is given the benefit of the originator's warranty under subsection (7).

Subsection (8) limits the warranties of the originator of an instruction when the uncertificated security is subject to a security interest and the originator is or acts for either the registered pledgee or registered owner who is the secured party. In such cases, when the instruction is for release, transfer to the debtor or transfer, after payment, to a third person on the debtor's order, the originator's warranties are limited in substantially the same way that subsection (4) limits the warranties of the pledgee of a certificated security acting under similar circumstances.

When the transferor of an uncertificated security is neither the registered owner nor the registered pledgee, the transferor will have no occasion to originate an instruction in connection with the transfer. In such cases, the transferor warrants the rightfulness of the transfer and the validity of the security to a purchaser for value, as provided in subsection (9).

§ 8—307. Effect of Delivery Without Indorsement; Right to Compel Indorsement

[Where] If a certificated security in registered form has been delivered to a purchaser without a necessary indorsement he may become a bona fide purchaser only as of the time the indorsement is supplied[.]; but against the transferor, the transfer is complete upon delivery and the purchaser has a specifically enforceable right to have any necessary indorsement supplied.

§ 8—308. [Indorsement, How Made; Special Indorsement; Indorser Not a Guarantor; Partial Assignment] Indorsements; Instructions

(1) An indorsement of a certificated security in registered form is made when an appropriate person signs on it or on a separate document an assignment or transfer of the security or a power to assign or transfer it or [when the] his signature [of such person] is written without more upon the back of the security.

(2) An indorsement may be in blank or special. An indorsement in blank includes an indorsement to bearer. A special indorsement specifies [the person] to whom the security is to be transferred, or who has power to transfer it. A holder may convert a blank indorsement into a special indorsement.

(3) [(5)] An indorsement purporting to be only of part of a certificated security representing units intended by the issuer to be separately transferable is effective to the extent of the indorsement.

(4) An "instruction" is an order to the issuer of an uncertificated security requesting that the transfer, pledge, or release from pledge of the uncertificated security specified therein be registered.

(5) An instruction originated by an appropriate person is:

(a) a writing signed by an appropriate person; or

(b) a communication to the issuer in any form agreed upon in a writing signed by the issuer and an appropriate person.

If an instruction has been originated by an appropriate person but is incomplete in any other respect, any person may complete it as authorized and the issuer may rely on it as completed even though it has been completed incorrectly.

(6) [(3)] "An appropriate person" in subsection (1) means [(a)] the person specified by the certificated security or by special indorsement to be entitled to the security [; or].

(7) "An appropriate person" in subsection (5) means:

(a) for an instruction to transfer or pledge an uncertificated security which is then not subject to a registered pledge, the registered owner; or

(b) for an instruction to transfer or release an uncertificated security which is then subject to a registered pledge, the registered pledgee.

(8) In addition to the persons designated in subsections (6) and (7), "an appropriate person" in subsections (1) and (5) includes:

(a) [(b) where] if the person [so specified] designated is described as a fiduciary but is no longer serving in the described capacity,[—]either that person or his successor; [or]

(b) [(c) where] if the [security or indorsement so specifies] persons designated are described as more than one person as fiduciaries and one or more are no longer serving in the described capacity,[—]the remaining fiduciary or fiduciaries, whether or not a successor has been appointed or qualified; [or]

(c) [(d) where] if the person [so specified] designated is an individual and is without capacity to act by virtue of death, incompetence, infancy, or otherwise,[—]his executor, administrator, guardian, or like fiduciary; [or]

(d) [(e) where] if the [security or indorsement so specifies] persons designated are described as more than one person as tenants by the entirety or with right of survivorship and by reason of death all cannot sign,[—] the survivor or survivors; [or]

(e) [(f)] a person having power to sign under applicable law or controlling instrument; [or] and

(f) [(g)] to the extent that the person designated or any of the foregoing persons may act through an agent,[—] his authorized agent.

(9) [(4)] Unless otherwise agreed, the indorser of a certificated security by his indorsement or the originator of an instruction by his origination assumes no obligation that the security will be honored by the issuer but only the obligations provided in Section 8—306.

(10) [(6)] Whether the person signing is appropriate is determined as of the date of signing and an indorsement made by or an instruction originated by [such a person] him does not become unauthorized for the purposes of this Article by virtue of any subsequent change of circumstances.

(11) [(7)] Failure of a fiduciary to comply with a controlling instrument or with the law of the state having jurisdiction of the fiduciary relationship, including any law requiring the fiduciary to obtain court approval of the transfer, pledge, or release, does not render his indorsement or an instruction originated by him unauthorized for the purposes of this Article.

Reasons for 1977 Change

The substance of the present section has been preserved, insofar as it applies to certificated securities, in subsections (1), (2), (3), (6), (8), (9), (10) and (11). Subsections (4), (5) and (7) deal solely with uncertificated securities. Present paragraph (3)(a) has been incorporated in new subsection (6). The remainder of present subsection (3) is incorporated in new subsection (8). Present subsections (4), (6) and (7) have been broadened to cover both forms of securities and are set forth in new subsections (9), (10) and (11). An attempt has been made to integrate the rules in order that issuers can rely on precisely the same documentation and evidence in connection with registration with respect to both certificated and uncertificated securities.

An order for the registration of transfer of a certificated security is the security itself, duly indorsed and presented to the issuer. Because uncertificated securities are not repre-

sented by instruments, a separate order, in some form, written or otherwise, is demanded. Subsection (4) defines an "instruction" as that order and further provides that not only registration of transfer, but also registration of pledge and release, can be requested thereby.

Subsection (5) provides that an instruction may be an appropriately signed writing, and it is contemplated that, in most cases, it will be. It further provides, however, that instructions may be other than signed writings when both parties, the issuer on the one hand and the registered owner or registered pledgee on the other, have agreed, in a signed writing, that some other procedure is mutually acceptable. Thus, paragraph (5)(b) is intended to facilitate the registration of transfers, pledges and releases on the authority of electronic, telegraphic or even oral instructions when the relevant parties are assured that the means selected will provide adequate safeguards against the execution of unauthorized transactions.

Subsection (7) designates the primary party appropriate to originate an instruction. When the uncertificated security is not subject to a registered pledge, the registered owner is that party and may properly originate an instruction to register either a transfer or pledge. When the uncertificated security is subject to a registered pledge, however, only the registered pledgee may properly originate an instruction to register either transfer or release. There is no provision to register a pledge other than that of a single registered pledgee. See Section 8—108.

The final phrase of subsection (9) has been inserted because of a possible ambiguity concerning the word "honored." Under the terms of Section 8—306 the transferor of a certificated security and the originator of an instruction do warrant, in effect, that the issuer will honor their respective orders to register the appropriate transaction. They do not, unless otherwise agreed, become sureties of the obligations of the issuer beyond the duty to register, as, for example, the issuer's obligations to pay interest and principal on a security which is an indebtedness of the issuer.

§ 8—309. Effect of Indorsement Without Delivery

An indorsement of a certificated security, whether special or in blank, does not constitute a transfer until delivery of the certificated security on which it appears or, if the indorsement is on a separate document, until delivery of both the document and the certificated security.

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§ 8—310. Indorsement of Certificated Security in Bearer Form

An indorsement of a certificated security in bearer form may give notice of adverse claims (Section 8—304) but does not otherwise affect any right to registration the holder [may possess] possesses.

§ 8—311. Effect of Unauthorized Indorsement or Instruction

Unless the owner or pledgee has ratified an unauthorized indorsement or instruction or is otherwise precluded from asserting its ineffectiveness:

(a) he may assert its ineffectiveness against the issuer or any purchaser, other than a purchaser for value and without notice of adverse claims, who has in good faith received a new, reissued, or re-registered certificated security on registration of transfer or received an initial transaction statement confirming the registration of transfer, pledge, or release of an equivalent uncertificated security to him; and

(b) an issuer who registers the transfer of a certificated security upon the unauthorized indorsement or who registers the transfer, pledge, or release of an uncertificated security upon the unauthorized instruction is subject to liability for improper registration (Section 8—404).

Reasons for 1977 Change

This section is broadened to give the same effect to an unauthorized instruction as the present statute gives to an unauthorized indorsement of a certificated security. Thus, the protection which paragraph (a) accords to a bona fide purchaser who receives a certificated security from the issuer is also accorded to a bona fide purchaser who receives an initial transaction statement with respect to an uncertificated security. Similarly, the liability of the issuer for improper registration set forth in paragraph (b) extends to improper registration pursuant to an unauthorized instruction.

§ 8—312. Effect of Guaranteeing Signature, [or] Indorsement or Instruction

(1) Any person guaranteeing a signature of an indorser of a certificated security warrants that at the time of signing:

(a) the signature was genuine; [and]

(b) the signer was an appropriate person to indorse (Section 8—308); and

(c) the signer had legal capacity to sign.

[But the guarantor does not otherwise warrant the rightfulness of the particular transfer.]

(2) Any person guaranteeing a signature of the originator of an instruction warrants that at the time of signing:

(a) the signature was genuine;

(b) the signer was an appropriate person to originate the instruction (Section 8—308) if the person specified in the instruction as the registered owner or registered pledgee of the uncertificated security was, in fact, the registered owner or registered pledgee of such security, as to which fact the signature guarantor makes no warranty;

(c) the signer had legal capacity to sign; and

(d) the taxpayer identification number, if any, appearing on the instruction as that of the registered owner or registered pledgee was the taxpayer identification number of the signer or of the owner or pledgee for whom the signer was acting.

(3) Any person specially guaranteeing the signature of the originator of an instruction makes not only the warranties of a signature guarantor (subsection (2)) but also warrants that at the time the instruction is presented to the issuer:

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

(b) the transfer, pledge, or release of the uncertificated security requested in the instruction will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction.

(4) [But] The guarantor under subsections (1) and (2) or the special guarantor under subsection (3) does not otherwise warrant the rightfulness of the particular transfer, pledge, or release.

(5) [(2)] Any person [may guarantee] guaranteeing an indorsement of a certificated security [and by so doing warrants not only the signature (subsection 1)] makes not only the warranties of a signature guarantor under subsection (1) but also

warrants the rightfulness of the particular transfer in all respects. [But no issuer may require a guarantee of indorsement as a condition to registration of transfer.]

(6) Any person guaranteeing an instruction requesting the transfer, pledge, or release of an uncertificated security makes not only the warranties of a special signature guarantor under subsection (3) but also warrants the rightfulness of the particular transfer, pledge, or release in all respects.

(7) [But] No issuer may require a special guarantee of signature (subsection (3)), a guarantee of indorsement (subsection (5)), or a guarantee of instruction (subsection (6)) as a condition to registration of transfer, pledge, or release.

(8) [(3)] The foregoing warranties are made to any person taking or dealing with the security in reliance on the guarantee, and the guarantor is liable to [such] the person for any loss resulting from breach of the warranties.

Reasons for 1977 Change

The substance of the present section has been preserved, insofar as it applies to certificated securities, in subsections (1), (4), (5), (7) and (8). Some of the language has been changed and restructured in order to integrate the material concerning uncertificated securities, but no change of substance is intended.

Subsection (2) sets forth the warranties that can reasonably be expected from the guarantor of the signature on an instruction, who, though familiar with the signer, does not have before him any evidence that the purported owner or pledgee is, in fact, the owner or pledgee of the subject uncertificated security. This is in distinct contrast to the position of the person guaranteeing a signature on a certificate who can see a certificate in the signer's possession in the name of or indorsed to the signer or in blank.

Thus, the warranty of appropriateness in clause (b) is expressly conditioned on the actual registration conforming to that represented by the originator. If the signer purports to be the owner or pledgee, the guarantor under clause (b), warrants only his identity. If, however, the signer is acting in a representative capacity, the guarantor warrants both his identity and his authority to act for the purported owner or pledgee. The additional warranty of clause (d) as to the taxpayer identification number is intended to prevent error or fraud resulting from identical or similar names. The warranties of subsection (2) are intended to provide satisfactory assurance to the issuer who needs no warranty as to the facts

of registration because he can ascertain those facts from his own records.

Subsection (3) sets forth a "special guarantee of signature" under which the guarantor additionally warrants both registered ownership or pledge and freedom from undisclosed defects of record. The guarantor of the signature of an indorser of a certificated security effectively makes these warranties to a purchaser for value on the evidence of a clean certificate issued in the name of the indorser, indorsed to the indorser or indorsed in blank. By specially guaranteeing under subsection (3), the guarantor warrants that the instruction will, when presented to the issuer, result in the requested registration free from defects not specified. It is contemplated that the special guarantee of signature will be used principally in brokerage transactions where the broker will be specially guaranteeing the signature on an instruction originated by his own customer. The broker's risk will be no greater than that of a broker who now commonly executes the sale of a security for his customer without the absolute assurance that his customer will deliver a clean certificate at settlement.

§ 8—313. When [Delivery] Transfer to [the] Purchaser Occurs: [; Purchaser's Broker] Financial Intermediary as [Holder] Bona Fide Purchaser; "Financial Intermediary"

(1) [Delivery] Transfer of a security or a limited interest (including a security interest) therein to a purchaser occurs only [when]:

(a) at the time he or a person designated by him acquires possession of a certificated security; [or]

(b) at the time the transfer, pledge, or release of an uncertificated security is registered to him or a person designated by him;

(c) [(b)] at the time his [broker] financial intermediary acquires possession of a certificated security specially indorsed to or issued in the name of the purchaser; [or]

(d) [(c)] at the time [his broker] a financial intermediary, not a clearing corporation, sends him confirmation of the purchase and also by book entry or otherwise identifies [a specific security in the broker's possession] as belonging to the purchaser[; or]

(i) a specific certificated security in the financial intermediary's possession;

(ii) a quantity of securities that constitute or are part of a fungible bulk of certificated securities in the financial intermediary's possession or of uncertificated securities registered in the name of the financial intermediary; or

(iii) a quantity of securities that constitute or are part of a fungible bulk of securities shown on the account of the financial intermediary on the books of another financial intermediary;

(e) [(d)] with respect to an identified certificated security to be delivered while still in the possession of a third person, not a financial intermediary, [when] at the time that person acknowledges that he holds for the purchaser; [or]

(f) with respect to a specific uncertificated security the pledge or transfer of which has been registered to a third person, not a financial intermediary, at the time that person acknowledges that he holds for the purchaser;

(g) [(e)] at the time appropriate entries to the account of the purchaser or a person designated by him on the books of a clearing corporation are made under Section 8—320[.];

(h) with respect to the transfer of a security interest where the debtor has signed a security agreement containing a description of the security, at the time a written notification, which, in the case of the creation of the security interest, is signed by the debtor (which may be a copy of the security agreement) or which, in the case of the release or assignment of the security interest created pursuant to this paragraph, is signed by the secured party, is received by

(i) a financial intermediary on whose books the interest of the transferor in the security appears;

(ii) a third person, not a financial intermediary, in possession of the security, if it is certificated;

(iii) a third person, not a financial intermediary, who is the registered owner of the security, if it is uncertificated and not subject to a registered pledge; or

(iv) a third person, not a financial intermediary, who is the registered pledgee of the security, if it is uncertificated and subject to a registered pledge;

(i) with respect to the transfer of a security interest where the transferor has signed a security agreement containing a description of the security, at the time new value is given by the secured party; or

(j) with respect to the transfer of a security interest where the secured party is a financial intermediary and the security has already been transferred to the financial intermediary under paragraphs (a), (b), (c), (d), or (g), at the time the transferor has signed a security agreement containing a description of the security and value is given by the secured party.

(2) The purchaser is the owner of a security held for him by [his broker] a financial intermediary, but [is not the holder] cannot be a bona fide purchaser of a security so held except [as] in the circumstances specified in [subparagraphs] paragraphs [(b)] (c), (d)(i), and [(e)] (g) of subsection (1). [Where] If a security so held is part of a fungible bulk, as in the circumstances specified in paragraphs (d)(ii) and (d)(iii) of subsection (1), the purchaser is the owner of a proportionate property interest in the fungible bulk.

(3) Notice of an adverse claim received by the [broker] financial intermediary or by the purchaser after the [broker] financial intermediary takes delivery of a certificated security as a holder for value or after the transfer, pledge, or release of an uncertificated security has been registered free of the claim to a financial intermediary who has given value is not effective either as to the [broker] financial intermediary or as to the purchaser. However, as between the [broker] financial intermediary and the purchaser the purchaser may demand [delivery] transfer of an equivalent security as to which no notice of [an] adverse claim has been received.

(4) A "financial intermediary" is a bank, broker, clearing corporation or other person (or the nominee of any of them) which in the ordinary course of its business maintains security accounts for its customers and is acting in that capacity. A financial intermediary may have a security interest in securities held in account for its customer.

Reasons for 1977 Change

The title of this section has been changed and its content broadened in order to identify the time when both certificated and uncertificated securities are transferred to purchasers. The content has been further extended to recognize that many transactions are conducted through financial intermediaries, a term defined in subsection (4) to include all entities, and not merely brokers, that maintain security accounts for their customers. It is one of the three sections in this revision in which it is intended to extend the coverage of Article 8 as to certificated securities. Sections 8—317 and 8—321 are the others.

Subsection (1) is expressly made applicable to limited interests, including security interests, as well as entire interests. Compare Section 8—301(2). The addition of the word "only" in the first sentence is intended to provide that the methods of transfer listed are exclusive and that compliance with one of them is essential to a valid transfer. Transfers by operation of law are excepted because they are not transfers to a "purchaser".

The rules of the present statute as they apply to certificated securities are preserved in subparagraphs (a), (c), (d)(i), (e) and (g). The coverage of (c) and (d)(i), however, is extended to situations where any financial intermediary, except a clearing corporation, is involved and the coverage of (e) is limited to third persons who are not financial intermediaries.

Subparagraph (b) is the basic rule for uncertificated securities and provides that a transfer (including a pledge or release, which are transfers of security interests) occurs when it is registered. Subparagraph (f) is the analogue of (e) and applies when an uncertificated security is controlled by a third person. In both (e) and (f), acknowledgement by the third person is the critical event.

Subparagraphs (d)(ii) and (d)(iii) have no counterpart in the present statute but are considered desirable express statements in the light of modern security holding practices of both brokers and banks. The final sentence of present subsection (2) implies this result without stating it expressly. Once the "fungible bulk" principle is established, it is immaterial whether the underlying securities are certificated, uncertificated or held in a clearing corporation account.

Entire subparagraph (d) is applicable to all financial intermediaries except clearing corporations and requires, as conditions of transfer, both a confirmation to the purchaser and a book entry. In contrast, subparagraph (g) applies only to

clearing corporations and requires only the appropriate book entry. The difference results from the fact that clearing corporations will normally control only securities belonging to their customers while other financial intermediaries may themselves be the beneficial owners or pledgees of securities not held in account for their customers. In the event of the insolvency of either the financial intermediary or the customer, it appears desirable to have some objective evidence of a transfer in addition to an internal book entry. This distinction preserves the similar distinction between subparagraphs (c) and (e) of the present statute.

Under the present statute, the rules of Section 8—313(1) are neither expressly applicable to security interests nor are they expressly made exclusive. On the other hand, when value has been given and the debtor has rights in the collateral, present Section 9—203(1) permits the creation of an enforceable security interest when either the secured party has possession of the collateral *or* the debtor has signed a written security agreement. Under present Article 9, a security interest created by signed agreement, although enforceable, would, with limited exceptions, be unperfected.

Under this revision, new Section 8—321 requires a transfer under Section 8—313(1) to create an enforceable security interest and Section 9—203(1) is expressly made subject to Section 8—321. As a result, it will not be possible to create a security interest in securities by mere written agreement. It is not considered necessary to continue to provide for the creation of unperfected security interests. It is considered desirable, however, to provide for the creation of security interests, unaccompanied by possession, which can be perfected under present Article 9.

Subparagraph (h), limited to the transfer of a security interest, deals with the situation where a security interest, pursuant to written agreement, is perfected by notice to a bailee under Section 9—305. Unlike a transfer under subparagraph (d), (e) or (f) of subsection (1), Section 9—305 does not require confirmation or acknowledgment by the controlling party, but only the receipt of notice. Subparagraph (h) provides that a transfer is effective when notice is received and further identifies the party to be notified. Subparagraph (h) is applicable to both certificated and uncertificated securities and, even when certificated securities are involved, eliminates speculation as to who is the bailee and, indeed, whether there is an instrument. Unlike Section 9—305, which merely requires notification, subsection (h) requires that the notification be signed by the transferor, thereby reducing the possibility of interference by fraudulent claimants. By this revision, securities are expressly excluded from the coverage of Section 9—305.

Subparagraph (i), also limited to the transfer of a security interest, deals with the situation where a security interest, pursuant to written agreement, for new value is automatically perfected for a period of 21 days under Section 9—304(4). Under subparagraph (i), such a security interest is effectively transferred when the new value is given. Section 8—321(2) provides for the expiration of perfection after 21 days. By this revision, securities are expressly excluded from the coverage of Section 9—304(4).

Subparagraph (j) is addressed to the situation where a financial intermediary holds securities in account for a customer and also acquires a security interest in those securities for its own account, *e. g.*, a margin account with a broker or a bank lending on the collateral of its borrower's custody account. In such cases, the financial intermediary's control of the securities is in a dual capacity, and a written agreement signed by the debtor was thought to be a desirable protection.

Present subsection (2) denies holder status to a broker's customer except in cases where the broker is holding a specific certificated security for the customer's account. The effect of this is to prevent the customer from becoming a bona fide purchaser when all he has is an interest in a fungible bulk of securities. Revised subsection (2) deals with the problem expressly in terms of who can or cannot become a bona fide purchaser. Note that in neither the present nor the revised statute can the purchaser who becomes such by acknowledgment by a third party bailee or agent attain bona fide purchaser status. Subsection (2) should be compared with Section 8—302(1)(c).

Subsection (3) states the principle that once a financial intermediary has become a bona fide purchaser subsequent notice of claims to either him or his customer are ineffective, and extends the coverage to uncertificated securities. The final sentence, now applicable to all financial intermediaries, gives the customer the right to obtain a "clean" security from his broker or bank.

New subsection (4) defines the term "financial intermediary" as an entity which maintains security accounts for its customers. Note that the definition applies only when the entity is acting in that capacity. Thus, a bank is a financial intermediary in transactions involving its custody accounts but is not a financial intermediary with respect to securities it holds as a pledgee or for its own account.

§ 8—314. Duty to [Deliver] Transfer, When Completed

(1) Unless otherwise agreed, [where] if a sale of a security **is made** on an exchange or otherwise through brokers:

(a) the selling customer fulfills his duty to [deliver when] transfer at the time he:

(i) [he] places [such] a certificated security in the possession of the selling broker or of a person designated by the broker; [or if requested causes an acknowledgment to be made to the selling broker that it is held for him; and]

(ii) causes an uncertificated security to be registered in the name of the selling broker or a person designated by the broker;

(iii) if requested, causes an acknowledgment to be made to the selling broker that [it] a certificated or uncertificated security is held for [him; and] the broker; or

(iv) places in the possession of the selling broker or of a person designated by the broker a transfer instruction for an uncertificated security, providing the issuer does not refuse to register the requested transfer if the instruction is presented to the issuer for registration within 30 days thereafter; and

(b) the selling broker, including a correspondent broker acting for a selling customer, fulfills his duty to [deliver] transfer at the time he:

(i) [by placing the] places a certificated security [or a like security] in the possession of the buying broker or a person designated by [him or] the buying broker;

(ii) causes an uncertificated security to be registered in the name of the buying broker or a person designated by the buying broker;

(iii) places in the possession of the buying broker or of a person designated by the buying broker a transfer instruction for an uncertificated security, providing the issuer does not refuse to register the requested transfer if the instruction is presented to the issuer for registration within 30 days thereafter; or

(iv) [by effecting] effects clearance of the sale in accordance with the rules of the exchange on which the transaction took place.

(2) Except as [otherwise] provided in this section and unless otherwise agreed, a transferor's duty to [deliver] transfer a security under a contract of purchase is not fulfilled until he:

(a) [he] places [the] a certificated security in form to be negotiated by the purchaser in the possession of the purchaser or of a person designated by the purchaser; [him or at the purchaser's request causes an acknowledgment to be made to the purchaser that it is held for him.]

(b) causes an uncertificated security to be registered in the name of the purchaser or a person designated by the purchaser; or

(c) [at the purchaser's request] if the purchaser requests, causes an acknowledgment to be made to the purchaser that [it] a certificated or uncertificated security is held for [him] the purchaser.

(3) Unless made on an exchange, a sale to a broker purchasing for his own account is within [this] subsection (2) and not within subsection (1).

Reasons for 1977 Change

This section presently provides that a transferor's duty is fulfilled by physical delivery of a certificated security. This rule is preserved in subparagraphs (1)(a)(i), (1)(b)(i) and (2)(a). New subparagraphs (1)(a)(ii), (1)(b)(ii) and (2)(b) permit the transferor also to perform by causing the registration of transfer of an uncertificated security to the transferee or his designee. Another alternative, causing a third party holder to acknowledge that he holds for the transferee if the transferee so requests, is provided in the present section and is explicitly stated in new subparagraphs (1)(a)(iii) and (2)(c). A selling broker may also fulfill his duty by effecting clearance pursuant to exchange rules. This is stated in new subparagraph (i)(b)(iv).

In brokerage transactions only, subparagraphs (1)(a)(iv) and (1)(b)(iii) permit yet another alternative. Under these, the transferor may conditionally satisfy his duty by the delivery of an instruction. Such delivery does not constitute complete performance if the instruction is timely presented for registration and the issuer refuses to comply with its request. The burden of timely presentment is placed on the recipient of the instruction and it is not intended that instructions so given will circulate in the manner in which certificated securities now commonly circulate by indorsement. It is contemplated that this method of performance will be commonly employed in transactions settled through brokers, with, in many cases, the selling broker specially guaranteeing the signature of the originator of the instruction pursuant to Section 8—312(3).

§ 8—315. Action Against [Purchaser] Transferee Based Upon Wrongful Transfer

(1) Any person against whom the transfer of a security is wrongful for any reason, including his incapacity, [may] as against anyone except a bona fide purchaser, may:

(a) reclaim possession of the certificated security wrongfully transferred; [or]

(b) obtain possession of any new certificated security [evidencing] representing all or part of the same rights; [or]

(c) compel the origination of an instruction to transfer to him or a person designated by him an uncertificated security constituting all or part of the same rights; or

(d) have damages.

(2) If the transfer is wrongful because of an unauthorized indorsement of a certificated security, the owner may also reclaim or obtain possession of the security or a new certificated security, even from a bona fide purchaser, if the ineffectiveness of the purported indorsement can be asserted against him under the provisions of this Article on unauthorized indorsements (Section 8—311).

(3) The right to obtain or reclaim possession of a certificated security or to compel the origination of a transfer instruction may be specifically enforced and [its] the transfer of a certificated or uncertificated security enjoined and [the] a certificated security impounded pending the litigation.

Reasons for 1977 Change

The coverage of this section is broadened to include remedies for the wrongful transfer of both certificated and uncertificated securities. Subparagraph (c) is added to subsection (1) to establish the alternative remedy of compelling the origination of an instruction to transfer an equivalent uncertificated security which is the functional equivalent of subparagraph (b).

Subsection (2) is applicable only to certificated securities and language is added to make that clear. The right to specific enforcement provided in subsection (3) is extended to the origination of a transfer instruction and the right to enjoin transfer is made applicable to both certificated and uncertificated securities.

§ 8—316. Purchaser's Right to Requisites for Registration of Transfer, Pledge, or Release on Books

Unless otherwise agreed, the transferor of a certificated security or the transferor, pledgor, or pledgee of an uncertificated security [must] on due demand must supply his purchaser with any proof of his authority to transfer, pledge, or release or with any other requisite [which may be] necessary to obtain registration of the transfer, pledge, or release of the security; but if the transfer, pledge, or release is not for value, a transferor, pledgor, or pledgee need not do so unless the purchaser furnishes the necessary expenses. Failure within a reasonable time to comply with a demand made [within a reasonable time] gives the purchaser the right to reject or rescind the transfer, pledge, or release.

Reasons for 1977 Change

Language has been added to this section in order to broaden its coverage to both certificated and uncertificated securities. Because uncertificated securities are not only transferred, but also can be pledged and released by registration, language has been added to include such transactions.

§ 8—317. [Attachment or Levy Upon Security] Creditors' Rights

(1) Subject to the exceptions in subsections (3) and (4), no attachment or levy upon a certificated security or any share or other interest [evidenced] represented thereby which is outstanding [shall be] is valid until the security is actually seized by the officer making the attachment or levy, but a certificated security which has been surrendered to the issuer may be [attached or levied upon at the source] reached by a creditor by legal process at the issuer's chief executive office in the United States.

(2) An uncertificated security registered in the name of the debtor may not be reached by a creditor except by legal process at the issuer's chief executive office in the United States.

(3) The interest of a debtor in a certificated security that is in the possession of a secured party not a financial intermediary or in an uncertificated security registered in the name of a secured party not a financial intermediary (or in the name of a nominee of the secured party) may be reached by a creditor by legal process upon the secured party.

(4) The interest of a debtor in a certificated security that is in the possession of or registered in the name of a financial intermediary or in an uncertificated security registered in the name of a financial intermediary may be reached by a creditor by legal process upon the financial intermediary on whose books the interest of the debtor appears.

(5) Unless otherwise provided by law, a creditor's lien upon the interest of a debtor in a security obtained pursuant to subsection (3) or (4) is not a restraint on the transfer of the security, free of the lien, to a third party for new value; but in the event of a transfer, the lien applies to the proceeds of the transfer in the hands of the secured party or financial intermediary, subject to any claims having priority.

(6) [(2)] A creditor whose debtor is the owner of a security [shall be] is entitled to [such] aid from courts of appropriate jurisdiction, by injunction or otherwise, in reaching [such] the security or in satisfying the claim by means [thereof as is] allowed at law or in equity in regard to property [which] that cannot readily be [attached or levied upon] reached by ordinary legal process.

Reasons for 1977 Change

This section has been substantially rewritten and expanded, not only to provide for the rights of creditors of the owners of uncertificated securities, but also to provide expressly for remedies against the interest of debtors in certificated securities which are not within the debtor's control. It is one of the three sections in this revision in which it is intended to extend the coverage of Article 8 as to certificated securities. Sections 8—313 and 8—321 are the others.

Subsection (1) states the rule of the present statute for certificated securities which provides that a creditor's lien upon a certificated security is not valid until actual seizure. The chief justification for this rule is the protection of purchasers from the debtor. The rule is entirely appropriate when the security is within the debtor's control. When the debtor does not have such control, the rule has no function.

The present statute recognizes a single exception to the rule where the security has been surrendered to the issuer. New subsection (1) includes this exception and expressly provides that such a security can be reached by serving the issuer at its chief executive office, replacing the cryptic phrase "at the source." The most logical place to serve the issuer would be the place where the transfer records are maintained, but that location might be difficult to identify, especially when the separate elements of a computer network might be situated in different places. The chief executive office is selected as the appropriate place by analogy to Section 9—103(3)(d).

Subsection (2) provides that process upon the issuer is the only method for a creditor to reach an uncertificated security registered in the name of the debtor. This conclusion was reached with some reluctance since it requires a creditor to institute legal action and/or a debtor to defend that action in a jurisdiction which may have no relationship to either of the parties or the dispute other than the happenstance that the debtor owns a security of the particular issuer. Nevertheless, attempts to formulate a procedure by which even a judgment creditor could effectively reach his debtor's uncertificated securities without such legal action resulted in what seemed to be an intolerable burden for issuers.

Subsection (3) provides a second exception to the seizure rule when a certificated security is in the possession of a secured party. In such a case, an effective lien can be established by service on the secured party without depriving him of his possession. This section does not attempt to provide for rights as between the creditor and the secured party, as, for example, whether or when the secured party must liquidate the security. For essentially the same reasons, subsection (3) also covers the case where an uncertificated security has been transferred into the name of a secured party either at the inception of the loan or thereafter.

Subsection (4) recognizes that certificated securities are frequently held in account for customers by banks or brokers and that such securities may be registered not only in the name of the debtor but, more commonly, in street or other nominee name. Additionally, in such cases, the securities may have been commingled, repledged or deposited so that no particular security could be identified as that of the debtor. The subsection provides that the debtor's account can be reached by process upon the entity upon whose books the interest of the debtor appears. This appears to be the most effective way of preventing the transfer of the debtor's interest and thus protecting the creditor. It is only that entity that is aware of the debtor's interest, irrespective of where the se-

curities are located or in what name they happen to be registered. For the same reason, subsection (4) also covers the case where uncertificated securities are registered in street name.

Subsection (5) expressly provides that securities in which the debtor's interest is reached pursuant to subsections (3) or (4) may be transferred for new value, free of the creditor's lien, but, when and if they are, that the lien will be transferred to the proceeds. Nothing in subsection (5) is intended to validate any transfer that would otherwise constitute a fraudulent conveyance. Furthermore, subsection (5) is expressly subject to the procedural laws of the states and no attempt has been made to prescribe the consequences of obtaining such a lien or the procedures for its enforcement.

Particular terms to describe creditor's process have been avoided in this section. This section is not intended to have any effect on the availability of garnishment or similar third-party process as a pre-judgment or post-judgment remedy. Such matters are a proper concern of the procedural rules of the states, subject, of course, to constitutional limitations.

§ 8—318. No Conversion by Good Faith [Delivery] Conduct

An agent or bailee who in good faith (including observance of reasonable commercial standards if he is in the business of buying, selling, or otherwise dealing with securities) has received certificated securities and sold, pledged, or delivered them or has sold or caused the transfer or pledge of uncertificated securities over which he had control according to the instructions of his principal, is not liable for conversion or for participation in breach of fiduciary duty although the principal [has] had no right [to dispose of them] so to deal with the securities.

Reasons for 1977 Change

The section which exonerates the agent or bailee who has made a good faith sale, pledge or delivery of certificated securities has been broadened to provide similar protection for similar parties engaging in similar activities with respect to uncertificated securities.

§ 8—319. Statute of Frauds

A contract for the sale of securities is not enforceable by way of action or defense unless:

(a) there is some writing signed by the party against whom enforcement is sought or by his authorized agent or broker, sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price; [or]

(b) delivery of [the] a certificated security or transfer instruction has been accepted, or transfer of an uncertificated security has been registered and the transferee has failed to send written objection to the issuer within 10 days after receipt of the initial transaction statement confirming the registration, or payment has been made, but the contract is enforceable under this provision only to the extent of [such] the delivery, registration, or payment; [or]

(c) within a reasonable time a writing in confirmation of the sale or purchase and sufficient against the sender under paragraph (a) has been received by the party against whom enforcement is sought and he has failed to send written objection to its contents within [ten] 10 days after its receipt; or

(d) the party against whom enforcement is sought admits in his pleading, testimony, or otherwise in court that a contract was made for the sale of a stated quantity of described securities at a defined or stated price.

Reasons for 1977 Change

This section extends the coverage of the statute of frauds to contracts for the sale of both certificated and uncertificated securities. The performance exceptions of paragraph (b) now include the acceptance of a transfer instruction by the alleged transferee and the registration of transfer of an uncertificated security to which registration the alleged transferee has not objected in writing within ten days after receiving the initial transaction statement confirming such registration. These additions, while necessary to enforcement against the alleged transferee, are unnecessary with respect to the transferor since each will almost certainly involve a writing signed by the transferor and thus will be within paragraph (a).

§ 8—320. Transfer or Pledge Within [a] Central Depository System

(1) In addition to other methods, a transfer, pledge, or release of a security or any interest therein may be effected by the making of appropriate entries on the books of a clearing corporation reducing the account of the transferor, pledgor, or pledgee and increasing the account of the transferee, pledgee, or pledgor by the amount of the obligation, or the number of shares or rights transferred, pledged, or released, if the security is shown on the account of a transferor, pledgor, or pledgee on the books of the clearing corporation; is subject to the control of the clearing corporation; and

(a) [(1)] if [a security] certificated,

(i)[(a)] is in the custody of [a] the clearing corporation, another clearing corporation, [or of] a custodian bank or a nominee of [either subject to the instructions of the clearing corporation] any of them; and

(ii)[(b)] is in bearer form or indorsed in blank by an appropriate person or registered in the name of the clearing corporation, [or] a custodian bank, or a nominee of [either] any of them; or [and]

(b) if uncertificated, is registered in the name of the clearing corporation, another clearing corporation, a custodian bank, or a nominee of any of them;

[(c) is shown on the account of a transferor or pledgor on the books of the clearing corporation;

then, in addition to other methods, a transfer or pledge of the security or any interest therein may be effected by the making of appropriate entries on the books of the clearing corporation reducing the account of the transferor or pledgor and increasing the account of the transferee or pledgee by the amount of the obligation or the number of shares or rights transferred or pledged.]

(2) Under this section entries may be made with respect to like securities or interests therein as a part of a fungible bulk and may refer merely to a quantity of a particular security without reference to the name of the registered owner, certificate or bond number, or the like, and, in appropriate cases, may be on a net basis taking into account other transfers, [or] pledges, or releases of the same security.

(3) A transfer [or pledge] under this section [has the effect of a delivery of a security in bearer form or duly indorsed in blank (Section 8—301) representing the amount of the obligation or the number of shares or rights transferred or pledged] is effective (Section 8—313) and the purchaser acquires the rights of the transferor (Section 8—301). A pledge or release under this section is the transfer of a limited interest. If a pledge or the creation of a security interest is intended, [the making of entries has the effect of a taking of delivery by the pledgee or a secured party (Sections 9—304 and 9—305)] the security interest is perfected at the time when both value is given by the pledgee and the appropriate entries are made (Section 8—321). A transferee or pledgee under this section [is a holder] may be a bona fide purchaser (Section 8—302).

(4) A transfer or pledge under this section [does] is not [constitute] a registration of transfer under Part 4 [of this Article].

(5) That entries made on the books of the clearing corporation as provided in subsection (1) are not appropriate does not affect the validity or effect of the entries [nor] or the liabilities or obligations of the clearing corporation to any person adversely affected thereby.

Reasons for 1977 Change

Changes have been made in this section to make it applicable to certificated and uncertificated securities. This will affect the operation of securities depositories in three ways. First, it will enable participants to add to their accounts with the depository by the registration of transfer of uncertificated securities to the depository or its nominee in addition to the current method of delivering certificated securities in negotiable form. Secondly, it will permit the depository to maintain its holdings of securities in uncertificated form, thus reducing custodial problems. Finally, it will permit the depository to transfer uncertificated securities out to its participants by causing the registration of transfer, as an alternative to the current method of maintaining an inventory of certificated securities for that purpose.

Subsection (1) has been restructured to make it clear that it covers securities that clearing corporation A may control through its account in clearing corporation B. The growing system of interfacing depositories makes such clarification desirable.

Subsection (3) has been rewritten to address certain consequences directly, rather than merely by analogy to the physical delivery of certificated securities.

§ 8—321. Enforceability, Attachment, Perfection and Termination of Security Interests

(1) A security interest in a security is enforceable and can attach only if it is transferred to the secured party or a person designated by him pursuant to a provision of Section 8—313(1).

(2) A security interest so transferred pursuant to agreement by a transferor who has rights in the security to a transferee who has given value is a perfected security interest, but a security interest that has been transferred solely under paragraph (i) of Section 8—313(1) becomes unperfected after 21 days unless, within that time, the requirements for transfer under any other provision of Section 8—313(1) are satisfied.

(3) A security interest in a security is subject to the provisions of Article 9, but:

(a) no filing is required to perfect the security interest; and

(b) no written security agreement signed by the debtor is necessary to make the security interest enforceable, except as otherwise provided in paragraph (h), (i), or (j) of Section 8—313(1).

The secured party has the rights and duties provided under Section 9—207, to the extent they are applicable, whether or not the security is certificated, and, if certificated, whether or not it is in his possession.

(4) Unless otherwise agreed, a security interest in a security is terminated by transfer to the debtor or a person designated by him pursuant to a provision of Section 8—313(1). If a security is thus transferred, the security interest, if not terminated, becomes unperfected unless the security is certificated and is delivered to the debtor for the purpose of ultimate sale or exchange or presentation, collection, renewal, or registration of transfer. In that case, the security interest becomes unperfected after 21 days unless, within that time, the security (or securities for which it has been exchanged) is transferred to the secured party or a person designated by him pursuant to a provision of Section 8—313(1).

Reasons for 1977 Change

This is an entirely new section and is intended to govern the creation, perfection and termination of security interests in all securities, certificated and uncertificated. It is one of three sections in this revision in which it is intended to extend to coverage of Article 8 as to certificated securities. Sections 8—313 and 8—317 are the others. Several sections of Article 9 are made subject to or are affected by this section.

Subsection (1) provides that an effective transfer under Section 8—313(1) is an essential element to the creation of an enforceable security interest. Under present Section 9—203 (1), an enforceable security interest can be created without possession if there is a written security agreement signed by the debtor. Under this revision, Section 9—203(1) is expressly made subject to this section.

Subsection (2) provides that when value has been given and the debtor has rights in the collateral, an appropriate transfer will result not only in an enforceable security interest but also in one that is perfected. Under this revision, an unperfected security interest in a security cannot be created. A security interest created by transfer under Section 8—313 (1)(i), however, may become unperfected if, within 21 days, the requirements of another method of effective transfer are not satisfied. This produces the same result as present Section 9—304(4). Securities are expressly excluded from the coverage of Section 9—304(4).

Subsection (3) expressly makes a security interest in securities subject to the provisions of Article 9 except those provisions dealing with the creation and perfection of security interests. Those matters are governed by this section. In addition, the provisions of Section 9—207, which govern the rights and duties of the pledgee of a certificated security, are extended, to the extent they are applicable, to all secured parties, whether or not the possession of a certificated security is involved. Thus, in the absence of agreement to the contrary, the secured party, who might be the registered owner of an uncertificated security, would have the duty to remit dividends he received to the debtor or to apply them in reduction of the obligation under Section 9—207(2)(c).

Subsection (4) provides that a security interest is terminated by re-transfer to the debtor unless the parties otherwise agree. Even when the parties agree that the security interest is to continue, it will become unperfected unless there is delivery of a certificated security for the limited purposes described in the second sentence. This provision is intended to produce the same result as present Section 9—304(5) from the coverage of which securities are expressly excluded. The final sentence limits the continued perfection to a 21 day period, as does Section 9—304(5), and requires re-transfer to the secured party, in a manner analogous to Section 9—304 (6), as a condition of continued or renewed perfection.

PART 4

REGISTRATION

§ 8—401. Duty of Issuer to Register Transfer, Pledge, or Release

(1) [Where] If a certificated security in registered form is presented to the issuer with a request to register transfer[,] or an instruction is presented to the issuer with a request to register transfer, pledge, or release, the issuer [is under a duty to] shall register the transfer, pledge, or release as requested if:

- (a) the security is indorsed or the instruction was originated by the appropriate person or persons (Section 8—308); [and]
- (b) reasonable assurance is given that those indorsements or instructions are genuine and effective (Section 8—402); [and]
- (c) the issuer has no duty [to inquire into] as to adverse claims or has discharged [any such] the duty (Section 8—403); [and]
- (d) any applicable law relating to the collection of taxes has been complied with; and
- (e) the transfer, pledge, or release is in fact rightful or is to a bona fide purchaser.

(2) [Where] If an issuer is under a duty to register a transfer, pledge, or release of a security, the issuer is also liable to the person presenting a certificated security or an instruction [it] for registration or his principal for loss resulting from any unreasonable delay in registration or from failure or refusal to register the transfer, pledge, or release.

Reasons for 1977 Change

Subsection (1) states the duty of the issuer to honor instructions to register the transfer, pledge or release of uncertificated securities in the same terms and with the same conditions that the present statute imposes with respect to the registration of transfer of certificated securities.

The issuer's liability under subsection (2) is extended to cover losses resulting from failure to take timely action with respect to instructions to transfer, pledge or release uncertificated securities.

§ 8—402. Assurance that Indorsements and Instructions Are Effective

(1) The issuer may require the following assurance that each necessary indorsement of a certificated security or each instruction (Section 8—308) is genuine and effective:

(a) in all cases, a guarantee of the signature ([subsection (1) of] Section 8—312(1) or (2)) of the person indorsing a certificated security or originating an instruction including, in the case of an instruction, a warranty of the taxpayer identification number or, in the absence thereof, other reasonable assurance of identity; [and]

(b) [where] if the indorsement is made or the instruction is originated by an agent, appropriate assurance of authority to sign;

(c) [where] if the indorsement is made or the instruction is originated by a fiduciary, appropriate evidence of appointment or incumbency;

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

(e) [where] if the indorsement is made or the instruction is originated by a person not covered by any of the foregoing, assurance appropriate to the case corresponding as nearly as may be to the foregoing.

(2) A "guarantee of the signature" in subsection (1) means a guarantee signed by or on behalf of a person reasonably believed by the issuer to be responsible. The issuer may adopt standards with respect to responsibility [provided such standards] if they are not manifestly unreasonable.

(3) "Appropriate evidence of appointment or incumbency" in subsection (1) means:

(a) in the case of a fiduciary appointed or qualified by a court, a certificate issued by or under the direction or supervision of that court or an officer thereof and dated within [sixty] 60 days before the date of presentation for transfer, pledge, or release; or

(b) in any other case, a copy of a document showing the appointment or a certificate issued by or on behalf of a person reasonably believed by the issuer to be responsible or, in the absence of [such a] that document or certificate, other evidence reasonably deemed by the

issuer to be appropriate. The issuer may adopt standards with respect to [such] the evidence [provided such standards] if they are not manifestly unreasonable. The issuer is not charged with notice of the contents of any document obtained pursuant to this paragraph (b) except to the extent that the contents relate directly to the appointment or incumbency.

(4) The issuer may elect to require reasonable assurance beyond that specified in this section, but if it does so and, for a purpose other than that specified in subsection (3)(b), both requires and obtains a copy of a will, trust, indenture, articles of co-partnership, by-laws, or other controlling instrument, it is charged with notice of all matters contained therein affecting the transfer, pledge, or release.

Reasons for 1977 Change

This section has been modified so as to permit the issuer to require, as a condition of honoring an instruction, precisely the same assurances and supplementary documentation as the present section permits the issuer to require as a condition of registering the transfer of a certificated security. In addition, under the last phrase of subparagraph (1)(a) the issuer may require either a warranty of the taxpayer identification number on an instruction as provided in Section 8—312(2)(d) or other evidence of identity.

§ 8—403. [Limited Duty of Inquiry] Issuer's Duty as to Adverse Claims

(1) An issuer to whom a certificated security is presented for registration [is under a duty to] shall inquire into adverse claims if:

(a) a written notification of an adverse claim is received at a time and in a manner [which affords] affording the issuer a reasonable opportunity to act on it prior to the issuance of a new, reissued, or re-registered certificated security, and the notification identifies the claimant, the registered owner, and the issue of which the security is a part, and provides an address for communications directed to the claimant; or

(b) the issuer is charged with notice of an adverse claim from a controlling instrument [which] it has elected to require under [subsection (4) of] Section 8—402(4).

(2) The issuer may discharge any duty of inquiry by any reasonable means, including notifying an adverse claimant by registered or certified mail at the address furnished by him or, if there be no such address, at his residence or regular place of business that the certificated security has been presented for registration of transfer by a named person, and that the transfer will be registered unless within [thirty] 30 days from the date of mailing the notification, either:

(a) an appropriate restraining order, injunction, or other process issues from a court of competent jurisdiction; or

(b) there is filed with the issuer an indemnity bond, sufficient in the issuer's judgment to protect the issuer and any transfer agent, registrar, or other agent of the issuer involved[,] from any loss [which] it or they may suffer by complying with the adverse claim [is filed with the issuer].

(3) Unless an issuer is charged with notice of an adverse claim from a controlling instrument which it has elected to require under [subsection (4) of] Section 8—402(4) or receives notification of an adverse claim under subsection (1) [of this section, where], if a certificated security presented for registration is indorsed by the appropriate person or persons the issuer is under no duty to inquire into adverse claims. In particular:

(a) an issuer registering a certificated security in the name of a person who is a fiduciary or who is described as a fiduciary is not bound to inquire into the existence, extent, or correct description of the fiduciary relationship; and thereafter the issuer may assume without inquiry that the newly registered owner continues to be the fiduciary until the issuer receives written notice that the fiduciary is no longer acting as such with respect to the particular security;

(b) an issuer registering transfer on an indorsement by a fiduciary is not bound to inquire whether the transfer is made in compliance with a controlling instrument or with the law of the state having jurisdiction of the fiduciary relationship, including any law requiring the fiduciary to obtain court approval of the transfer; and

(c) the issuer is not charged with notice of the contents of any court record or file or other recorded or unrecorded document even though the document is in its

possession and even though the transfer is made on the indorsement of a fiduciary to the fiduciary himself or to his nominee.

(4) An issuer is under no duty as to adverse claims with respect to an uncertificated security except:

(a) claims embodied in a restraining order, injunction, or other legal process served upon the issuer if the process was served at a time and in a manner affording the issuer a reasonable opportunity to act on it in accordance with the requirements of subsection (5);

(b) claims of which the issuer has received a written notification from the registered owner or the registered pledgee if the notification was received at a time and in a manner affording the issuer a reasonable opportunity to act on it in accordance with the requirements of subsection (5);

(c) claims (including restrictions on transfer not imposed by the issuer) to which the registration of transfer to the present registered owner was subject and were so noted in the initial transaction statement sent to him; and

(d) claims as to which an issuer is charged with notice from a controlling instrument it has elected to require under Section 8—402(4).

(5) If the issuer of an uncertificated security is under a duty as to an adverse claim, he discharges that duty by:

(a) including a notation of the claim in any statements sent with respect to the security under Sections 8—408(3), (6), and (7); and

(b) refusing to register the transfer or pledge of the security unless the nature of the claim does not preclude transfer or pledge subject thereto.

(6) If the transfer or pledge of the security is registered subject to an adverse claim, a notation of the claim must be included in the initial transaction statement and all subsequent statements sent to the transferee and pledgee under Section 8—408.

(7) Notwithstanding subsections (4) and (5), if an uncertificated security was subject to a registered pledge at the time the issuer first came under a duty as to a particular adverse claim, the issuer has no duty as to that claim if transfer of the

<u>security is requested by the registered pledgee or an appropriate person acting for the registered pledgee unless:</u>

<u>(a) the claim was embodied in legal process which expressly provides otherwise;</u>

<u>(b) the claim was asserted in a written notification from the registered pledgee;</u>

<u>(c) the claim was one as to which the issuer was charged with notice from a controlling instrument it required under Section 8—402(4) in connection with the pledgee's request for transfer; or</u>

<u>(d) the transfer requested is to the registered owner.</u>

Reasons for 1977 Change

The present law permits an adverse claimant to delay the registration of transfer of a certificated security by thirty days merely by sending a timely written notification to the issuer identifying the claimant, registered owner and issue and giving an address for communications. This rather loose procedure has not constituted a serious problem for two reasons. First, the transfer of a certificated security is effected by delivery and the rights of the parties are established before the security is presented to the issuer for registration. More significantly, the bona fide purchaser of a security takes free of adverse claims and claims known to the issuer need not be known to him.

The present system enables the claimant to assert his rights in court before the issuer lets a new certificated security loose which might find its way into the hands of a bona fide purchaser. He can effectively do so, of course, only when the rights of a bona fide purchaser have not already intervened, but, in that minority of instances, he does receive protection. Conversely, the ease with which a claimant can register his claim with the issuer is not a great burden on the owner since the clean certificate in his hands gives him the power to transfer to a bona fide purchaser free of the adverse claim. Thus, the present statute requires no notice to the owner when a claim is filed with the issuer and the claim has no effect on transactions until the certificate is presented for registration of transfer. By then, the effect is usually limited to mere delay.

With uncertificated securities, however, transfer does not take place until registration so that any mandated delay seriously impairs an owner's ability to sell or pledge his security. Since a prudent purchaser may not pay until he re-

ceives a clean initial transaction statement, the effect of a mere letter notifying the issuer of an adverse claim, however frivolous, would be disastrous. Because of this important difference, the rules of the present section, in subsections (1), (2) and (3) have been restated, unchanged, but limited to situations involving only certificated securities. New rules, applying only to uncertificated securities, are set forth in subsections (4), (5) and (6) and are intended to accommodate the interests of owners, purchasers, issuers and adverse claimants.

Subsection (4) states that an issuer has no duty as to adverse claims except in four described situations. Mere written notifications result in a duty only when they come from existing owners and pledgees and are analogous to stop payment orders on checks. There is a duty as to claims to which the security was subject when it was purchased by the present owner, a situation with which the owner is already familiar. There is a duty as to claims arising from the issuer's request for documentation under Section 8—402.

The significant difference is that claims asserted by third parties, in order to impose a duty on the issuer, must be supported by legal process. This will constitute assurance that the claim is not merely frivolous and that its assertion is more than harassment. In most cases the owner will have been notified and have had the opportunity to be heard. While claims thus asserted may ultimately be adjudged invalid, the owner will not be tied up by a bare written communication from the claimant. On the other hand, while a more substantial burden is imposed on the claimant, there is a channel through which he can assert his claim before the rights of a bona fide purchaser intervene.

Once it is established that the claim imposes a duty on the issuer, notations of the claim must be contained in all statements sent with respect to the security and registration of transfer or pledge must be refused unless the nature of the claim is consistent with transfer or pledge subject to the claim. When transfer or pledge is registered subject to the claim, the final sentence of subsection (5) requires that the claim be noted in all statements sent to the transferee or pledgee.

Subsection (7) deals with the situation where an uncertificated security is already subject to a registered pledge when the issuer first learns of an adverse claim as to which he has a duty. **In that event, the registered pledgee who became such without notice of the claim may be a bona fide purchaser with the right to transfer the security free of the claim. That right cannot be curtailed by the claim of a third party (in-**

cluding the registered owner) unless legal process embodying the claim expressly deals with the pledgee's interest. There is obviously no curtailment of the pledgee's right when the claim is asserted by the pledgee himself. It should be curtailed if the pledgee's right to obtain registration of transfer is called into question by a controlling instrument which the issuer elects to require before acting on the pledgee's request. Since the transfer to the registered owner is the equivalent of a release of the pledge, such a transfer should not terminate the issuer's duty as to the claim.

§ 8—404. Liability and Non-Liability for Registration

(1) Except as [otherwise] provided in any law relating to the collection of taxes, the issuer is not liable to the owner, pledgee, or any other person suffering loss as a result of the registration of a transfer, pledge, or release of a security if:

- (a) there were on or with [the] a certificated security the necessary indorsements or the issuer had received an instruction originated by an appropriate person (Section 8—308); and
- (b) the issuer had no duty [to inquire into] as to adverse claims or has discharged [any such] the duty (Section 8—403).

(2) [Where] If an issuer has registered a transfer of a certificated security to a person not entitled to it, the issuer on demand [must] shall deliver a like security to the true owner unless:

- (a) the registration was pursuant to subsection (1); [or]
- (b) the owner is precluded from asserting any claim for registering the transfer under [subsection (1) of the following section] Section 8—405(1); or
- (c) [such] the delivery would result in overissue, in which case the issuer's liability is governed by Section 8—104.

(3) If an issuer has improperly registered a transfer, pledge, or release of an uncertificated security, the issuer on demand from the injured party shall restore the records as to the injured party to the condition that would have obtained if the improper registration had not been made unless:

- (a) the registration was pursuant to subsection (1); or
- (b) the registration would result in overissue, in which case the issuer's liability is governed by Section 8—104.

Reasons for 1977 Change

Subsection (1) exonerates the issuer from liability to any person arising from registration of transfer, pledge or re-

lease of an uncertificated security under the same conditions that the present statute provides with respect to the registration of transfer of a certificated security.

The remedy for improper registration under subsection (2), i. e., the delivery of a like security to the true owner, is inapplicable to uncertificated securities. Thus, subsection (3) provides an analogous remedy for uncertificated securities, the restoration of the records to their proper condition. The same exception is made in the event of overissue. The exception of paragraph (2)(b) is inapplicable to uncertificated securities which, by definition, cannot be lost, destroyed or stolen, and is omitted from subsection (3).

§ 8—405. Lost, Destroyed, and Stolen Certificated Securities

(1) [Where] If a certificated security has been lost, apparently destroyed, or wrongfully taken, and the owner fails to notify the issuer of that fact within a reasonable time after he has notice of it and the issuer registers a transfer of the security before receiving [such a] notification, the owner is precluded from asserting against the issuer any claim for registering the transfer under [the preceding section] Section 8—404 or any claim to a new security under this section.

(2) [Where] If the owner of [the] a certificated security claims that the security has been lost, destroyed, or wrongfully taken, the issuer [must] shall issue a new certificated security or, at the option of the issuer, an equivalent uncertificated security in place of the original security if the owner:

- (a) so requests before the issuer has notice that the security has been acquired by a bona fide purchaser; [and]
- (b) files with the issuer a sufficient indemnity bond; and
- (c) satisfies any other reasonable requirements imposed by the issuer.

(3) If, after the issue of [the] a new certificated or uncertificated security, a bona fide purchaser of the original certificated security presents it for registration of transfer, the issuer [must] shall register the transfer unless registration would result in overissue, in which event the issuer's liability is governed by Section 8—104. In addition to any rights on the indemnity bond, the issuer may recover the new certificated security from the person to whom it was issued or any person taking under him

except a bona fide purchaser or may cancel the uncertificated security unless a bona fide purchaser or any person taking under a bona fide purchaser is then the registered owner or registered pledgee thereof.

Reasons for 1977 Change

Subsection (1) is applicable only to certificated securities, since only they can be lost, destroyed or stolen.

Subsection (2) permits the issuer to satisfy his obligation to replace a lost, destroyed or stolen certificated security by issuing a replacement in either certificated or uncertificated form. Such alternatives exist only when the particular issue is partly certificated and partly uncertificated. In that event, the owner may have the privilege of exchanging one for the other under Section 8—407, thus placing the ultimate option with him. Compare explanation of changes under Section 8—104.

§ 8—406. Duty of Authenticating Trustee, Transfer Agent, or Registrar

(1) [Where] If a person acts as authenticating trustee, transfer agent, registrar, or other agent for an issuer in the registration of transfers of its certificated securities or in the registration of transfers, pledges, and releases of its uncertificated securities, [or] in the issue of new securities, or in the cancellation of surrendered securities:

(a) he is under a duty to the issuer to exercise good faith and due diligence in performing his functions; and

(b) [he has] with regard to the particular functions he performs, he has the same obligation to the holder or owner of [the] a certificated security or to the owner or pledgee of an uncertificated security and has the same rights and privileges as the issuer has in regard to those functions.

(2) Notice to an authenticating trustee, transfer agent, registrar or other [such] agent is notice to the issuer with respect to the functions performed by the agent.

Reasons for 1977 Change

The coverage of this section is broadened to include the agents of the issuers of both certificated and uncertificated securities.

§ 8—407. Exchangeability of Securities

(1) No issuer is subject to the requirements of this section unless it regularly maintains a system for issuing the class of securities involved under which both certificated and uncertificated securities are regularly issued to the category of owners, which includes the person in whose name the new security is to be registered.

(2) Upon surrender of a certificated security with all necessary indorsements and presentation of a written request by the person surrendering the security, the issuer, if he has no duty as to adverse claims or has discharged the duty (Section 8—403), shall issue to the person or a person designated by him an equivalent uncertificated security subject to all liens, restrictions, and claims that were noted on the certificated security.

(3) Upon receipt of a transfer instruction originated by an appropriate person who so requests, the issuer of an uncertificated security shall cancel the uncertificated security and issue an equivalent certificated security on which must be noted conspicuously any liens and restrictions of the issuer and any adverse claims (as to which the issuer has a duty under Section 8—403(4)) to which the uncertificated security was subject. **The certificated security shall be registered in the name of and delivered to:**

(a) the registered owner, if the uncertificated security was not subject to a registered pledge; or

(b) the registered pledgee, if the uncertificated security was subject to a registered pledge.

Reasons for 1977 Change

This is an entirely new section which deals with the right of the holder of a certificated security to exchange it for an equivalent uncertificated security and the right of the registered owner or registered pledgee of an uncertificated security to obtain a certificated security in exchange for it. This section is applicable only in those situations where both certificated and uncertificated securities exist within the same issue and either form is available to the particular owner. Subsection (1) so limits its applicability.

Neither this nor any other section of this Article is intended to mandate the establishment or continuance of a dual system of registration. It is contemplated that some issuers may provide for both forms of securities on a more or less indefinite basis. Issuers of existing issues which are necessarily wholly certificated may make uncertificated securities available with the intention to phase out the certificated securities over a period of time. Some issuers, if permitted by relevant law, may restrict the availability of uncertificated securities to particular categories of owners, e. g., brokers, banks and institutions.

Subsections (2) and (3) establish the mechanism for exchange. When a certificated security is surrendered for exchange and the issuer has a duty as to adverse claims, that duty must be discharged before an equivalent uncertificated security can be issued. When an instruction requests the issuance of a certificated security in exchange for an uncertificated security, adverse claims as to which the issuer has a duty are to be noted conspicuously thereon. In either case, the existence of the issuer's duty is determined by the provisions of Section 8—403.

§ 8—408. Statements of Uncertificated Securities

(1) Within 2 business days after the transfer of an uncertificated security has been registered, the issuer shall send to the new registered owner and, if the security has been transferred subject to a registered pledge, to the registered pledgee a written statement containing:

(a) a description of the issue of which the uncertificated security is a part;

(b) the number of shares or units transferred;

(c) the name and address and any taxpayer identification number of the new registered owner and, if the security has been transferred subject to a registered pledge, the name and address and any taxpayer identification number of the registered pledgee;

(d) a notation of any liens and restrictions of the issuer and any adverse claims (as to which the issuer has a duty under Section 8—403(4)) to which the uncertificated security is or may be subject at the time of registration or a statement that there are none of those liens, restrictions, or adverse claims; and

(e) the date the transfer was registered.

(2) Within 2 business days after the pledge of an uncertificated security has been registered, the issuer shall send to the

registered owner and the registered pledgee a written statement containing:

(a) a description of the issue of which the uncertificated security is a part;

(b) the number of shares or units pledged;

(c) the name and address and any taxpayer identification number of the registered owner and the registered pledgee;

(d) a notation of any liens and restrictions of the issuer and any adverse claims (as to which the issuer has a duty under Section 8—103(4)) to which the uncertificated security is or may be subject at the time of registration or a statement that there are none of those liens, restrictions, or adverse claims; and

(e) the date the pledge was registered.

(3) Within 2 business days after the release from pledge of an uncertificated security has been registered, the issuer shall send to the registered owner and the pledgee whose interest was released a written statement containing:

(a) a description of the issue of which the uncertificated security is a part;

(b) the number of shares or units released from pledge;

(c) the name and address and any taxpayer identification number of the registered owner and the pledgee whose interest was released;

(d) a notation of any liens and restrictions of the issuer and any adverse claims (as to which the issuer has a duty under Section 8—403(4)) to which the uncertificated security is or may be subject at the time of registration or a statement that there are none of those liens, restrictions or adverse claims; and

(e) the date the release was registered.

(4) An "initial transaction statement" is the statement sent to:

(a) the new registered owner and, if applicable, to the registered pledgee pursuant to subsection (1);

(b) the registered pledgee pursuant to subsection (2); or

(c) the registered owner pursuant to subsection (3).

Each initial transaction statement shall be signed by or on behalf of the issuer and must be identified as "Initial Transaction Statement".

(5) Within 2 business days after the transfer of an uncertificated security has been registered, the issuer shall send to the former registered owner and the former registered pledgee, if any, a written statement containing:

(a) a description of the issue of which the uncertificated security is a part;

(b) the number of shares or units transferred;

(c) the name and address and any taxpayer identification number of the former registered owner and of any former registered pledgee; and

(d) the date the transfer was registered.

(6) At periodic intervals no less frequent than annually and at any time upon the reasonable written request of the registered owner, the issuer shall send to the registered owner of each uncertificated security a dated written statement containing:

(a) a description of the issue of which the uncertificated security is a part;

(b) the name and address and any taxpayer identification number of the registered owner;

(c) the number of shares or units of the uncertificated security registered in the name of the registered owner on the date of the statement;

(d) the name and address and any taxpayer identification number of any registered pledgee and the number of shares or units subject to the pledge; and

(e) a notation of any liens and restrictions of the issuer and any adverse claims (as to which the issuer has a duty under Section 8—403(4)) to which the uncertificated security is or may be subject or a statement that there are none of those liens, restrictions, or adverse claims.

(7) At periodic intervals no less frequent than annually and at any time upon the reasonable written request of the registered pledgee, the issuer shall send to the registered pledgee of each uncertificated security a dated written statement containing:

(a) a description of the issue of which the uncertificated security is a part;

(b) the name and address and any taxpayer identification number of the registered owner;

(c) the name and address and any taxpayer identification number of the registered pledgee;

(d) the number of shares or units subject to the pledge; and

(e) a notation of any liens and restrictions of the issuer and any adverse claims (as to which the issuer has a duty under Section 8—403(4)) to which the uncertificated security is or may be subject or a statement that there are none of those liens, restrictions, or adverse claims.

(8) If the issuer sends the statements described in subsections (6) and (7) at periodic intervals no less frequent than quarterly, the issuer is not obliged to send additional statements upon request unless the owner or pledgee requesting them pays to the issuer the reasonable cost of furnishing them.

(9) Each statement sent pursuant to this section must bear a conspicuous legend reading substantially as follows: "This statement is merely a record of the rights of the addressee as of the time of its issuance. Delivery of this statement, of itself, confers no rights on the recipient. This statement is neither a negotiable instrument nor a security."

Reasons for 1977 Change

This is an entirely new section which obliges the issuer of uncertificated securities to send certain statements. The required statements are of two types. Transaction statements, required by subsections (1), (2), (3) and (5), are analogous to debit and credit advices and the periodic statements can be reconciled from them. Periodic statements, required by subsections (6) and (7) are analogous to bank statements and will advise owners and pledgees of their positions at given points in time.

The transaction statements, which are mandated upon the registration of transfer, pledge or release, must be sent within two days after the relevant registration, but it is contemplated that such statements will be prepared virtually simultaneously with the actual registration and sent immediately thereafter.

The transaction statements are intended to serve two functions. They are notice to the transferor (the owner in the case of a transfer or pledge or the pledgee in the case of a release or the transfer of a security subject to a pledge) that his interest has been reduced. In the event of fraudulent, unauthorized or otherwise improper registration, the transaction statement will serve as notice that timely action should be taken.

More importantly, these statements are notice to the transferee (new owner in the case of a transfer, pledgee in the case of a pledge, present owner in the case of a release) that the increase of his interest has, in fact, been registered. Furthermore, since all statements except those required by subsection (5) must include a notation of defects or an express statement that there are none, these statements will give the transferee the assurance equivalent to that afforded by a "clean" certificated security and create an estoppel against the issuer.

It is contemplated that transferees will and should be able to rely on these statements and, in many cases, will not part with their consideration until they receive them. In order that they will have the desired effect of establishing rights for the transferee against the issuer, subsection (4) requires that the copy of each transaction statement sent to the transferee, called an "initial transaction statement," be signed. Note that Section 1—201(39) does not require a manual signature for compliance with this requirement. Compare also Sections 8—103(b), 8—105(3)(d), 8—202, 8—204(b), 8—205, 8—206, 8—208, 8—304 and 8—313(3) for the effects of initial transaction statements.

The frequency of one year, with which periodic statements must be sent to owners and pledgees, is intended to be a minimum requirement for all issuers, including closely held corporations. Owners and pledgees are entitled to request additional statements of position at any time. It is contemplated, however, that publicly held issuers will adopt the practice of sending quarterly statements conforming to the common practice of sending quarterly reports and dividend checks. For those that do, subsection (8) eliminates the obligation to furnish additional statements of position on request unless the issuer is reimbursed for the additional cost.

Subsection (9) requires a conspicuous legend to be borne by each statement as a protection against unjustified reliance on statements of uncertificated securities by persons who might deal with them. Other than the aforesaid legend, the form of the statements required by this section is not prescribed. Perhaps the forms now used by the transfer agents of mutual funds to confirm acquisitions, dispositions, reinvestment of dividends, periodic liquidations and statements of position might serve as a model.

ARTICLE 9

SECURED TRANSACTIONS; SALES OF ACCOUNTS[, CONTRACT RIGHTS] AND CHATTEL PAPER

PART 1

SHORT TITLE, APPLICABILITY AND DEFINITIONS

§ 9—102. Policy and [Scope] Subject Matter of Article

(1) Except as otherwise provided [in Section 9—103 on multiple state transactions and] in Section 9—104 on excluded transactions, this Article applies [so far as concerns any personal property and fixtures within the jurisdiction of this state]

(a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts [or contract rights]; and also

(b) to any sale of accounts [contract rights] or chattel paper.

(2) This Article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This Article does not apply to statutory liens except as provided in Section 9—310.

(3) The application of this Article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this Article does not apply.

Reasons for 1972 Change

The omissions in the first paragraph of subsection (1) make applicable the general choice of law principles of Section 1—105 (except for special rules stated in Section 9—103), instead of an incomplete statement in this section.

The omission is clause (1) (b) conforms to the elimination of the term "contract rights" from the Article. See Reasons for Change under Section 9—106.

[§ 9—103. Accounts, Contract Rights, General Intangibles and Equipment Relating to Another Jurisdiction; and Incoming Goods Already Subject to a Security Interest]

[(1) If the office where the assignor of accounts or contract rights keeps his record concerning them is in this state, the validity and perfection of a security interest therein and the possibility and effect of proper filing is governed by this Article; otherwise by the law (including the conflict of laws rules) of the jurisdiction where such office is located.]

[(2) If the chief place of business of a debtor is in this state, this Article governs the validity and perfection of a security interest and the possibility and effect of proper filing with regard to general intangibles or with regard to goods of a type which are normally used in more than one jurisdiction (such as automotive equipment, rolling stock, airplanes, road building equipment, commercial harvesting equipment, construction machinery and the like) **if such goods are classified as equipment or classified as inventory by reason of their being leased by the debtor to others. Otherwise, the law (including the conflict of laws rules)** of the jurisdiction where such chief place of business is located shall govern. If the chief place of business is located in a jurisdiction which does not provide for perfection of the security interest by filing or recording in that jurisdiction, then the security interest may be perfected by filing in this state. [For the purpose of determining the validity and perfection of a security interest in an airplane, the chief place of business of a debtor who is a foreign air carrier under the Federal Aviation Act of 1958, as amended, is the designated office of the agent upon whom service of process may be made on behalf of the debtor.]]

[(3) If personal property other than that governed by subsections (1) and (2) is already subject to a security interest when it is brought into this state, the validity of the security interest in this state is to be determined by the law (including the conflict of laws rules) of the jurisdiction where the property was when the security interest attached. However, if the parties to the transaction understood at the time that the security interest attached that the property would be kept in this state and it was brought into this state within 30 days after the security interest attached for purposes other than transportation through this state, then the validity of the security interest in this state is to be determined by the law of this state. If the security interest was already perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this state, the security interest continues perfected in this state for four months and also thereafter if within the four month period it is perfected in this state. The security interest may also be perfected in this state after the expiration of the four month period; in such case perfection dates from the time of perfection in this state. If the security interest was not perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this state, it may be perfected in this state; in such case perfection dates from the time of perfection in this state.]

[(4) Notwithstanding subsections (2) and (3), if personal property is covered by a certificate of title issued under a statute of this state or any other jurisdiction which requires indication on a certificate of title of any security interest in the property as a condition of perfection, then the perfection is governed by the law of the jurisdiction which issued the certificate.]

[[(5) Notwithstanding subsection (1) and Section 9—302, if the office where the assignor of accounts or contract rights keeps his records concerning them is not located in a jurisdiction which is a part of the United States, its territories or possessions, and

the accounts or contract rights are within the jurisdiction of this state or the transaction which creates the security interest otherwise bears an appropriate relation to this state, this Article governs the validity and perfection of the security interest and the security interest may only be perfected by notification to the account debtor.]]

§ 9—103. Perfection of Security Interests in Multiple State Transactions

(1) Documents, instruments and ordinary goods.

(a) This subsection applies to documents and instruments and to goods other than those covered by a certificate of title described in subsection (2), mobile goods described in subsection (3), and minerals described in subsection (5).

(b) Except as otherwise provided in this subsection, perfection and the effect of perfection or non-perfection of a security interest in collateral are governed by the law of the jurisdiction where the collateral is when the last event occurs on which is based the assertion that the security interest is perfected or unperfected.

(c) If the parties to a transaction creating a purchase money security interest in goods in one jurisdiction understand at the time that the security interest attaches that the goods will be kept in another jurisdiction, then the law of the other jurisdiction governs the perfection and the effect of perfection or non-perfection of the security interest from the time it attaches until thirty days after the debtor receives possession of the goods and thereafter if the goods are taken to the other jurisdiction before the end of the thirty-day period.

(d) When collateral is brought into and kept in this state while subject to a security interest perfected under the law of the jurisdiction from which the collateral was removed, the security interest remains perfected, but if action is required by Part 3 of this Article to perfect the security interest,

(i) if the action is not taken before the expiration of the period of perfection in the other jurisdiction or the end of four months after the collateral is brought into this state, whichever period first expires, the security interest becomes unperfected at the end of that period

and is thereafter deemed to have been unperfected as against a person who became a purchaser after removal;

(ii) if the action is taken before the expiration of the period specified in subparagraph (i), the security interest continues perfected thereafter;

(iii) for the purpose of priority over a buyer of consumer goods (subsection (2) of Section 9—307), the period of the effectiveness of a filing in the jurisdiction from which the collateral is removed is governed by the rules with respect to perfection in subparagraphs (i) and (ii).

(2) Certificate of title.

(a) This subsection applies to goods covered by a certificate of title issued under a statute of this state or of another jurisdiction under the law of which indication of a security interest on the certificate is required as a condition of perfection.

(b) Except as otherwise provided in this subsection, perfection and the effect of perfection or non-perfection of the security interest are governed by the law (including the conflict of laws rules) of the jurisdiction issuing the certificate until four months after the goods are removed from that jurisdiction and thereafter until the goods are registered in another jurisdiction, but in any event not beyond surrender of the certificate. After the expiration of that period, the goods are not covered by the certificate of title within the meaning of this section.

(c) Except with respect to the rights of a buyer described in the next paragraph, a security interest, perfected in another jurisdiction otherwise than by notation on a certificate of title, in goods brought into this state and thereafter covered by a certificate of title issued by this state is subject to the rules stated in paragraph (d) of subsection (1).

(d) If goods are brought into this state while a security interest therein is perfected in any manner under the law of the jurisdiction from which the goods are removed and a certificate of title is issued by this state and the certificate does not show that the goods are subject to the security interest or that they may be subject to security interests not shown on the certificate, the security interest is subordinate to the rights of a buyer of the goods who is not in the business of selling goods of that kind to the extent that he gives value and receives delivery of the goods after issuance of the certificate and without knowledge of the security interest.

(3) Accounts, general intangibles and mobile goods.

(a) This subsection applies to accounts (other than an account described in subsection (5) on minerals) and general intangibles (other than uncertificated securities) and to goods which are mobile and which are of a type normally used in more than one jurisdiction, such as motor vehicles, trailers, rolling stock, airplanes, shipping containers, road building and construction machinery and commercial harvesting machinery and the like, if the goods are equipment or are inventory leased or held for lease by the debtor to others, and are not covered by a certificate of title described in subsection (2).

(b) The law (including the conflict of laws rules) of the jurisdiction in which the debtor is located governs the perfection and the effect of perfection or non-perfection of the security interest.

(c) If, however, the debtor is located in a jurisdiction which is not a part of the United States, and which does not provide for perfection of the security interest by filing or recording in that jurisdiction, the law of the jurisdiction in the United States in which the debtor has its major executive office in the United States governs the perfection and the effect of perfection or non-perfection of the security interest through filing. In the alternative, if the debtor is located in a jurisdiction which is not a part of the United States or Canada and the collateral is accounts or general intangibles for money due or to become due, the security interest may be perfected by notification to the account debtor. As used in this paragraph, "United States" includes its territories and possessions and the Commonwealth of Puerto Rico.

(d) A debtor shall be deemed located at his place of business if he has one, at his chief executive office if he has more than one place of business, otherwise at his residence. If, however, the debtor is a foreign air carrier under the Federal Aviation Act of 1958, as amended, it shall be deemed located at the designated office of the agent upon whom service of process may be made on behalf of the foreign air carrier.

(e) A security interest perfected under the law of the jurisdiction of the location of the debtor is perfected until the expiration of four months after a change of the debtor's location to another jurisdiction, or until perfection would have ceased by the law of the first jurisdiction, whichever period first expires. Unless perfected in the new jurisdiction before the end of that period, it becomes unperfected thereafter and is deemed to have been unperfected as against [illegible]

(4) Chattel paper.

The rules stated for goods in subsection (1) apply to a possessory security interest in chattel paper. The rules stated for accounts in subsection (3) apply to a non-possessory security interest in chattel paper, but the security interest may not be perfected by notification to the account debtor.

(5) Minerals.

Perfection and the effect of perfection or non-perfection of a security interest which is created by a debtor who has an interest in minerals or the like (including oil and gas) before extraction and which attaches thereto as extracted, or which attaches to an account resulting from the sale thereof at the wellhead or minehead are governed by the law (including the conflict of laws rules) of the jurisdiction wherein the wellhead or minehead is located.

(6) Uncertificated securities.

The law (including the conflict of laws rules) of the jurisdiction of organization of the issuer governs the perfection and the effect of perfection or non-perfection of a security interest in uncertificated securities.

Reasons for 1977 Change

Uncertificated securities are included in the definition of "General intangibles" under Section 9—106. Since the perfection of a security interest in an uncertificated security is normally accomplished by registration of pledge or transfer under Article 8, uncertificated securities are excluded from the coverage of subsection (3) under which the location of the debtor would govern. New subsection (6) prescribes the law of the issuer's jurisdiction of organization as the governing law, consistent with Section 8—106.

Reasons for 1972 Change

The section has been completely rewritten to clarify the relationship of its several provisions to each other and to other sections defining the applicable law. Now that the Code has been adopted in all states but Louisiana and also adopted in the District of Columbia and the Virgin Islands, the emphasis in the revision has been to make clear where perfection of a security interest must take place, rather than on problems of actual conflicts of rules of law.

1. The section now concerns itself exclusively with perfection of security interests and the effect of perfection or non-perfection thereof. The 1962 Code has several references to the "validity" of a security agreement, and these have been deleted. Likewise, a deletion has been made from Section 9—102 of the language which went beyond that section's basic function of defining the scope of Article 9 and purported to state a choice of law rule. These two changes make it clear that Article 9 does not govern problems of

choice of law between the original parties, and that this question is governed by the general choice of law provision in Section 1—105.

2. While most of the substantive materials of the section are in the 1962 Text, the statement thereof and their relationship to each other were not clear. In the revision they are clarified according to the following structure:

The basic rule of this section is that the controlling law, as to perfection of the security interests and the effect of perfection or non-perfection, is the law of the jurisdiction where the collateral is when the last event occurs on which is based the assertion that the security interest is perfected or unperfected (paragraph (1) (b)). There are certain exceptions: (i) In the case of a purchase money security interest in goods, where the parties intended to remove the collateral to another jurisdiction within 30 days after the debtor received possession of the goods, the law of the latter jurisdiction will govern the initial perfection until the expiration of the 30-day period, and thereafter if the goods are removed to the other jurisdiction before the end of the period (paragraph (1) (c)). (ii) Where the collateral is covered by a certificate of title, perfection will be governed by the law of the issuing jurisdiction (subsection (2)). (iii) If the collateral is certain mobile goods or certain intangibles, perfection will be governed by the law of the jurisdiction wherein is located the debtor (subsection (3)).

Where the collateral has been removed from the jurisdiction whose law first governed, the jurisdiction into which it is removed (i. e., "this state") adds a local requirement of re-perfection to the requirements of the state from which the collateral was removed—i. e., refiling is required within 4 months after removal, or within any lesser period during which perfection would have continued in the other jurisdiction (paragraphs (1) (d) and (2) (c)).

3. The two former rules for determining place of perfection as to intangibles (namely, for accounts, the office where the records were kept concerning the accounts; and for general intangibles, the chief place of business of the debtor) have been consolidated into the rule that the filing is at the debtor's location. That location will ordinarily be the office designated in the 1962 Text as "chief place of business," now redesignated as "chief executive office." A new provision (paragraph (3) (e)) has been added to cover the case where that office moves from one jurisdiction to another.

A principal objection to the original rule that the place for filing as to accounts was the place where the debtor kept his records with respect to them was that persons seeking to search records might not know where this place might be, in the case of a far-flung debtor or of multicorporate enterprises with central accounting. Where the debtor assigned his accounts without recourse, as in factoring, he might keep few records with respect to them. Moreover, it was thought undesirable to have one rule for accounts and another rule for general intangibles, because in many financing situations both types of receivables may be involved. See discussion in Reasons for Change to Section 9—106. Therefore, it was decided to adopt for both types of intangibles the rule heretofore applicable to general intangibles.

§ 9—104. Transactions Excluded From Article

This Article does not apply

(a) to a security interest subject to any statute of the United States [such as the Ship Mortgage Act, 1920,] to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property; or

(b) to a landlord's lien; or

(c) to a lien given by statute or other rule of law for services or materials except as provided in Section 9—310 on priority of such liens; or

(d) to a transfer of a claim for wages, salary or other compensation of an employee; or

[(e) to an equipment trust covering railway rolling stock; or]

<u>(e) to a transfer by a government or governmental subdivision or agency; or</u>

(f) to a sale of accounts[, contract rights] or chattel paper as part of a sale of the business out of which they arose, or an assignment of accounts [, contract rights] or chattel paper which is for the purpose of collection only, or a transfer of a [contract] right <u>to payment under a contract</u> to an assignee who is also to do the performance under the contract <u>or a transfer of a single account to an assignee in whole or partial satisfaction of a preexisting indebtedness;</u> or

(g) to a transfer of an interest in or claim in or under any policy of insurance, <u>except as provided with respect to proceeds (Section 9—306) and priorities in proceeds (Section 9—312); or</u>

(h) to a right represented by a judgment (other than a judgment taken on a right to payment which was collateral); or

(i) to any right of set-off; or

(j) except to the extent that provision is made for fixtures in Section 9—313, to the creation or transfer of an interest in or lien on real estate, including a lease or rents thereunder; or

(k) to a transfer in whole or in part of [any of the following:] any claim arising out of tort; [any deposit, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization.]; or

(*l*) to a transfer of an interest in any deposit account (subsection (1) of Section 9—105), except as provided with respect to proceeds (Section 9—306) and priorities in proceeds (Section 9—312).

Reasons for 1972 Change

Former paragraph (e), excluding railway equipment trusts from the coverage of Article 9, has been deleted. The whole thrust of Article 9 is to eliminate differences based on the form of a transaction, and the equipment trust serves the same function as other purchase money forms of financing. In fact, a form known as the "New York equipment trust" comes closer to a conditional sale contract then it does to a Pennsylvania equipment trust, and thus the former exclusion left substantial uncertainty. Railway financing on rolling stock will continue to be exempt from the filing provisions of Article 9 by virture of Section 9—302(3) and (4). Thus, the principal purpose of the former exclusion will be retained. There is, however, no reason why the other provisions of Article 9 by virtue of Section 9—302(3) and (4). closure, etc., should not be available to the parties to railway financing, since these problems are not adequately covered in any other statutes.

A new paragraph (e) has been added to make clear that this Article does not apply to security interests created by governmental debtors.

Other changes reflect the elimination of the term "contract rights" and the fact that, while transfers of claims under insurance policies and deposit accounts are in general excluded from the Article by this section, proceeds claims thereto are subject to Section 9—306.

§ 9—105. Definitions and Index of Definitions

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

(a) "Account debtor" means the person who is obligated on an account, chattel paper[, contract right] or general intangible;

(b) "Chattel paper" means a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods, but a charter or other contract involving the use or hire of a vessel is not chattel paper. When a transaction is evidenced both by such a security agreement or a lease and by an instrument or a series of instruments, the group of writings taken together constitutes chattel paper;

(c) "Collateral" means the property subject to a security interest, and includes accounts[, contract rights] and chattel paper which have been sold;

(d) "Debtor" means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral, and includes the seller of accounts[, contract rights] or chattel paper. Where the debtor and the owner of the collateral are not the same person, the term "debtor" means the owner of the collateral in any provision of the Article dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires;

(e) "Deposit account" means a demand, time, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization, other than an account evidenced by a certificate of deposit;

(f) [(e)] "Document" means document of title as defined in the general definitions of Article 1 (Section 1—201)[;], and a receipt of the kind described in subsection (2) of Section 7—201;

(g) "Encumbrance" includes real estate mortgages and other liens on real estate and all other rights in real estate that are not ownership interests.

(h) [(f)] "Goods" includes all things which are movable at the time the security interest attaches or which are fixtures (Section 9—313), but does not include money, documents, instruments, accounts, chattel paper, general intangibles, [contract rights and other things in action,] or minerals or the like (including oil and gas) before extraction. "Goods" also includes standing timber which is to be cut and removed under a conveyance or contract for sale, the unborn young of animals, and growing crops.

(i) [(g)] "Instrument" means a negotiable instrument (defined in Section 3—104), or a certificated security (defined in Section 8—102) or any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment;

(j) "Mortgage" means a consensual interest created by a real estate mortgage, a trust deed on real estate, or the like;

(k) An advance is made "pursuant to commitment" if the secured party has bound himself to make it, whether or not a subsequent event of default or other event not within his control has relieved or may relieve him from his obligation.

(l) [(h)] "Security agreement" means an agreement which creates or provides for a security interest;

(m) [(i)] "Secured party" means a lender, seller or other person in whose favor there is a security interest, including a person to whom accounts[, contract rights] or chattel paper have been sold. When the holders of obligations issued under an indenture of trust, equipment trust agreement or the like are represented by a trustee or other person, the representative is the secured party;

(n) "Transmitting utility" means any person primarily engaged in the railroad, street railway or trolley bus business, the electric or electronics communications transmission business, the transmission of goods by pipeline, or the transmission or the production and transmission of electricity, steam, gas or water, or the provision of sewer service.

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

"Account". Section 9—106.
"Attach". Section 9—203.
"Construction mortgage". Section 9—**313(1).**
"Consumer goods". Section 9—109(1).
["Contract right". Section 9—106.]
"Equipment". Section 9—109(2).
"Farm products". Section 9—109(**3**).
"Fixture". Section 9—313.
"Fixture filing". Section 9—313.
"General intangibles". Section 9—**106.**
"Inventory". Section 9—109(4).
"Lien creditor". Section 9—301(**3**).
"Proceeds". Section 9—306(1).
"Purchase money security interest". **Section 9—107.**
"United States". Section 9—103.

(3) The following definitions in other Articles apply to this Article:

"Check". Section 3—104.
"Contract for sale". Section 2—106.
"Holder in due course". Section 3—302.
"Note". Section 3—104.
"Sale". Section 2—106.

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

Reasons for 1977 Change

Because Section 8—102 now defines "security" as either a certificated or an uncertificated security, the word "certificated" is inserted to limit the definition only to those securities which are represented by instruments.

Reasons for 1972 Change

A definition of "transmitting utility" has been added to identify a class of debtor with special filing problems on far-flung properties, for which special filing rules are stated in Part 4.

A definition of "deposit account" has been added to facilitate references to such accounts in the section on proceeds (Section 9—306).

A definition of "pursuant to commitment" has been added as the basis for use of this concept in Sections 9—301, 9—307, and 9—312.

Definitions of "encumbrance" and "mortgage" have been added as the basis for the use thereof in Section 9—313.

The definition of "document" has been amended to include therein the kind of receipt issued by a person who is not technically a warehouseman, as described in Section 7—201(2).

The exclusion of "other things in action" from the definition of "goods" has been deleted as unnecessary. "General intangibles", which under Section 9—106 includes "things in action", are themselves excluded from the definition of goods.

Other minor changes reflect the elimination of the classification "contract right" in Section 9—106.

§ 9—106. Definitions: "Account"; ["Contract Right";] "General Intangibles"

"Account" means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper[.], whether or not it has been earned by performance. ["Contract right" means any right to payment under a contract not yet earned by performance and not evidenced by an instrument or chattel paper.] "General intangibles" means any personal property (including things in action) other than goods, accounts, [contract rights,] chattel paper, documents, [and] instruments, and money. **All rights to payment earned or unearned under a charter or other contract involving the use or hire of a vessel and all rights incident to the charter or contract are** [contract rights and neither] **accounts** [nor general intangibles].

Reasons for 1972 Change

The term "contract right" has been eliminated as unnecessary. As indicated by a sentence now being eliminated from Section 9—306(1), "contract right" was thought of as an "account" before the right to payment became unconditional by performance by the creditor. But the distinction between "account" and "contract right" was not used in the Article except in subsection (2) to Section 9—318 on the right of original parties to modify an assigned contract, and that subsection has been redrafted to preserve the distinction without needing the term "contract right". The term has been troublesome in creating a "proceeds" problem where a contract right becomes an "account" by performance; in the Code's former denial that there could be any right in an account until it came into existence (former Section 9—204 (2) (d)), notwithstanding a security interest in the pre-existing contract right; and in the danger of inadequate description in financing statements by claiming "accounts" or "general intangibles" when before performance they should have been described as "contract rights"; and in other respects.

"Money" is expressly excluded from the catch-all definition, "general intangible", to preclude any possible reading that a security interest in money may be perfected by filing.

The other changes are conforming changes.

§ 9—114. Consignment

(1) A person who delivers goods under a consignment which is not a security interest and who would be required to file under this Article by paragraph (3) (c) of Section 2—326 has priority over a secured party who is or becomes a creditor of the consignee and who would have a perfected security interest in the goods if they were the property of the consignee, and also has **priority** with respect to identifiable cash proceeds received on **or before** delivery of the goods to a buyer, if

(a) the consignor complies with the filing provision of the Article on Sales with respect to consignments (paragraph (3) (c) of Section 2—326) before the consignee receives possession of the goods; and

(b) the consignor gives notification in writing to the holder of the security interest if the holder has filed a financing statement covering the same types of goods before the date of the filing made by the consignor; and

(c) the holder of the security interest receives the notification within five years before the consignee receives possession of the goods; and

(d) the notification states that the consignor expects to deliver goods on consignment to the consignee, describing the goods by item or type.

(2) In the case of a consignment which is not a security interest and in which the requirements of the preceding subsection have not been met, a person who delivers goods to another is subordinate to a person who would have a perfected security interest in the goods if they were the property of the debtor.

Reasons for 1972 Adoption of New Section

An uncertainty has existed under the 1962 Code whether the filing rule in Section 2—326(3) applicable to true consignments requires only filing under Part 4 of Article 9 or also requires notice to prior inventory secured parties of the debtor under Section 9—312(3). The new Section 9—114 accepts the latter view, and provides in substance that, in order to protect his ownership of the consigned goods, the consignor must give the same notice to an inventory secured party of the debtor that he would have to give if his transaction with the consignee was in the form of a security transaction instead of in the form of a consignment. This new section follows closely the language of Section 9—312(3).

PART 2

VALIDITY OF SECURITY AGREEMENT AND RIGHTS OF PARTIES THERETO

§ 9—203. Attachment and Enforceability of Security Interest; Proceeds; Formal Requisites

[(1) Subject to the provisions of Section 4—208 on the security interest of a collecting bank and Section 9—113 on a security interest arising under the Article on Sales, a security interest is not enforceable against the debtor or third parties unless

(a) the collateral is in the possession of the secured party; or

(b) the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops or oil, gas or minerals to be extracted or timber to be cut, a description of the land concerned. In describing collateral, the word "proceeds" is sufficient without further description to cover proceeds of any character.]

(1) Subject to the provisions of Section 4—208 on the security interest of a collecting bank, Section 8—321 on security interests in securities and Section 9—113 on a security interest arising under the Article on Sales, a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless

(a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned;

(b) value has been given; and

(c) the debtor has rights in the collateral.

(2) A security interest attaches when it becomes enforceable against the debtor with respect to the collateral. Attachment occurs as soon as all of the events specified in subsection (1) have taken place unless explicit agreement postpones the time of attaching.

(3) Unless otherwise agreed a security agreement gives the secured party the rights to proceeds provided by Section 9—306.

(4) [(2)] A transaction although subject to this chapter, is also subject to Tit[le] 32, chapter 5, as enacted by Chapter 283, Laws of Montana 1959, to Tit[le] 31, chapter 1, part 2, as enacted by Chapter 282, Laws of Montana 1959, an[d] to 81-8-301 through 81-8-305, Title 61, chapter 3, and Title 31, chapter part 4, as amended, and in the case of conflict between the provisions of th[is] chapter and any such statute, the provisions of such statute control. Failur[e] to comply with any applicable statute has only the effect which is specifie[d] therein.

Reasons for 1977 Change

The added language in subsection (1) expressly makes this section subject to Section 8—321. Section 8—321(1) provides that an enforceable security interest in a security can be created only by a transfer which complies with Section 8—313(1).

It should be noted that both subsection (1) of this section and Section 8—321(2) contain the requirements that value be given and that the debtor have rights in the collateral. Subparagraph (1)(a) of this section, however, requires either possession by the secured party or a security agreement signed by the debtor. Of the various provisions of Section 8—313(1), some require possession by the secured party, some require a signed security agreement and the rest require procedures which are functionally equivalent to possession.

It is intended that compliance with some provision of Section 8—313(1) is essential to the creation of an enforceable security interest in a security and, conversely, that compliance with the requirements of subsection (1) of this section will not, of itself, suffice.

Reasons for 1972 Change

Subsection (1) has been revised to incorporate into the concept of enforceability of a security interest the elements of agreement, value, and rights in the collateral, which formerly were stated in Section 9—204. These are combined with the requirement of written agreement (unless the security interest is evidenced by possession of the collateral by the secured party), and the security interest is said to "attach" when all of the events specified have occurred. This drafting cures the former anomaly that a security interest could attach and be perfected, and yet be unenforceable against anyone for lack of a written security agreement.

The requirement that a security agreement covering oil, gas or minerals to be extracted contain a description of the land concerned has been eliminated since the Article does not recognize a security interest in such collateral until it has been extracted from the land.

The former reference to proceeds in subsection (1) has been eliminated and new subsection (3) added to make clear that claims to proceeds under Section 9—306 do not require a statement in the security agreement, for it is assumed that the parties so intend unless otherwise agreed.

§ 9—204. [When Security Interest Attaches;] After-Acquired Property; Future Advances

[(1) A security interest cannot attach until there is agreement (subsection (3) of Section 1—201) that it attach and value is given and the debtor has rights in the collateral. It attaches as soon as all of the events in the preceding sentence have taken place unless explicit agreement postpones the time of attaching.]

[(2) For the purposes of this section the debtor has no rights

(a) in crops until they are planted or otherwise become growing crops, in the young of livestock until they are conceived;

(b) in fish until caught, in oil, gas or minerals until they are extracted, in timber until it is cut;

(c) in a contract right until the contract has been made;

(d) in an account until it comes into existence.]

[(3) Except as provided in subsection (4) a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement.]

[(4) No security interest attaches under an after-acquired property clause

(a) to crops which become such more than one year after the security agreement is executed except that a security interest in crops which is given in conjunction with a lease or a land purchase or improvement transaction evidenced by a contract, mortgage or deed of trust may if so agreed attach to crops to be grown on the land concerned during the period of such real estate transaction;

(b) to consumer goods other than accessions (Section 9—314) when given as additional security unless the debtor acquires rights in them within ten days after the secured party gives value.]

(1) Except as provided in subsection (2), a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral.

(2) No security interest attaches under an after-acquired property clause to consumer goods other than accessions (Section 9—314) when given as additional security unless the debtor acquires rights in them within ten days after the secured party gives value.

(3) (5) Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment (subsection (1) of Section 9—105).

Reasons for 1972 Change

Former subsection (1) has been eliminated. The term "attach" has been moved to Section 9—203 and related to the concept of enforceability of the security interest between the parties to the security agreement contained in that section.

Former subsection (2) has been eliminated as unnecessary and in some cases confusing. Its operation appeared to be arbitrary, and it is believed that the questions considered are best left to the courts.

Former subsections (3) and (5), now subsections (1) and (3), have been rewritten for clarity.

Former subsection (4) is redesignated (2), and clause (a) thereof relating to crops eliminated. That clause provided that no security interest in crops attaches under an after-acquired property clause to crops which become such more than one year after the security agreement, unless the agreement involved certain real estate transactions. The obvious purpose of this provision was to protect a necessitous farmer from encumbering his crops for many years in the future. The provision did not work because there was no corresponding limit on the scope of a financing statement covering crops, and under the Code's notice-filing rules the priority position of a security arrangement covering successive crops would be as effectively protected by the filing of a first financing statement whether the granting clause as to successive crops was in one security agreement with an after-acquired property clause or in a succession of security agreements. On the other hand the clause did require an annual security agreement for crops even when the encumbrance on crops was agreed to as part of a long-term financing covering farm machinery and other assets. The provision thus appeared to be meaningless in operation except to cause unnecessary paperwork, but it did introduce some element of uncertainty as to its purpose.

§ 9—205. Use or Disposition of Collateral Without Accounting Permissible

A security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods) or to collect or compromise accounts [contract rights] or chattel paper, or to accept the return of goods or make repossessions, or to use, commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral. This section does not relax the requirements of possession where perfection of a security interest depends upon possession of the collateral by the secured party or by a bailee.

Reasons for 1972 Change

The change reflects the deletion of the defined term "contract right" from the Article.

PART 3

RIGHTS OF THIRD PARTIES; PERFECTED AND UNPERFECTED SECURITY INTERESTS; RULES OF PRIORITY

§ 9—301. Persons Who Take Priority Over Unperfected Security Interests; Right of "Lien Creditor"

(1) Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of

(a) persons entitled to priority under Section 9—312;

(b) a person who becomes a lien creditor [without knowledge of the security interest and] before [it] the security interest is perfected;

(c) in the case of goods, instruments, documents, and chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business, or is a buyer of farm products in ordinary course of business, to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected;

(d) in the case of accounts [, contract rights,] and general intangibles, a person who is not a secured party and who is a transferee to the extent that he gives value without knowledge of the security interest and before it is perfected.

(2) If the secured party files with respect to a purchase money security interest before or within ten days after the debtor receives possession of the collateral [comes into possession of the debtor], he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

(3) A "lien creditor" means a creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for benefit of creditors from the time of assignment, and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment. [Unless all the creditors represented had knowledge of the security interest such a representative of creditors is a lien

creditor without knowledge even though he personally has knowledge of the security interest.]

(4) A person who becomes a lien creditor while a security interest is perfected takes subject to the security interest only to the extent that it secures advances made before he becomes a lien creditor or within 45 days thereafter or made without knowledge of the lien or pursuant to a commitment entered into without knowledge of the lien.

Reasons for 1972 Change

Paragraph (1) (b) has been amended to eliminate the element of knowledge in the conditions under which a lien creditor may defeat an unperfected security interest. Knowledge of the security interest will no longer subordinate the lien creditor to the unfiled security interest. The former section denied the lien creditor priority even though he had no knowledge when he got involved by extending credit, if he acquired knowledge while attempting to extricate himself. It was completely inconsistent in spirit with the rules of priority between security interests, where knowledge plays a very minor role.

The change in subsection (2) is made to conform the language to that of the related provision in Section 9—312(4).

The second sentence of subsection (3) is deleted because the question of knowledge has been eliminated from paragraph (1) (b).

New subsection (4) deals with the question of the extent to which advances made under a perfected security interest after the rights of a lien creditor have attached to the collateral will come ahead of the position of the lien creditor. This subsection should be read with Section 9—307(3) (which deals with the same problem in the case of an intervening buyer) and Section 9—312(7) (which deals with the same problem in the case of a secured party), and paragraph (5) of Reasons for Change under Section 9—312.

In the case of the lien creditors dealt with by this subsection, the rule chosen is crucial to the priority of the security interest for advances over a federal tax lien for 45 days after the tax lien has been filed, as contemplated under section 6323(c) (2) and (d) of the Internal Revenue Code of 1954 as amended by the Federal Tax Lien Act of 1966. The actual importance of the priority rule chosen between a secured party and possible lien creditors during the 45 days is believed to be slight; but the rule chosen is essential to give the secured party the protection against Federal tax liens believed to have been intended by the Federal Tax Lien of 1966, the operation of which is made to depend on state law. The rule of state law was not certain before this revision. Accordingly, the priority of the security interest for future advances over the judgment lien has to be absolute for the 45 days, without regard to any knowledge of the secured party that the judgment lien exists. After the 45 days the priority of the security interest depends on the secured party's lack of knowledge of the lien at the time he makes the subsequent advance or commits to do so.

§ 9—302. When Filing Is Required to Perfect Security Interest; Security Interests to Which Filing Provisions of This Article Do Not Apply

(1) A financing statement must be filed to perfect all security **interests** except the following:

(a) a security interest in collateral in possession of the secured party under Section 9—305;

(b) a security interest temporarily perfected in instruments or documents without delivery under Section 9—304 or in proceeds for a 10 day period under Section 9—306;

[(c) a purchase money security interest in farm equipment having a purchase price not in excess of $2500; but filing is required for a fixture under Section 9—313 or for a motor vehicle required to be licensed;]

(c) a security interest created by an assignment of a beneficial interest in a trust or a decedent's estate;

(d) a purchase money security interest in consumer goods; but filing is required [for a fixture under Section 9—313 or for a motor vehicle required to be licensed;] for a motor vehicle required to be registered; and fixture filing is required for priority over conflicting interests in fixtures to the extent provided in Section 9—313;

(e) an assignment of accounts [or contract rights] which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts [or contract rights] of the assignor;

(f) a security interest of a collecting bank (Section 4—208) or in securities (Section 8—321)
or arising under the Article on Sales (see Section 9—113) or covered in subsection (3) of this section;

(g) an assignment for the benefit of all the creditors of the transferor, and subsequent transfers by the assignee thereunder.

(2) If a secured party assigns a perfected security interest, no filing under this Article is required in order to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

[(3) The filing provisions of this Article do not apply to a security interest in property subject to a statute

(a) of the United States which provides for a national registration or filing of all security interests in such property; or

(b) of this state which provides for central filing of, or which requires indication on a certificate of title of, such security interests in such property.]

[(4) A security interest in property covered by a statute described in subsection (3) can be perfected only by registration or filing under that statute or by indication of the security interest on a certificate of title or duplicate thereof by a public official.]

(3) The filing of a financing statement otherwise required by this Article is not necessary or effective to perfect a security interest in property subject to

(a) a statute or treaty of the United States which provides for a national or international registration or a national or international certificate of title or which specifies a place of filing different from that specified in this Article for filing of the security interest; or

(b) the following statutes of this state; Chapter 3, Title 61; Chapter 2, Title 23; ; but during any period in which collateral is inventory held for sale by a person who is in the business of selling goods of that kind, the filing provisions of this Article (Part 4) apply to a security interest in that collateral created by him as debtor; or

(c) a certificate of title statute of another jurisdiction under the law of which indication of a security interest on the certificate is required as a condition of perfection (subsection (2) of Section 9—103).

(4) Compliance with a statute or treaty described in subsection (3) is equivalent to the filing of a financing statement under this Article, and a security interest in property subject to the statute or treaty can be perfected only by compliance therewith except as provided in Section 9—103 on multiple state transactions. Duration and renewal of perfection of a security interest perfected by compliance with the statute or treaty are governed by the provisions of the statute or treaty; in other respects the security interest is subject to this Article.

Reasons for 1977 Change

Section 8—321(2) provides that security interests in securities created in accordance with its provisions are perfected. Since none of its provisions, including the provisions of Section 8—313(1) incorporated therein, require filing, security interests in securities are excepted from the normal filing requirements of Article 9 by the language added to subparagraph (1)(f) of this section. Note that most of the requirements of Section 8—313(1) involve either possession or its functional equivalent.

Reasons for 1972 Change

Former paragraph (1) (c), which created a nonfiling rule for purchase money security interests in certain farm equipment, has been eliminated. The analogy drawn in the 1962 Code of farm equipment to consumer goods (for which a similar nonfiling rule is provided in paragraph (1) (d)) is believed to be inappropriate. The effect of the rule was to make farmers' equipment unavailable to them as collateral for loans from some lenders.

A new paragraph (1) (e) exempts from filing rules security interests created by assignments of beneficial interests in trusts and estates, because these assignments are not ordinarily thought of as subject to this Article, and a filing rule might operate to defeat many assignments.

The requirement of filing for purchase-money security interests in consumer goods which are fixtures has been made applicable only for priority against real estate interests (Section 9—313).

A new paragraph (1) (g) has been added exempting from filing assignments for the benefit of creditors because they are not financing transactions.

Former subsections (3) and (4) have been rewritten into new subsections (3) and (4). The alternatives of former subsection (3) had proved unacceptable formulations in many states. The states adopted non-uniform amendments to use language more closely geared to their certificate of title laws than the uniform alternatives. It is believed that the simplest thing is to have each state specify its statutes intended to be applicable as it adopts the revised Article 9.

Former Alternative B to subsection (3) has been abandoned as no longer serving any purpose: it had been an attempt to convert obsolete non-mandatory certificate of title laws into laws under which notation on the certificate of title was the necessary method of perfection of a security interest.

Subsection (3) continues to carry the thought that was formerly only in Alternative B—namely, that the certificate of title procedure does not control the perfection of inventory or "floor plan" security interests, but instead normal Code filing rules are applicable. Non-uniform variations to the contrary under some state laws are believed to increase operating burdens and it is hoped that the states will abandon them.

References to federal statutes have been broadened to include treaties.

§ 9—304. Perfection of Security Interest in Instruments, Documents, and Goods Covered by Documents; Perfection by Permissive Filing; Temporary Perfection Without Filing or Transfer of Possession

(1) A security interest in chattel paper or negotiable documents may be perfected by filing. A security interest in money or instruments (other than certificated securities or instruments which constitute part of chattel paper) can be perfected only by the secured party's taking possession, except as provided in subsections (4) and (5) of this section and subsections (2) and (3) of Section 9—306 on proceeds.

(2) During the period that goods are in the possession of the issuer of a negotiable document therefor, a security interest in the goods is perfected by perfecting a security interest in the document, and any security interest in the goods otherwise perfected during such period is subject thereto.

(3) A security interest in goods in the possession of a bailee other than one who has issued a negotiable document therefor is perfected by issuance of a document in the name of the secured party or by the bailee's receipt of notification of the secured party's interest or by filing as to the goods.

(4) A security interest in instruments (other than certificated securities) or negotiable documents is perfected without filing or the taking of possession for a period of 21 days from the time it attaches to the extent that it arises for new value given under a written security agreement.

(5) A security interest remains perfected for a period of 21 days without filing where a secured party having a perfected security interest in an instrument (other than a certificated security), a negotiable document or goods in possession of a bailee other than one who has issued a negotiable document therefor

(a) makes available to the debtor the goods or documents representing the goods for the purpose of ultimate sale or exchange or for the purpose of loading, unloading, storing, shipping, transshipping, manufacturing, processing or otherwise dealing with them in a manner preliminary to their sale or exchange. [;or] but priority between conflicting security interests in the goods is subject to subsection (3) of Section 9—312; or

(b) delivers the instrument to the debtor for the purpose of ultimate sale or exchange or of presentation, collection, renewal or registration of transfer.

(6) After the 21 day period in subsections (4) and (5) perfection depends upon compliance with applicable provisions of this Article.

Reasons for 1972 Change

The change in subsection (1) corrects an inadvertent omission in the 1962 Text, and makes clear that a security interest in money cannot be perfected by filing.

A provision has been added to subsection (5) making it clear that the 21-day period referred to therein deals only with perfection, but that there must be compliance with the notice provisions of Section 9—312(3) in order to achieve priority over earlier inventory financers. Corresponding clarifying changes have been made in Section 9—312(3).

Reasons for 1977 Change

The definition of "instrument" in Section 9—105(1)(i) includes a certificated security and the perfection of security interests in all securities is governed by Section 8—321. Hence, certificated securities are expressly excluded from this section.

Note that a perfected security interest under Section 8—321 must be created by a transfer under Section 8—313(1) which, when certificated securities are involved, requires possession or a functional equivalent thereof. The 21 day initial grace period of subsection (4) is reflected in Section 8—313(1)(i) and the reference thereto in Section 8—321(2). The 21 day grace period of subsection (5) is reflected in Section 8—321 (4).

§ 9—305. When Possession by Secured Party Perfects Security Interest Without Filing

A security interest in letters of credit and advices of credit (subsection (2)(a) of Section 5—116), goods, instruments (other than certificated securities), money, negotiable documents, or chattel paper may be perfected by the secured party's taking possession of the collateral. If such collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest. A security interest is perfected by possession from the time possession is taken without relation back and continues only so long as possession is retained, unless otherwise specified in this Article. **The security interest may be otherwise perfected as provided in this Article before or after the period of possession by the secured party.**

Reasons for 1972 Change

The change corresponds to the change in Section 9-304 to clarify the special position of money.

Reasons for 1977 Change

The definition of "instrument" in Section 9—105(1)(i) includes a certificated security and the perfection of security interests in all securities is governed by Section 8—321. Hence, certificated securities are expressly excluded from this section.

The typical pledge of a certificated security is unaffected by this change since Section 8—313(1)(a) provides for transfer by delivery and Section 8—321(2) provides that a security interest thus transferred is perfected. Section 9—305 has been relied on to perfect security interests in securities in the hands of third parties (first pledgees, brokers, custodian banks, etc.) by notifying such third parties and assuming that they are bailees of certificated securities. When certificated securities have been repledged, held in nominee name or deposited in a securities depository, there is some doubt as to the identity of the bailee or, indeed, whether there is even an instrument that can be identified as the subject matter of the security interest.

The transfer rules of Section 8—313(1), which are incorporated in Section 8—321, are intended to settle such questions with respect to both certificated securities and uncertificated securities, which, by definition, cannot be "possessed." Note that Section 8—313(1)(h) deals explicitly with the problem of perfection by notice, provides that the notice be signed by the debtor-transferor and identifies the proper party to be notified.

§ 9—306. "Proceeds"; Secured Party's Rights on Disposition of Collateral

(1) ["Proceeds" includes whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of. The term also includes the account arising when the right to payment is earned under a contract right.]
"Proceeds" includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement. Money, checks, deposit accounts, and the like are "cash proceeds". All other proceeds are "non-cash proceeds".

(2) Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof [by the debtor] unless [his action was] the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

(3) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless

[(a) a filed financing statement covering the original collateral also covers proceeds; or]

(a) a filed financing statement covers the original collateral and the proceeds are collateral in which a se-

curity interest may be perfected by filing in the office or offices where the financing statement has been filed and, if the proceeds are acquired with cash proceeds, the description of collateral in the financing statement indicates the types of property constituting the proceeds; or

(b) a filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds; or

(c) [(b)] the security interest in the proceeds is perfected before the expiration of the ten day period.

Except as provided in this section, a security interest in proceeds can be perfected only by the methods or under the circumstances permitted in this Article for original collateral of the same type.

(4) In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest only in the following proceeds:

(a) in identifiable non-cash proceeds[;] and in separate deposit accounts containing only proceeds;

(b) in identifiable cash proceeds in the form of money which is [not] neither commingled with other money [or] nor deposited in a [bank] deposit account prior to the insolvency proceedings;

(c) in identifiable cash proceeds in the form of checks and the like which are not deposited in a [bank] deposit account prior to the insolvency proceedings; and

(d) in all cash and [bank] deposit accounts of the debtor [if other cash] in which proceeds have been commingled with other funds. [or deposited in a bank account,] but the perfected security interest under this paragraph (d) is

(i) subject to any right of set-off; and

(ii) limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings [and commingled or deposited in a bank account prior to the insolvency proceedings less the amount of cash proceeds received by the debtor and paid over to the secured party during the ten day period,] less the sum of (I) the payments to the secured party on account of cash proceeds received by the debtor during such period and (II) the cash proceeds received by the debtor during such period to which the secured party is entitled under paragraphs (a) through (c) of this subsection (4).

(5) If a sale of goods results in an account or chattel paper which is transferred by the seller to a secured party, and if the goods are returned to or are repossessed by the seller or the secured party, the following rules determine priorities:

(a) If the goods were collateral at the time of sale, for an indebtedness of the seller which is still unpaid, the original security interest attaches again to the goods and continues as a perfected security interest if it was perfected at the time when the goods were sold. If the security interest was originally perfected by a filing which is still effective, nothing further is required to continue the perfected status; in any other case, the secured party must take possession of the returned or repossessed goods or must file.

(b) An unpaid transferee of the chattel paper has a security interest in the goods against the transferor. Such security interest is prior to a security interest asserted under paragraph (a) to the extent that the transferee of the chattel paper was entitled to priority under Section 9—308.

(c) An unpaid transferee of the account has a security interest in the goods against the transferor. Such security interest is subordinate to a security interest asserted under paragraph (a).

(d) A security interest of an unpaid transferee asserted under paragraph (b) or (c) must be perfected for protection against creditors of the transferor and purchasers of the returned or repossessed goods.

Reasons for 1972 Change

The first sentence of subsection (1) is rewritten for clarity.

The former second sentence of subsection (1) is omitted consistently with the abandonment of the term "contract right" in Section 9—106.

The new second sentence of subsection (1) is intended to overrule various cases to the effect that proceeds of insurance on collateral are not proceeds of the collateral. The

"except" clause is intended to say that if the insurance contract specifies the person to whom the insurance is payable, the concept of "proceeds" will not interfere with performance of the contract.

Heretofore an apparent inconsistency and ambiguity has existed between the last sentence of Section 9—203(1) (b) of the 1962 Code, which indicated that a claim to proceeds had to be an express term of a security agreement, and Section 9—306(2), which indicated that a right to proceeds was automatic without reference to a term of a security agreement. This ambiguity has been clarified in favor of an automatic right to proceeds, on the theory that this is the intent of the parties, unless otherwise agreed. Further, there has been eliminated the requirement of claiming proceeds in a financing statement, which had resulted in a checking of a box on each financing statement in order to claim proceeds. Instead, the filed claim to the original collateral is treated as constituting automatically a filing as to proceeds. To this principle, a limitation has been stated: Where the filing as to the original collateral is an inappropriate means of perfection as to proceeds of certain types, or is made at a place that is inappropriate as to such proceeds, the filed claim to the original collateral perfects the claim to proceeds for only 10 days. One example of this is negotiable instruments as proceeds, as to which filing is inappropriate under Section 9—304(1). Another example is the case of accounts as proceeds of inventory, as to which under the rules of Section 9—103 the state of filing for the accounts might be different from the state of filing for the inventory.

The revised subsection (4) is a clarification based on the California revision. It makes clear that the claim to cash allowed in insolvency is exclusive of any other claim based on tracing.

§ 9—307. Protection of Buyers of Goods

(1) A buyer in ordinary course of business (subsection (9) of Section 1—201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.

(2) In the case of consumer goods [and in the case of farm equipment having an original purchase price not in excess of $2500 (other than fixtures, see Section 9—313)], a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes [or his own farming operations] unless prior to the purchase the secured party has filed a financing statement covering such goods.

(3) A buyer other than a buyer in ordinary course of business (subsection (1) of this section) takes free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the purchase, or more than 45 days after the purchase, whichever first occurs, unless made pursuant to a commitment entered into without knowledge of the purchase and before the expiration of the 45 day period.

Reasons for 1972 Change

The change in subsection (2) is a conforming change made necessary by the deletion of Section 9—302(1) (c) of the 1962 Code, which provided in substance that a purchase money security interest in farm equipment having an original purchase price not in excess of $2500 need not be filed. The omission of that provision in Subsection 9—302(1) makes any corresponding reference unnecessary in the present section.

Subsection (3) is one of three new provisions clarifying the extent to which future advances under a security interest may outrank an intervening right. See Sections 9—301(4) and 9—312(7) and paragraph (5) of Reasons for Change under Section 9—312.

§ 9—308. Purchase of Chattel Paper and [Non-Negotiable] Instruments

[A purchaser of chattel paper or a non-negotiable instrument who gives new value and takes possession of it in the ordinary course of his business and without knowledge that the specific paper or instrument is subject to a security interest has priority over a security interest which is perfected under Section 9—304 (permissive filing and temporary perfection). A purchaser of chattel paper who gives new value and takes possession of it in the ordinary course of his business has priority over a security interest in chattel paper which is claimed merely as proceeds of inventory subject to a security interest (Section 9—306), even though he knows that the specific paper is subject to the security interest.]

A purchaser of chattel paper or an instrument who gives new value and takes possession of it in the ordinary course of his business has priority over a security interest in the chattel paper or instrument

(a) which is perfected under Section 9—301 (permissive filing and temporary perfection) or under Section 9—306 (perfection as to proceeds) if he acts without knowledge that the specific paper or instrument is subject to a security interest; or

(b) which is claimed merely as proceeds of inventory subject to a security interest (Section 9—306) even though he knows that the specific paper or instrument is subject to the security interest.

Reasons for 1972 Change

The section has been rewritten for clarity.

Another purpose of the changes is to make the rules of this section applicable to negotiable instruments. Heretofore, the holder of a negotiable instrument was under some circumstances in a less protected position against competing claims than the holder of chattel paper. The holder of a negotiable instrument had protection only if he achieved the holder in due course status referred to in Section 9—309, which status would not be achieved if the holder had knowledge of a conflicting proceeds claim. In contrast, the holder of chattel paper who met the stated conditions was protected under the second sentence of Section 9—308 of the 1962 Code even if he had knowledge of the conflicting proceeds claim. Under the changes, the holder of a negotiable instrument who may not qualify as holder in due course may nevertheless qualify for the protections of this section.

§ 9—309. Protection of Purchasers of Instruments [and], Documents and Securities

Nothing in this Article limits the rights of a holder in due course of a negotiable instrument (Section 3—302) or a holder to whom negotiable document of title has been duly negotiated (Section 7—501) or a bona fide purchaser of a security (Section [8—301] 8—302) and such holders or purchasers take priority over an earlier security interest even though perfected. Filing under this Article does not constitute notice of the security interest to such holders or purchasers.

Reasons for 1977 Change

This section presently resolves the conflict which may result when a financial intermediary or secured party wrongfully transfers a certificated security he controls. Since the term "security" now includes, under revised Section 8—102, uncertificated securities, this section will also cover the situation where a financial intermediary or secured party who is the registered owner or registered pledgee of an uncertificated security wrongfully causes the registration of transfer or pledge. In either case, a bona fide purchaser (including a pledgee) from the financial intermediary or secured party will prevail over a secured creditor of the beneficial owner who has created and perfected his security interest by notice to or acknowledgment from the wrongful transferor under Section 8—321.

§ 9—312. Priorities Among Conflicting Security Interests in the Same Collateral

[(1) The rules of priority stated in the following sections shall govern where applicable: Section 4—208 with respect to the security interest of collecting banks in items being collected, accompanying documents and proceeds; Section 9—301 on certain priorities; Section 9—304 on goods covered by documents; Section 9—306 on proceeds and repossessions; Section 9—307 on buyers of goods; Section 9—308 on possessory against non-possessory interests in chattel paper or non-negotiable instruments; Section 9—309 on security interests in negotiable instruments, documents or securities; Section 9—310 on priorities between perfected security interests and liens by operation of law; Section 9—313 on security interests in fixtures as against interests in real estate; Section 9—314 on security interests in accessions as against interest in goods; Section 9—315 on conflicting security interests where goods lose their identity or become part of a product; and Section 9—316 on contractual subordination.]

(1) The rules of priority stated in other sections of this Part and in the following sections shall govern when applicable: Section 4—208 with respect to the security interests of collecting banks in items being collected, accompanying documents and proceeds; Section 9—103 on security interests related to other jurisdictions; Section 9—114 on consignments.

(2) A perfected security interest in crops for new value given to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops by planting or otherwise takes priority over an earlier perfected security interest to the extent that such earlier interest secures obligations due more than six months before the crops become growing crops by planting or otherwise, even though the person giving new value had knowledge of the earlier security interest.

[(3) A purchase money security interest in inventory collateral has priority over a conflicting security interest in the same collateral if

(a) the purchase money security interest is perfected at the time the debtor receives possession of the collateral; and

(b) any secured party whose security interest is known to the holder of the purchase money security interest or who, prior to the date of the filing made by the holder of the purchase money security interest, had filed a financing statement covering the same items or type of inventory, has received notification of the purchase money security interest before the debtor receives possession of the collateral covered by the purchase money security interest; and

(c) such notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.]

(3) A perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and also has priority in identifiable cash proceeds received on or before the delivery of the inventory to a buyer if

(a) the purchase money security interest is perfected at the time the debtor receives possession of the inventory; and

(b) the purchase money secured party gives notification in writing to the holder of the conflicting security interest if the holder had filed a financing statement covering the same types of inventory (i) before the date of the filing made by the purchase money secured party, or (ii) before the beginning of the 21 day period where the purchase money security interest is temporarily perfected without filing or possession (subsection (5) of Section 9—304); and

(c) the holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and

(d) the notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

(4) A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within ten days thereafter.

(5) In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set forth in subsections (3) and (4) of this section), priority between conflicting security interests in the same collateral shall be determined [as follows:

(a) in the order of filing if both are perfected by filing, regardless of which security interest attached first under Section 9—204(1) and whether it attached before or after filing;

(b) in the order of perfection unless both are perfected by filing, regardless of which security interest attached first under Section 9—204(1) and, in the case of a after filing; and

(c) in the order of attachment under Section 9—204(1) so long as neither is perfected.]

according to the following rules:

(a) Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection.

(b) So long as conflicting security interests are unperfected, the first to attach has priority.

[(6) For the purpose of the priority rules of the immediately preceding subsection, a continuously perfected security interest shall be treated at all times as if perfected by filing if it was originally so perfected and it shall be treated at all times as if perfected otherwise than by filing if it was originally perfected otherwise than by filing.]

(6) For the purposes of subsection (5) a date of filing or perfection as to collateral is also a date of filing or perfection as to proceeds.

(7) If future advances are made while a security interest is perfected by filing, the taking of possession, or under Section 8—321 on securities, the security interest has the same priority for the purposes of subsection (5) with respect to the future advances as it does with respect to the first advance. If a commitment is made before or while the security interest is so perfected, the security interest has the same priority with respect to advances made pursuant thereto. In other cases a perfected security interest has priority from the date the advance is made.

Reasons for 1977 Change

The insertion in subsection (7) protects the future advances of a secured party who has perfected his security interest in securities under Section 8—321 even if the method did not involve his taking possession of the collateral.

Reasons for 1972 Change

(1) The change in subsection (1) is primarily a simplification of statement.

(2) Changes have been made in subsection (3) to answer unresolved questions under the 1962 Code.

(a) One change answers the question how often a notice must be given under that subsection. The period of five years has been chosen by analogy to the duration of a financing statement.

(b) Another change answers the question of the priority status of the security interest in inventory temporarily perfected for 21 days without filing or perfection in a situation which begins with release of a pledged document under Section 9—304(5). The answer provided is the usual rule that the purchase-money claimant to preserve his priority resulting from the document must give the required notice before the debtor receives possession of the inventory. If the secured party fails to give timely notice, he loses his priority under this subsection.

(c) One of the most widely discussed questions under the 1962 Code was the question of the priority between a person claiming accounts as proceeds of inventory and a person claiming the accounts by direct filing with respect thereto. One issue was whether the special position of an inventory financer as a purchase money financer or as the first financer in the business cycle of the debtor gave him any special position as to accounts resulting from the inventory. In general, as revised, a negative answer has been given, and a prior right to inventory does not confer a prior right to any proceeds except identifiable cash proceeds received on or before the delivery of the inventory (i. e., without the intervention of an account). Other aspects of this issue are discussed under subsection (5) of this section.

(3) A different answer has been given in subsection (4) relating to purchase money security interests in collateral other than inventory. Here, where it is not ordinarily expected that the collateral will be sold and that proceeds will result, it seems appropriate to give the party having a purchase money security interest in the original collateral an equivalent priority in its proceeds. The 1962 Code was unclear on this point.

(4) Existing subsection (5) contains two principal rules. Paragraph (a) is a first-to-file rule where both competing security interests are perfected by filing. Paragraph (b) is a first-to-perfect rule when either of the security interests is or both of them are perfected otherwise than by filing. A traffic rule is provided by existing subsection (6) to the effect that a continuously perfected security interest shall be treated for the purpose of the foregoing rules as if at all times perfected in the manner it was first perfected. The problems raised have been the subject of an enormous legal literature. They are complicated by the unforeseeable effect of the temporary perfection of security interest in proceeds without filing under Section 9—306, and by speculation as to whether a secured party could claim that his security interest was originally perfected without filing under this rule even though the security interest in proceeds was claimed in his filing as to the original collateral. They are further com-

plicated by the question whether different rules would apply when a financing statement was drawn to cover, e. g., inventory and its proceeds (which would include accounts) and when it was drawn to cover inventory and accounts.

To settle these questions it is proposed to replace the present paragraphs (a) and (b) of subsection (5) by a single rule, subsection (5), and to eliminate existing subsection (6). Together with this treatment should be noted the fact that a filing as to proceeds automatically arises from a filed security interest in original collateral under the proposed revision of Section 9—306(3), subject to limitations therein discussed. New proposed subsection (6) makes it clear that subject to these limitations the time of filing or perfection as to original collateral is the time of filing or perfection as to proceeds.

The rule of proposed subsection (5) ranks conflicting perfected security interests by their priority in time, dating back to the respective times when without interruption the security interests were either perfected or were the subjects of appropriate filings.

Perhaps the most debated subject under Article 9 has been the question whether between conflicting security interests a priority as to original collateral confers a priority as to proceeds. As indicated above, in the case of collateral other than inventory, e. g., equipment, it seems clear that the policy favoring the purchase money secured party in Section 9—312 (4) should give him the first claim to the proceeds. This is so even though the security interests will have been perfected simultaneously when the proceeds arise and the debtor acquires rights therein.

Proper policy is much less clear when the collateral involved is inventory and proceeds consisting of accounts. (Policy as to other types of receivables as proceeds is expressed in Sections 9—308 and 9—309). Accounts financing is more important in the economy than the financing of the kinds of inventory that produce accounts, and the desirable rule is one which makes accounts financing certain as to its legal position. Therefore, the rule proposed is that where a financing statement as to accounts is filed first (with or without related inventory financing), the security interest in accounts should not be defeated by any subsequent claim to accounts as proceeds of a security interest in inventory filed later. There is therefore no provision in Section 9—312(3) carrying forward to accounts any priority right in inventory, and proposed subsections (5) and (6) adhere firmly to the principle that a date of filing as to original collateral also defines the date of filing as to proceeds. Correspondingly, a financing statement

as to inventory (carrying with it a claim to proceeds) which is filed first will under the same provisions have priority over a later-filed security interest in accounts.

(5) The priority of future advances against an intervening party has been the subject of much discussion and disagreement. Where both interests are filed security interests, the first-to-file rule of present Section 9—312(5) (a) or the corresponding proposed revision is clearly applicable. Under the 1962 Code, the position of an intervening pledgee in reference to a subsequent advance by an earlier-filed secured party is debatable. The proposed unified priority rule of subsection 9—312(5) would indicate that subsequent advances by the first-filed party have priority, and subsequent advances under a security interest perfected by possession likewise have priority over an intervening filed security interest. These priority rules are expressly stated in proposed subsection (7). That proposal also deals with the rare case of the priority position of a subsequent advance made by a secured party whose security interest is temporarily perfected without either filing or possession, against an intervening secured party. Since there is no notice by the usual methods of filing or possession of the existence of the security interest, the subsequent advances rank only from the actual date of making unless made pursuant to commitment.

Different but related problems exist with reference to the status of subsequent advances when the intervening party is a judgment creditor. He is not directly part of the Code's system of priorities. It seems unfair to make it possible for a debtor and secured party with knowledge of the judgment lien to squeeze out a judgment creditor who has successfully levied on a valuable equity subject to a security interest, by permitting later enlargement of the security interest by an additional advance, unless that advance was committed in advance without such knowledge. Proposed Section 9—301(4) provides that a lien creditor does not take subject to a subsequent advance unless it is given or committed without knowledge, but there is an exception protecting future advances within 45 days after the levy regardless of knowledge. The 45-day period corresponds to a provision on protection of advances made after the filing of tax liens in the Federal Tax Lien Act of 1966.

A similar problem arises where the intervening party is a buyer of the collateral subject to the security interest. While buyers must necessarily take subject to rights of secured parties, the buyer should take subject to subsequent advances only to the extent that they are given "pursuant to commitment" or within the period of 45 days after the purchase but not later than the time that the secured party acquires knowledge of the purchase. It is so proposed in Section 9—307(3). A definition of the quoted phrase appears in Section 9—105.

§ 9—313. Priority of Security Interests in Fixtures

[(1) The rules of this section do not apply to goods incorporated into a structure in the manner of lumber, bricks, tile, cement, glass, metal work and the like and no security interest in them exists under this Article unless the structure remains personal property under applicable law. The law of this state other than this Act determines whether and when other goods become fixtures. This Act does not prevent creation of an encumbrance upon fixtures or real estate pursuant to the law applicable to real estate.]

[(2) A security interest which attaches to goods before they become fixtures takes priority as to the goods over the claims of all persons who have an interest in the real estate except as stated in subsection (4).]

[(3) A security interest which attaches to goods after they become fixtures is valid against all persons subsequently acquiring interests in the real estate except as stated in subsection (4) but is invalid against any person with an interest in the real estate at the time the security interest attaches to the goods who has not in writing consented to the security interest or disclaimed an interest in the goods as fixtures.]

[(4) The security interests described in subsections (2) and **(3)** do not take priority over

(a) a subsequent purchaser for value of any interest in the real estate; or

(b) a creditor with a lien on the real estate subsequently obtained by judicial proceedings; or

(c) a creditor with a prior encumbrance of record on the real estate to the extent that he makes subsequent advances

if the subsequent purchase is made, the lien by judicial proceedings is obtained, or the subsequent advance under the prior encumbrance is made or contracted for without knowledge of the security interest and before it is perfected. A purchaser of the real estate at a foreclosure sale other than an encumbrancer purchasing at his own foreclosure sale is a subsequent purchaser within this section.]

(1) In this section and in the provisions of Part 4 of this Article referring to fixture filing, unless the context otherwise requires

(a) goods are "fixtures" when they become so related to particular real estate that an interest in them arises under real estate law

(b) a "fixture filing" is the filing in the office where a mortgage on the real estate would be filed or recorded of a financing statement covering goods which are or are to become fixtures and conforming to the requirements of subsection (5) of Section 9—402

(c) a mortgage is a "construction mortgage" to the extent that it secures an obligation incurred for the construction of an improvement on land including the acquisition cost of the land, if the recorded writing so indicates.

(2) A security interest under this Article may be created in goods which are fixtures or may continue in goods which become fixtures, but no security interest exists under this Article in ordinary building materials incorporated into an improvement on land.

(3) This Article does not prevent creation of an encumbrance upon fixtures pursuant to real estate law.

(4) A perfected security interest in fixtures has priority over the conflicting interest of an encumbrancer or owner of the real estate where

(a) the security interest is a purchase money security interest, the interest of the encumbrancer or owner arises before the goods become fixtures, the security interest is perfected by a fixture filing before the goods become fixtures or within ten days thereafter, and the debtor has an interest of record in the real estate or is in possession of the real estate; or

(b) the security interest is perfected by a fixture filing before the interest of the encumbrancer or owner is of record, the security interest has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner, and the debtor has an interest of record in the real estate or is in possession of the real estate; or

(c) the fixtures are readily removable factory or office machines or readily removable replacements of domestic appliances which are consumer goods, and before the goods become fixtures the security interest is perfected by any method permitted by this Article; or

(d) the conflicting interest is a lien on the real estate obtained by legal or equitable proceedings after the security interest was perfected by any method permitted by this Article.

(5) A security interest in fixtures, whether or not perfected, has priority over the conflicting interest of an encumbrancer or owner of the real estate where

(a) the encumbrancer or owner has consented in writing to the security interest or has disclaimed an interest in the goods as fixtures; or

(b) the debtor has a right to remove the goods as against the encumbrancer or owner. If the debtor's right terminates, the priority of the security interest continues for a reasonable time.

(6) Notwithstanding paragraph (a) of subsection (4) but otherwise subject to subsections (4) and (5), a security interest in fixtures is subordinate to a construction mortgage recorded before the goods become fixtures if the goods become fixtures before the completion of the construction. To the extent that it is given to refinance a construction mortgage, a mortgage has this priority to the same extent as the construction mortgage.

(7) In cases not within the preceding subsections, a security interest in fixtures is subordinate to the conflicting interest of an encumbrancer or owner of the related real estate who is not the debtor.

(8) [(5)] When [under subsections (2) or (3) or (4) a] the secured party has priority over [the claims of all persons who have interests in] all owners and encumbrancers of the real estate, he may, on default, subject to the provisions of Part 5, remove his collateral from the real estate but he must reimburse any encumbrancer or owner of the real estate who is not the debtor and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate security for the performance of this obligation.

Reasons for 1972 Change

As the Code came to be widely enacted, the real estate bar came to realize the impact of the fixture provisions on real estate financing and real estate titles. They apparently had not fully appreciated the impact of these provisions of Article 9 on real estate matters during the enactment of the Code, because of the commonly-held assumption that Article 9 was concerned only with chattel security matters.

The treatment of fixtures in pre-Code law had varied widely from state to state. The treatment in Article 9 was based generally on prior treatment in the Uniform Conditional Sales Act, which, however, had been enacted in only a dozen states. In other states the word "fixture" had come to mean that a former chattel had become real estate for all purposes and that any chattel rights therein were lost. For lawyers trained in such states the Code provisions seemed to be extreme. Some sections of the real estate bar began attempting with some success to have Section 9—313 amended to bring it closer to the pre-Code law in their states. In some states, such as California and Iowa, Section 9—313 simply was not enacted.

Even supporters of Article 9 and of its fixture provisions came to recognize that there were some ambiguities in Section 9—313, particularly in its application to construction mortgages, and also in its failure to make it clear that filing of fixture security interests was to be in real estate records where they could be found by a standard real estate search.

Section 9—313 and related provisions of Part 4 have been redrafted to meet the legitimate criticisms and to make a substantial shift in the law in favor of construction mortgages. The specific changes are described in the 1972 Comments to Section 9—313, and the Comments to the several sections of Part 4.

§ 9—318. Defenses Against Assignee; Modification of Contract After Notification of Assignment; Term Prohibiting Assignment Ineffective; Identification and Proof of Assignment

(1) Unless an account debtor has made an enforceable agreement not to assert defenses or claims arising out of a sale as

provided in Section 9—206 the rights of an assignee are subject to

(a) all the terms of the contract between the account debtor and assignor and any defense or claim arising therefrom; and

(b) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives notification of the assignment.

(2) So far as the right to payment or a part thereof under an assigned contract has not been fully earned by performance, [right has not already become an account,] and notwithstanding notification of the assignment, any modification of or substitution for the contract made in good faith and in accordance with reasonable commercial standards is effective against an assignee unless the account debtor has otherwise agreed but the assignee acquires corresponding rights under the modified or substituted contract. The assignment may provide that such modification or substitution is a breach by the assignor.

(3) The account debtor is authorized to pay the assignor until the account debtor receives notification that the [account] amount due or to become due has been assigned and that payment is to be made to the assignee. A notification which does not reasonably identify the rights assigned is ineffective. If requested by the account debtor, the assignee must seasonably furnish reasonable proof that the assignment has been made and unless he does so the account debtor may pay the assignor.

(4) A term in any contract between an account debtor and an assignor [which] is ineffective if it prohibits assignment of an account [or contract right to which they are parties is ineffective] or prohibits creation of a security interest in a general intangible for money due or to become due or requires the account debtor's consent to such assignment or security interest.

Reasons for 1972 Change

The principal changes conform to the elimination of the term "contract right" in Section 9—106.

Minor changes in subsections (3) and (4) eliminate technical difficulties in the 1962 Code which arose out of the fact that the term "account debtor" used in these subsections is defined to include debtors under general intangibles and chattel paper, and is therefore broader than the term "account" heretofore used in these subsections. Subsection (4) is broadened to apply to general intangibles for money due as well as to accounts.

30-9-401. Place of filing — erroneous filing — removal of collateral. (1) Except for financing statements filed pursuant to 30-9-409, the proper place to file in order to perfect a security interest is as follows:

(a) when the collateral is equipment used in farming operations, or farm products, or accounts[contract rights,] or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the county clerk and recorder in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the county clerk and recorder in the county where the goods are kept. and in addition when the collateral is crops growing or to be grown in the office of the county clerk and recorder in the county where the land [on which the crops are growing or to be grown] is located;

(b) when the collateral is [goods which at the time the security interest attaches are or are to become fixtures] timber to be cut or is minerals or the like (including oil and gas) or accounts subject to subsection (5) of Section 9—103, or when the financing statement is filed as a fixture filing (Section 9—313) and the collateral is goods which are or are to be become fixtures, then in the office where a mortgage on the real estate [concerned] would be filed or recorded;

(c) in all other cases, in the office of the secretary of state.

(2) A filing which is made in good faith in an improper place or not in all of the places required by this section is nevertheless effective with regard to any collateral as to which the filing complied with the requirements of this chapter and is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement.

(3) A filing which is made in the proper place in this state continues effective even though the debtor's residence or place of business or the location of the collateral or its use, whichever controlled the original filing, is thereafter changed.

(4) [If collateral is brought into this state from another jurisdiction, the] The rules stated in Section 9—103 determine whether filing is necessary in this state.

(5) For the purposes of this section, the residence of an organization is its place of business if it has one or its chief executive office if it has more than one place of business.

The several alternatives for subsection (1) have been rewritten to provide for filing in the real estate records of security interests intended to give a priority as a "fixture filing" under Section 9—313.

This requirement for filing in real estate records applies only if the priority advantages of Section 9—313 are desired. If the secured party is not concerned about priority against real estate parties, he can file for a fixture as for an ordinary chattel, in the chattel records, omitting the filing in the real estate records, and he will have a security interest perfected against everyone but real estate parties. In the case of a purchase money security interest in consumer goods, he need not file at all. See Section 9—313(1)(d). For the question of the effect of the regular chattel filing in lieu of fixture filing in the event of the debtor's bankruptcy, see Comment 4(c) to Section 9—313.

This requirement for filing in real estate records applies also to timber to be cut and to minerals or the like (including oil and gas) financed at the wellhead or minehead or accounts resulting from the sale thereof.

This filing is not merely in the *office* where a mortgage of real estate would be recorded, but it is intended that it be filed *in the real estate records*. This is made clear by the model form in Section 9—402(3) which recites that the financing statement is to be filed for record in the real estate records, the required recital in Section 9—402(5), and the provision of Section 9—403(7) requiring the indexing thereof in the real estate records. Thus, it is intended that these filings will be readily disclosed on any real estate search and they can be treated like any real estate encumbrance so disclosed.

There has been some difficulty in the concept that one files against farmers at their residences, in view of the number of incorporated farms. A new subsection (5) is therefore added to define the residence of an organization.

§ 9—402. Formal Requisites of Financing Statement; Amendments; Mortgage as Financing Statement

(1) A financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor [and the secured party], gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral. A financing statement may be filed before a security agreement is made or a security interest otherwise attaches. When the financing statement covers crops growing or to be grown [or goods which are or are to become fixtures], the statement must also contain a description of the real estate concerned. When the financing statement covers timber to be cut or covers minerals or the like (including oil and gas) or accounts subject to subsection (5) of Section 9—103, or when the financing statement is filed as a fixture filing (Section 9—313) and the collateral is goods which are or are to become fixtures, the statement must also comply with subsection (5). A copy of the security agreement is sufficient as a financing statement if it contains the above information and is signed by [both parties.] the debtor. A carbon, photographic or other reproduction of a security agreement or a financing statement is sufficient as a financing statement if the security agreement so provides or if the original has been filed in this state.

(2) A financing statement which otherwise complies with subsection (1) is sufficient [although] when it is signed [only] by the secured party instead of the debtor if it is filed to perfect a security interest in

(a) collateral already subject to a security interest in another jurisdiction when it is brought into this state, or when the debtor's location is changed to this state. Such a financing statement must state that the collateral was brought into this state or that the debtor's location was changed to this state under such circumstances; or

(b) proceeds under Section 9—306 if the security interest in the original collateral was perfected. Such a financing statement must describe the original collateral; or

(c) collateral as to which the filing has lapsed; or

(d) collateral acquired after a change of name, identity or corporate structure of the debtor (subsection (7)).

(3) A form substantially as follows is sufficient to comply with subsection (1):

Name of debtor (or assignor) ....
Address ....
Name of secured party (or assignee) ....
Address ....

1. This financing statement covers the following types (or items) of property:
(Describe) ....

2. (If collateral is crops) The above described crops are growing or are to be grown on:
(Describe Real Estate) ....

[3. (If collateral is goods which are or are to become fixtures) The above described goods are affixed or to be affixed to:
(Describe Real Estate) ....]

3. (If applicable) The above goods are to become fixtures on*

*** Where appropriate substitute either "The above timber is standing on . . . ." or "The above minerals or the like (including oil and gas) or accounts will be financed at the wellhead or minehead of the well or mine located on . . . ."**

(Describe Real Estate) ....
and this financing statement is to be filed [[for record]] in the real estate records. (If the debtor does not have an interest of record) The name of a record owner is ....

4. (If [proceeds or] products of collateral are claimed) [Proceeds—] Products of the collateral are also covered.

(use whichever is applicable)	.... **Signature of Debtor (or Assignor)**
	.... **Signature of Secured Party (or Assignee)**

(4) A financing statement may be amended by filing a writing signed by both the debtor and the secured party. An amendment does not extend the period of effectiveness of a financing statement. [The term "financing statement" as used in this Article means the original financing statement and any amendments but if] If any amendment adds collateral, it is effective as to the added collateral only from the filing date of the amendment. In this Article, unless the context otherwise requires, the term "financing statement" means the original financing statement and any amendments.

(5) A financing statement covering timber to be cut or covering minerals or the like (including oil and gas) or accounts subject to subsection (5) of Section 9—103, or a financing statement filed as a fixture filing (Section 9—313) where the debtor is not a transmitting utility, must show that it covers this type of collateral, must recite that it is to be filed in the real estate records, and the financing statement must contain a description of the real estate sufficient if it were contained in a mortgage of the real estate to give constructive notice of the mortgage under the law of this state . If the debtor does not have an interest of record in the real estate, the financing statement must show the name of a record owner.

(6) A mortgage is effective as a financing statement filed as a fixture filing from the date of its recording if (a) the goods are described in the mortgage by item or type, (b) the goods are or are to become fixtures related to the real estate described in the mortgage, (c) the mortgage complies with the requirements for a financing statement in this section other than a recital that it is to be filed in the real estate records, and (d) the mortgage is duly recorded. No fee with reference to the financing statement is required other than the regular recording and satisfaction fees with respect to the mortgage.

(7) A financing statement sufficiently shows the name of the debtor if it gives the individual, partnership or corporate name of the debtor, whether or not it adds other trade names or the names of partners. Where the debtor so changes his name or in the case of an organization its name, identity or corporate structure that a filed financing statement becomes seriously misleading, the filing is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change, unless a new appropriate financing statement is filed before the expiration of that time. **A filed financing statement remains effective with respect to collateral transferred by the debtor even though the secured party knows of or consents to the transfer.**

<u>(8)</u> [(5)] A financing statement substantially complying <u>with</u> the requirements of this section is effective even though it contains minor errors which are not seriously misleading.

Reasons for 1972 Change

Certain changes are conforming changes to new requirements of Section 9—401 that certain financing statements covering such collateral as timber and minerals be filed in the real estate records. Persons interested in real estate have complained with some justice that the provisions of the 1962 Code failed in several ways to tie the fixture filings to the real estate search system. Among these was the absence of clear specification that the fixture security interest was to be indexed in the real estate records. On this point, a responsive change has been made in Section 9—403. Other objections related to the adequacy of the real estate description and to the fact that the debtor might not be an owner of an interest of record in the real estate. The optional language in subsection (5) is designed to meet the objection as to real estate descriptions but without imposing on a fixture-secured party the duty of obtaining a "legal description" unless the state's recording system requires it. While no doubt a full "legal description" is proper practice in conveyancing, it is believed that something significantly less, like a street address, would be adequate in most states, and would frequently be a guide to a recorded map. Where a state has a tract index system or other special system not dependent on a grantor-grantee index, special adaptations may be required and no attempt is made in the Code to deal with all such situations.

Another objection of real estate parties has been that the name of the debtor might not be in the real estate chain of title and there have been numerous non-uniform amendments to Sections 9—401, 9—402, or 9—403 designed to require the showing of the name of the record owners of the real estate in the financing statement. Since Section 9-313(4) (a) and (b) permit fixture filing against persons in possession of the real estate who do not have interests of record, Section 9—402 requires the naming of an owner of record of the real estate in such cases, and Section 9—403(7) requires indexing the fixture filing against the name.

Subsection (6) makes it possible for a real estate mortgage to serve as a financing statement, and a related change in Section 9—403(6) makes it unnecessary to file continuation statements for such a financing statement.

Subsection (1) has been changed to require only the signature of the debtor rather than that of the secured party. The requirement of signatures of secured parties has sometimes misled secured parties, who are accustomed to pre-Code practice and real estate practice under which only the debtor, not the secured party, need sign such instruments as chattel mortgages and real estate mortgages. Thus, when the security agreement was used as the financing statement, it might have been defective under the 1962 Code for failure to have the signature of the secured party. This change also fits in with the provisions of Section 9—403(6), under which a real estate mortgage (customarily signed only by the debtor) may be effective as a financing statement.

Changes in the form of financing statement in subsection (3) conform to the foregoing and are also intended to have the secured party make clear when a financing statement is intended to be filed in real estate records. This had been a matter of some concern when the parties used the term "fixture" loosely in their description of goods.

Certain of the changes in Section 9—402 are not related to real estate filings. The changes in paragraph (2) (a) conform to Section 9—103(3), which requires refiling when the debtor's location changes. Additions in subsections (2) (d) and (7) relating to the problem of the name of the debtor against which a filing should be made and the effect of transfer are discussed in the related Comments.

§ 9—403. What Constitutes Filing; Duration of Filing; Effect of Lapsed Filing; Duties of Filing Officer

(1) Presentation for filing of a financing statement and tender of the filing fee or acceptance of the statement by the filing officer constitutes filing under this Article.

<u>(2) Except as provided in subsection (6) a</u> [(2) A] filed financing statement [which states a maturity date of the obligation secured of five years or less is effective until such maturity date and thereafter for a period of sixty days. Any other filed financ-

ing statement] is effective for a period of five years from the date of filing. The effectiveness of a filed financing statement lapses [on the expiration of such sixty day period after a stated maturity date or] on the expiration of [such five] the five year period [, as the case may be] unless a continuation statement is filed prior to the lapse. If a security interest perfected by filing exists at the time insolvency proceedings are commenced by or against the debtor, the security interest remains perfected until termination of the insolvency proceedings and thereafter for a period of sixty days or until expiration of the five year period, whichever occurs later. Upon [such] lapse the security interest becomes unperfected, unless it is perfected without filing. If the security interest becomes unperfected upon lapse, it is deemed to have been unperfected as against a person who became a purchaser or lien creditor before lapse. [A filed financing statement which states that the obligation secured is payable on demand is effective for five years from the date of filing.]

(3) A continuation statement may be filed by the secured party [(i) within six months before and sixty days after a stated maturity date of five years or less, and (ii) otherwise] within six months prior to the expiration of the five year period specified in subsection (2). Any such continuation statement must be signed by the secured party, identify the original statement by file number and state that the original statement is still effective. A continuation statement signed by a person other than the secured party of record must be accompanied by a separate written statement of assignment signed by the secured party of record and complying with subsection (2) of Section 9—105, including payment of the required fee. Upon timely filing of the continuation statement, the effectiveness of the original statement is continued for five years after the last date to which the filing was effective whereupon it lapses in the same manner as provided in subsection (2) unless another continuation statement is filed prior to such lapse. Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the original statement. Unless a statute on disposition of public records provides otherwise, the filing officer may remove a lapsed statement from the files and destroy it[.] immediately if he has retained a microfilm or other photographic record, or in other cases after one year after the lapse. The filing officer shall so arrange matters by physical annexation of financing statements to continuation statements or other related filings, or by other means, that if he physically destroys the financing statements of a period more than five years past, those which have been continued by a continuation statement or which are still effective under subsection (6) shall be retained.

(4) Except as provided in subsection (7) a [(4) A] filing officer shall mark each statement with a [consecutive] file number and with the date and hour of filing and shall hold the statement or a microfilm or other photographic copy thereof for public inspection. In addition the filing officer shall index the statements according to the name of the debtor and shall note in the index the file number and the address of the debtor given in the statement.

[(5) Except financing statements filed pursuant to 30-9-409, if the instrument covers crops growing or to be grown or goods which are, or are to become fixtures, or timber, said instrument shall be indexed in accordance with the requirements applicable to the recording of mortgages of real estate under the laws of this state. For the purpose of such indexing, each of the debtor (or assignor) and the record owner or record lessee of any real estate described in the financing statement shall be considered a mortgagor with respect to the financing statement and the secured party (or assignee) shall be considered a mortgagee with respect to the financing statement.]

[(6) If the collateral is equipment or rolling stock of railroads or street railways, the fee for filing, indexing, and furnishing filing data for an original or a continuation statement shall be $15. In all other cases the uniform fee for filing, indexing and furnishing filing data for an original or a continuation statement shall be $2.]

(5) The uniform fee for filing and indexing and for stamping a copy furnished by the secured party to show the date and place of filing for an original financing statement or for a continuation statement shall be $.......... if the statement is in the standard form prescribed by the [[Secretary of State]] and otherwise shall be $......... plus in each case, if the financing statement is subject to subsection (5) of Section 9—102, $......... The uniform fee for each name more than one required to be indexed shall be $........... The secured party may at his option show a trade name for any person and an extra uniform indexing fee of $.......... shall be paid with respect thereto.

(6) If the debtor is a transmitting utility and a filed financing statement so states, it is effective until a termination statement is filed. A real estate mortgage which is effective as a fixture filing under subsection (6) of Section 9—102 remains effective as a fixture filing until the mortgage is released or satisfied of record or its effectiveness otherwise terminates as to the real estate.

(7) When a financing statement covers timber to be cut or covers minerals or the like (including oil and gas) or accounts subject to subsection (5) of Section 9—103, or is filed as a fixture filing, the filing officer shall index it under the names of the debtor and any owner of record shown on the financing statement in the same fashion as if they were the mortgagors in a mortgage of the real estate described, and, to the extent that the law of this state provides for indexing of mortgages under the name of the mortgagee, under the name of the secured party as if he were the mortgagee thereunder, or where indexing is by description in the same fashion as if the financing statement were a mortgage of the real estate de-

Reasons for 1972 Change

The change in subsection (2) makes every financing statement (except those described in subsection (6)), effective for a full five years, thus changing the rule of the 1962 Code that a financing statement which showed a maturity less than 5 years was effective only for the period until maturity plus 60 days. This limitation could have been easily evaded simply by not showing a maturity, even though there was one. The change facilitates renewals or extensions up to a maximum combined duration of five years, without the danger of the financing statement ceasing to be effective.

Subsection (2) also recognizes that financing statements might expire during an insolvency proceeding. While the prevailing line of decisions is to the effect that the situation is frozen at the moment of bankruptcy without an obligation to refile, there are contrary decisions, and this situation might prove an inadvertent trap to a secured party who failed to refile or file a continuation statement during a bankruptcy. The change continues the validity of the financing statement until the end of the insolvency proceedings and for 60 days thereafter, or until the expiration of the five-year period, whichever is later. Ordinarily, if the secured party expects that the secured debt may continue in existence after the end of the insolvency proceedings, he should file a continuation statement on the normal schedule, to preserve the filing for use at the end of the insolvency proceeding and to preclude any discontinuity of the filings.

Subsection (2) also clarifies the effect of lapse, a matter on which there has been some dispute among writers on the subject. Compare also Section 9—103(1) (d).

Subsection (5) is intended to adopt non-uniform amendments made in some states giving the filing officer authority to charge extra fees if the financing statement does not conform to a uniform prescribed size and content. It also permits the secured party to show a trade name at his option and to have it indexed for an extra fee.

New subsection (6) deals with transmitting utilities (Sections 9—105 and 9—401(5)) and also with real estate mortgages which are effective as financing statements under Section 9—402(6). In these special cases a financing statement is good indefinitely and its validity is not limited to five years. The filing in real estate records of a financing statement which is also a real estate mortgage will give notice to persons searching the record as to this continuing validity and will not interfere with the purpose of the Code's standard rule of five-year validity for financing statements. The name of a transmitting utility should give equivalent notice in filings against that kind of company.

The purpose of the standard rule is to permit the files to be self-clearing, so that whether or not termination statements have been filed, the filing officer can clear the files after a suitable period after the five-year validity expires, unless the duration of the financing statement has been continued by a continuation statement.

Various technical changes in this section are designed to facilitate the handling of financing statements by filing officers in reference to the use of microfilm, etc., and to carry out the principle of the self-clearing nature of the files after five years.

New subsection (7) deals with a point in reference to fixtures on which the 1962 Code was properly subject to criticism, namely, that it was not explicitly stated that the fixture filing in the county where a real estate mortgage would be recorded was intended to be made and be indexed in the *real estate records*. This principle is now stated and is also made applicable to timber to be cut and to minerals and the like (including oil and gas) financed at the wellhead or minehead or accounts resulting from the sale thereof.

The other minor changes coordinate with the addition of subsection (7) to Section 9—402.

§ 9—404. Termination Statement

(1) If a financing statement covering consumer goods is filed on or after ...., then within one month or within ten days following written demand by the debtor after there is no outstanding secured obligation and no commitment to make advances, incur obligations or otherwise give value, the secured party must file with each filing officer with whom the financing statement was filed, a termination statement to the effect that he no longer claims a security interest under the financing statement, which shall be identified by file number. In other cases whenever [Whenever] there is no outstanding secured obligation and no commitment to make advances, incur obligations or otherwise give value, the secured party must on written demand by the debtor send the debtor, for each filing officer with whom the financing statement was filed, a termination statement to the effect that he no longer claims a security inter-

est under the financing statement, which shall be identified by file number. A termination statement signed by a person other than the secured party of record must [include or] be accompanied by [the assignment or] a separate written statement of assignment signed by the secured party of record [that he has assigned the security interest to the signer of the termination statement, and] complying with subsection (2) of Section 9—405, including payment of the required fee. [The uniform fee for filing and indexing such an assignment or statement thereof shall be $........] If the affected secured party fails to file such a termination statement as required by this subsection, or to send such a termination statement within ten days after proper demand therefor he shall be liable to the debtor for one hundred dollars, and in addition for any loss caused to the debtor by such failure.

(2) On presentation to the filing officer of such a termination statement he must note it in the index. [The filing officer shall remove from the files, mark "terminated" and send or deliver to the secured party the financing statement and any continuation statement, statement of assignment or statement of release pertaining thereto.] If he has received the termination statement in duplicate, he shall return one copy of the termination statement to the secured party stamped to show the time of receipt thereof. If the filing officer has a microfilm or other photographic record of the financing statement, and of any related continuation statement, statement of assignment and statement of release, he may remove the originals from the files at any time after receipt of the termination statement, or if he has no such record, he may remove them from the files at any time after one year after receipt of the termination statement.

(3) If the termination statement is in the standard form prescribed by the [[Secretary of State]], the uniform fee for filing and indexing [a] the termination statement [including sending or delivering the financing statement] shall be $........, and otherwise shall be $........, plus in each case an additional fee of $........ for each name more than one against which the termination statement is required to be indexed.

Note: *The date to be inserted should be the effective date of the revised Article 9.*

Reasons for 1972 Change

The additions to subsection (1) require the filing of termination statements in the case of consumer goods even without a demand by the consumer. It is believed that consumers will frequently not understand the importance of making demand in order to clear the files. The scope of the change is not as great as might first appear, because (1) filing is not required for purchase money security interests in consumer goods, except in the case of motor vehicles (Section 9—302(1)(d)); and (2) perfection of security interests in most motor vehicles is governed by certificate of title laws, not by the provisions of Article 9.

The other changes are purely formal and tie in with corresponding changes in filing mechanics in other sections.

§ 9—405. Assignment of Security Interest; Duties of Filing Officer; Fees

(1) A financing statement may disclose an assignment of a security interest in the collateral described in the financing statement by indication in the financing statement of the name and address of the assignee or by an assignment itself or a copy thereof on the face or back of the statement. [Either the original secured party or the assignee may sign this statement as the secured party.] On presentation to the filing officer of such a financing statement the filing officer shall mark the same as provided in Section 9—403(4). The uniform fee for filing, indexing and furnishing filing data for a financing statement so indicating an assignment shall be $........ if the statement is in the standard form prescribed by the [[Secretary of State]] and otherwise shall be $........, plus in each case an additional fee of $...... for each name more than one against which the financing statement is required to be indexed.

(2) A secured party may assign of record all or part of his rights under a financing statement by the filing in the place where the original financing statement was filed of a separate written statement of assignment signed by the secured party of record and setting forth the name of the secured party of record and the debtor, the file number and the date of filing of the financing statement and the name and address of the assignee and containing a description of the collateral assigned. A copy of the assignment is sufficient as a separate statement if it complies with the preceding sentence. On presentation to the filing officer of such a separate statement, the filing officer shall mark such separate statement with the date and hour of the filing. He shall note the assignment on the index of the financing statement, or in the case of a fixture filing, or a filing covering timber to be cut, or covering minerals or the like (including oil and gas or ac-

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counts subject to subsection (5) of Section 9—103, he shall index the assignment under the name of the assignor as grantor and, to the extent that the law of this state provides for indexing the assignment of a mortgage under the name of the assignee, he shall index the assignment of the financing statement under the name of the assignee. The uniform fee for filing, indexing and furnishing filing data about such a separate statement of assignment shall be $...... if the statement is in the standard form prescribed by the [[Secretary of State]] and otherwise shall be $......, plus in each case an additional fee of $...... for each name more than one against which the statement of assignment is required to be indexed. Notwithstanding the provisions of this subsection, an assignment of record of a security interest in a fixture contained in a mortgage effective as a fixture filing (subsection (6) of Section 9—402) may be made only by an assignment of the mortgage in the manner provided by the law of this state other than this Act.

(3) After the disclosure or filing of an assignment under this section, the assignee is the secured party of record.

Reasons for 1972 Change

The changes are all conforming changes connecting with changes in mechanics in other sections of Part 4; with the addition of timber and minerals or the like (including oil and gas) at wellhead or minehead and accounts resulting from the sale thereof to the groups of collateral which must be filed and indexed in the real estate records; and with the provision (Section 9—402(6)) that a mortgage of real estate may act as a financing statement of fixtures.

§ 9—406. Release of Collateral; Duties of Filing Officer; Fees

A secured party of record may by his signed statement release all or a part of any collateral described in a filed financing statement. The statement of release is sufficient if it contains a description of the collateral being released, the name and address of the debtor, the name and address of the secured party, and the file number of the financing statement. A statement of release signed by a person other than the secured party of record must be accompanied by a separate written statement of assignment signed by the secured party of record and complying with subsection (2) of Section 9—405, including payment of the required fee. Upon presentation of such a statement of release to the filing officer he shall mark the statement with the hour and date of filing and shall note the same upon the margin of the index of the filing of the financing statement. The uniform fee for filing and noting such a statement of release shall be $...... if the statement is in the standard form prescribed by the [[Secretary of State]] and otherwise shall be $........, plus in each case an additional fee of $........ for each name more than one against which the statement of release is required to be indexed.

Reasons for 1972 Change

The changes are merely conforming changes to changes in other sections.

[[§ 9—407. Information From Filing Officer]]

[[(1) If the person filing any financing statement, termination statement, statement of assignment, or statement of release, furnishes the filing officer a copy thereof, the filing officer shall upon request note upon the copy the file number and date and hour of the filing of the original and deliver or send the copy to such person.]]

[[(2) Upon request of any person, the filing officer shall issue his certificate showing whether there is on file on the date and hour stated therein, any presently effective financing statement naming a particular debtor and any statement of assignment thereof and if there is, giving the date and hour of filing of each such statement and the names and addresses of each secured party therein. The uniform fee for such a certificate shall be $........ [plus $........ for each financing statement and for each statement of assignment reported therein.] if the request for the certificate is in the standard form prescribed by the [[Secretary of State]] and otherwise shall be $........ [plus $........ for each financing statement and for each statement of assignment reported therein.] Upon request the filing officer shall furnish a copy of any filed financing statement or statement of assignment for a uniform fee of $........ per page.]]

Reasons for 1972 Change

The change in this section is merely a conforming change to the changes in other sections.

§ 9—412 Financing Statements Covering Consigned or Leased Goods

A consignor or lessor of goods may file a financing statement using the terms "consignor," "consignee," "lessor," "lessee" or the like instead of the terms specified in Section 9—102. The provisions of this Part shall apply as appropriate to such a financing statement but its filing shall not of itself be a factor in determining whether or not the consignment or lease is intended as security (Section 1—201(37)). However, if it is determined for other reasons that the consignment or lease is so intended, a security interest of the consignor or lessor which attaches to the consigned or leased goods is perfected by such filing.

Reasons for 1972 Adoption of New Section

This new section adapts the filing system of the Article to consignments and leases. Filing of consignments is required under certain conditions (Sections 2—326(3), 9—114). Filing of true leases which are not security interests (Section 1—201(37)) is not required; but because the question whether a lease is a true lease may be a close one, filing is permitted for leases.

PART 5

DEFAULT

§ 9—501. Default; Procedure When Security Agreement Covers Both Real and Personal Property

(1) When a debtor is in default under a security agreement, a secured party has the rights and remedies provided in this Part and except as limited by subsection (3) those provided in the security agreement. He may reduce his claim to judgment, foreclose or otherwise enforce the security interest by any available judicial procedure. If the collateral is documents the secured party may proceed either as to the documents or as to the goods covered thereby. A secured party in possession has the rights,

remedies and duties provided in Section 9—207. The rights and remedies referred to in this subsection are cumulative.

(2) After default, the debtor has the rights and remedies provided in this Part, those provided in the security agreement and those provided in Section 9—207.

(3) To the extent that they give rights to the debtor and impose duties on the secured party, the rules stated in the subsections referred to below may not be waived or varied except as provided with respect to compulsory disposition of collateral (subsection (3) of Section 9—504 and [(subsection (1) of] Section 9—505) and with respect to redemption of collateral (Section 9—506) but the parties may by agreement determine the **standards by which the fulfillment of these rights and duties is to be measured if such standards are not manifestly unreasonable:**

(a) subsection (2) of Section 9—502 and subsection (2) of Section 9—504 insofar as they require accounting for surplus proceeds of collateral;

(b) subsection (3) of Section 9—504 and subsection (1) of Section 9—505 which deal with disposition of collateral;

(c) subsection (2) of Section 9—505 which deals with acceptance of collateral as discharge of obligation;

(d) Section 9—506 which deals with redemption of collateral; and

(e) subsection (1) of Section 9—507 which deals with the secured party's liability for failure to comply with this Part.

(4) If the security agreement covers both real and personal property, the secured party may proceed under this Part as to the personal property or he may proceed as to both the real and the personal property in accordance with his rights and remedies in respect of the real property in which case the provisions of this Part do not apply.

(5) When a secured party has reduced his claim to judgment the lien of any levy which may be made upon his collateral by virtue of any execution based upon the judgment shall relate back to the date of the perfection of the security interest in such collateral. A judicial sale, pursuant to such execution, is a foreclosure of the security interest by judicial procedure within the meaning of this section, and the secured party may purchase at **the sale and thereafter hold the collateral free of any other requirements of this Article.**

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Reasons for 1972 Change

The change is purely technical, to clear up an ambiguity as to whether a debtor could after default agree on the time within which a sale might be held or the time after which a secured party might keep the goods in lieu of a sale.

§ 9—502. Collection Rights of Secured Party

(1) When so agreed and in any event on default the secured party is entitled to notify an account debtor or the obligor on an instrument to make payment to him whether or not the assignor was theretofore making collections on the collateral, and also to take control of any proceeds to which he is entitled under Section 9—306.

(2) A secured party who by agreement is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor and who undertakes to collect from the account debtors or obligors must proceed in a commercially reasonable manner and may deduct his reasonable expenses of realization from the collections. If the security agreement secures an indebtedness, the secured party must account to the debtor for any surplus, and unless otherwise agreed, the debtor is liable for any deficiency. **But, if the underlying transaction was a sale of accounts [, contract rights,] or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency only if the security agreement so provides.**

Reasons for 1972 Change

The change is only the deletion of the term "contract rights", which is being eliminated as a defined term under the Article.

§ 9—504. Secured Party's Right to Dispose of Collateral After Default; Effect of Disposition

(1) A secured party after default may sell, lease or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing. Any sale of goods is subject to the Article on Sales (Article 2). **The proceeds of disposition shall be applied in the order following to**

(a) the reasonable expenses of retaking, holding, preparing for sale <u>or lease,</u> selling, <u>leasing</u> and the like and, to the

extent provided for in the agreement and not prohibited by law, the reasonable attorneys' fees and legal expenses incurred by the secured party;

(b) the satisfaction of indebtedness secured by the security interest under which the disposition is made;

(c) the satisfaction of indebtedness secured by any subordinate security interest in the collateral if written notification of demand therefor is received before distribution of the proceeds is completed. If requested by the secured party, the holder of a subordinate security interest must seasonably furnish reasonable proof of his interest, and unless he does so, the secured party need not comply with his demand.

(2) If the security interest secures an indebtedness, the secured party must account to the debtor for any surplus, and, unless otherwise agreed, the debtor is liable for any deficiency. But if the underlying transaction was a sale of accounts [, contract rights,] or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency only if the security agreement so provides.

(3) Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable. Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, <u>if he has not signed after default a statement renouncing or modifying his right to notification of sale. In the case of consumer goods no other notification need be sent. In other cases notification shall be sent to any other secured party from whom the secured party has received (before sending his notification to the debtor or before the debtor's renunciation of his rights) written notice of a claim of an interest in the collateral</u> **[and except in the case of consumer goods to any other person who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this state or who is known by the secured party to have a security interest in the collateral]. The secured party may buy at any public sale and if the collateral**

is of a type customarily sold in a recognized market or is of a type which is the subject of widely distributed standard price quotations he may buy at private sale.

(4) When collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor's rights therein, discharges the security interest under which it is made and any security interest or lien subordinate thereto. The purchaser takes free of all such rights and interests **even though the secured party fails to comply with the requirements of this Part or of any judicial proceedings**

(a) in the case of a public sale, if the purchaser has no knowledge of any defects in the sale and if he does **not** buy in collusion with the secured party, other bidders or the person conducting the sale; or

(b) in any other case, if the purchaser acts in good faith.

(5) A person who is liable to a secured party under a guaranty, indorsement, repurchase agreement or the like and who **receives** a transfer of collateral from the secured party or is subrogated to his rights has thereafter the rights and duties of the **secured party**. Such a transfer of collateral is not a sale or **disposition** of the collateral under this Article.

Reasons for 1972 Change

Under the 1962 Code the secured party giving notice of sale had to notify (except in the case of consumer goods) not only every other person who had duly filed a financing statement indexed in the name of the debtor in the state and who still had a security interest in the collateral, but also any other person known by the secured party to have an interest in the collateral. This meant that the secured party had to search the records in every case of notice of sale, to ascertain whether there were any other secured parties with financing statements that might be deemed to cover the collateral in question. Moreover, he ran the risk that some informal communication by letter, or even orally, might be deemed to have given him knowledge of the interest of that other party. These burdens of searching the record and of checking the secured party's files were greater than the circumstances called for because as a practical matter there would seldom be a junior secured party who really had an interest needing protection in the case of a foreclosure sale. Therefore, a change is made requiring notice to persons other than the debtor only if such persons had notified the secured party in writing of their claim of an interest in the collateral before

he sent his notification to the debtor or before the debtor's renunciation of his rights. Express provision is made to recognize the right of a debtor to renounce or modify his right to notice after, but not before, default. A corresponding change is made in Section 9—505.

§ 9—505. Compulsory Disposition of Collateral; Acceptance of the Collateral as Discharge of Obligation

(1) If the debtor has paid sixty per cent of the cash price in the case of a purchase money security interest in consumer goods or sixty per cent of the loan in the case of another security interest in consumer goods, and has not signed after default a statement renouncing or modifying his rights under this Part a secured party who has taken possession of collateral must dispose of it under Section 9—504 and if he fails to do so within ninety days after he takes possession the debtor at his option may recover in conversion or under Section 9—507(1) on secured party's liability.

(2) In any other case involving consumer goods or any other collateral a secured party in possession may, after default, propose to retain the collateral in satisfaction of the obligation. Written notice of such proposal shall be sent to the debtor [and except in the case of consumer goods to any other secured party who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this state or is known by the secured party in possession to have a security interest in it. If the debtor or other person entitled to receive notification objects in writing within thirty days from the receipt of the notification or if any other secured party objects in writing thirty days after the secured party obtains possession the secured party must dispose of the collateral under Section 9—504.] if he has not signed after default a statement renouncing or modifying his rights under this subsection. In the case of consumer goods no other notice need be given. In other cases notice shall be sent to any other secured party from whom the secured party has received (before sending his notice to the debtor or before the debtor's renunciation of his rights) written notice of a claim of an interest in the collateral. If the secured party receives objection in writing from a person entitled to receive notification within twenty-one days after the notice was sent, the secured party must dispose of the collateral under Section 9—504. **In the absence of such written objection the se-**

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cured party may retain the collateral in satisfaction of the debtor's obligation.

Reasons for 1972 Change

Under subsection (2) of this section the secured party may in lieu of sale give notice to the debtor and certain other persons that he proposes to retain the collateral in lieu of sale. Under the 1962 Code the other persons were the same as those who were entitled to notice of sale under Section 9—504(3), and such other persons are limited by the change in the same fashion as they were limited in Section 9—504(3) and for the same reasons. See the Reasons for Change under Section 9—504.

DEPARTMENT OF INSTITUTIONS

TED SCHWINDEN, GOVERNOR

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STATE OF MONTANA

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Exhibit B
3-21-83
SB 394

March 21, 1983

Representative Dave Brown
Chairman
House Standing Committee on the
Judiciary, House of Representatives
State Capitol
Helena, Montana 59602

Dear Representative Brown: DAVE

Apparently your committee has already taken executive action on SB 394 and that it be reported out with a "do pass" recommendation. That is unfortunate. Since, however, an alternative method of execution with our warden now responsible for the process, appears to be the preference of both houses, there is a procedural problem which needs to be corrected prior to taking an further action on the bill.

I would recommend that the bill be reconsidered and amended and specifically that lines 15, 16 and 17 on page 8 of the bill be deleted in their entirety.

The reason for this is summarized in the following:

1. To require a pharmacist to dispense without a prescription, a schedule II, controled substance, such as sodium pentothal, compromises the pharmacist with statutes in the Pharmacy Practices Act of this State, but more importantly, would place him in direct violation of federal law that guides the handling of controlled substances.

2. It would be difficult, in fact - almost impossible, to find a physician licensed in this state to write a prescription for sodium pentothal for purposes of execution. I would speculate they would resist on the basis that any involvement, even remote, would violate their code of ethics and the oath that they take to sustain life.

3. There is, however, a solution. I have consulted with the Compliance Office of the Department of Justice, Drug Enforcement Administration in Seattle. They recommend that we not tamper with the Pharmacy Practices Act as the bill suggests, but that we apply for and secure approval for a license to procure and use this schedule II substance as a "research" entity sanctioned by the Drug Enforcement Administration. This would allow the Warden to procure directly from the manufacturer, a supply of sodium pentothal in injectable form and in appropriate dosages. It would also allow the Warden to "dispense" or hand over to the executioner a quantity of sodium pentothal for the purposes of execution. The executioner is authorized by law to administer such drugs for the purposes of an execution by a lethal injection and therefore does not require a license. This would not involve or compromise any licensed practitioner in the state of Montana, principally doctors, and would not compromise or involve a licensed pharmacist operating under State law. As far as we can tell this is the most workable method to handle this very delicate situation.

4. The two chemical paralytic agents that would have to be used to insure death would more than likely be [following upon the recommendations from the Texas Corrections Department] (1) pancuronium bromide - a skelital muscle relaxant that suppresses the respiratory system, (2) potassium chloride, which would arrest the heart and circulatory system. These substances are referred to as legend drugs but fall under the jurisdiction of the Food and Drug Administration. The Food and Drug Administration prohibits their dispensation without a prescription. However, we can work with our physicians or through the Board of Pharmacy to secure a supply of these substances through a pharmaceutical outlet on a doctor's order. This would not be the same as a prescription for a schedule II substance. The doctor would simply order for us, on behalf of the Warden, a sufficient supply of these substances to store for our use at Montana State Prison. The use, procurement, and the control of legend drugs such as described above, does not get us involved in the very delicate control requirements of a schedule II substance.

If we follow these procedures, it looks as if we can accomplish what is intended by the legislature without creating ethical and legal problems for our pharmacists and physicians.

We offer these suggestions as an aid to you and your committee, in view of the fact that we will ultimately become responsible for the business of executing death row inmates, and therefore would want the statutory provisions which authorizes executions to be workable and free of complications.

Respectfully yours,

CURT CHISHOLM
Deputy Director
Department of Institutions

CC:sd

cc: Warden Henry Risley
Gene Huntington
Senator Bob Brown