SB

88

HOUSE COMMITTEE REPORT

(7)
Date Referred: March 23, 1990 FURTHER REFERRALS:

Date of Committee Action: 4-25-90

The JUDICIARY Committee considered: SB 88

SENATE BILL NO. 88 UCC - INVESTMENT SECURITIES

"An Act relating to investment securities under the Uniform Commercial Code."

RECOMMENDATIONS:
[ ] be replaced with _____ [ ] the same title [ ] a new title
[ ] have attached amendment(s)
[ ] do pass
[ ] do not pass
[X] no recommendation
[X] individual recommendations
[ ] additional referral to the _____ Committee

ADOPTS: _____ letter of intent

ATTACHES NEW FISCAL NOTE(s): (Dept)
[ ] fiscal impact _____
[ ] zero fiscal note _____
[ ] zero with analysis _____

APPROVES PREVIOUS: (Date/Dept)
[ ] fiscal note(s) _____
[ ] zero fiscal note(s) _____
[X] zero fn/analysis LAW 3/23/90

SIGNING DO PASS:

Gruenberg
martin
Ellis

SIGNING: (Check approp. column)

	Do Not Pass	No Rec	Amend
Goll		X	
Miller		X	
Davis		X	

Chairman's Signature

HOUSE COMMITTEE REPORT

(7)
Date Referred: January 17, 1990 FURTHER REFERRALS: JUDICIARY

Date of Committee Action: 3/20/90

The LABOR & COMMERCE Committee considered: SB 88

SENATE BILL NO. 88 UCC - INVESTMENT SECURITIES

"An Act relating to investment securities under the Uniform Commercial Code."

RECOMMENDATIONS:
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[✓] no recommendation
[ ] individual recommendations
[ ] additional referral to the ______________ Committee

ADOPTS: ______________ letter of intent

ATTACHES NEW FISCAL NOTE(s): (Dept)
[ ] fiscal impact ______________
2 [✓] zero fiscal note Dept. Revenue, Natural Resources
[✓] zero with analysis Dept of Law

APPROVES PREVIOUS: (Date/Dept)
[ ] fiscal note(s) ______________
[ ] zero fiscal note(s) ______________
[ ] zero fn/analysis ______________

SIGNING DO PASS:
(signature) Boyer
(signature) Greenberg
(signature) Leman

SIGNING: (Check approp. column)

	Do Not Pass	No Rec	Amend
(signature) Donley		✓	
(signature) Finkelstein		✓	
(signature) Bowker		✓	
(signature) Collins		✓	

(signature)
Chairman's Signature

Federal Preemption Remains a Serious Threat to the UCC

Article 8 of the Uniform Commercial Code once again faces a serious threat from the Federal Government. The Market Reform Act of 1989, which has been proposed to the U.S. Congress jointly by the Securities and Exchange Commission (SEC) and the Treasury Department, would, if enacted, amend the Securities Exchange Act of 1934 and preempt an undetermined portion of Article 8 and affect Article 9 as well.

The Market Reform Act (Senate Bill 648) will most likely move to the floor sometime in the coming year. The bill has four principal provisions dealing with: large stock and options trader reporting; risk assessment for holding company systems of securities firms; coordinated clearing and settlement of securities transactions, including federal preemption of UCC Article 8; and emergency market trading suspensions.

The threat of preemption actually started with the stock market crash of October 1987. The huge market movements that occurred created margin and other settlement obligations within the stock, option, and futures markets that involved extremely large cash payments. Because many of the participants in each of these markets also participate in other markets, the size of these cash flows were larger than would have been required if clearance and settlement of products in these markets were coordinated. The tremendous cash flows necessitated by the lack of coordinated settlements placed great strains on our nation's payment systems, and deprived the trading markets of liquidity at a time when it was most needed.

Several reports noted this problem and suggested that improvements in clearance and settlement, and specifically increased intermarket coordination, are among the important reforms needed. The SEC report cites the lack of uniformity between the states in the area of transfers and pledges of uncertificated securities as a contributing factor. The report specifically notes that not all the states have adopted the Article 8 Amendments to the UCC.

Section 17A(f)(1) of the Securities Exchange Act, as amended, would authorize the SEC to promulgate rules concerning the transfer and pledge of certificated and uncertificated securities. Paragraph (f)(1) would authorize the SEC to preempt state commercial laws (such as Article 8 of the Uniform Commercial Code) governing transfer and pledge of securities, but only upon making three affirmative findings: (1) that the rule is necessary or appropriate for the protection of investors or in the public interest and is reasonably designed to promote the prompt, accurate, and safe clearance and settlement of securities transactions; (2) that in the absence of a uniform rule, the safe and efficient operation of the national system for clearance and settlement of securities transactions will be, or is, substantially impeded (for example due to the lack of scope or inconsistent standards of such state laws); and (3) that to the extent such rule will impair or diminish directly or indirectly rights of investors under state law concerning transfers of securities, that the benefits of such rule exceed the detriment to investors.

Obviously this is a serious threat to Article 8 of the UCC. The Article 8 Amendments have still not been adopted in ten states and the District of Columbia. Five states picked up the legislation in 1989, but this is not enough. The only sure way to stop federal preemption is to complete adoptions of UCC-8 everywhere.

The Market Reform Act of 1989 is likely to go to the floor for discussion early in the new year. With 11 jurisdictions still without Article 8, federal preemption is a real possibility, but one that can certainly be avoided with prompt action on our part.

To maintain the UCC as the preeminent work of the Conference will require diligent effort on all our parts. Changes in business practices and technological developments have assured changes in the UCC. It must evolve as business practices do. Commissioners cannot be slow in pressing for adoption of UCC amendments as they are completed.

ASCC

ALASKA STATE CHAMBER OF COMMERCE
310 Second Street
Juneau, Alaska 99801
(907) 586-2323

April 13, 1989

Department of Law

APR 14 1989

AM
7 8 9 10 11 12 1 2 3 4 5 6

Arthur H. Peterson, Esquire
Assistant Attorney General
Department of Law
State of Alaska
P. O. Box K
Juneau, Alaska 99811-0300

Re: SB 88 and HB 67

Dear Art:

This responds to your letter of March 9, 1989 concerning the views of the Alaska State Chamber of Commerce on the referenced proposed legislation.

As a general proposition, we endorse uniform state laws, therefore, we are sympathetic to the purposes intended to be served by each of these measures. Further, we note with some interest that the new Corporations Code will take effect July 1, 1989 and that pending amendments to that new code will incorporate the concept of "certificateless securities" into the law; therefore, the amendment to the Uniform Commercial Code proposed by SB 88 is conceptually consistent with other developments in this area. (There is a difference in the terminology, SB 88 using the term "uncertificated securities", but we presume that minor point can be readily resolved.)

We also regard it as notable that the amendments suggested by SB 88 have been adopted by 35 other jurisdictions, including states which our courts regularly look to in considering interpretations of the law. A network of uniform solutions to commercial problems nationwide will help to maintain a sense of certainty in business dealings which can, in the long run, only promote commercial development and prosperity.

For these reasons, the Alaska State Chamber of Commerce endorses SB 88 as introduced on January 9, 1989 by request of the Governor, on the understanding that the terminology will be harmonized with SB 204.

We are much more concerned with HB 67 dealing with leases of personal property under the Uniform Commercial Code, because, unlike SB 88, HB 67 has been adopted by only one

state, and despite the obvious hope that it will ultimately be embraced by the rest of the nation, that has not happened yet. The basis for this concern, of course, is that as the draft legislation is considered by other states, deficiencies in the law may be discovered which are not apparent at this time, with the result that either the Alaska Statute is not uniform with that adopted by other jurisdictions, or that it is deceptively similar, inducing an unjustified reliance on a presumption of consistency.

There is no prize for being the first to adopt a proposed uniform state law. In fact, it is well known that many such proposed uniform acts take many years to be adopted, and in some cases, it simply doesn't happen. In a similar vein, it is unlikely in the extreme that any state would be so impressed with Alaska's decision that it would blindly follow our lead. Prudence dictates patience in this case.

Finally, although the leasing of personal property is a common activity in Alaska, as elsewhere, we are not aware of any unusual problems associated with this sort of lease which cannot be adequately addressed under existing provisions of law. The primary value of this act, therefore, is that it would make Alaska law consistent with the laws in other states, which, of course, this bill would not do at this time.

Accordingly, the Alaska State Chamber of Commerce does not support adoption of HB 67 now; however, we would be willing to reconsider our position at some future date when these provisions have been incorporated into the legal framework of a significant number of other jurisdictions.

We appreciate the opportunity to comment on these measures, and hope that our comments have been helpful to you.

Sincerely,

J. P. Tangen,
Legislative Co-Chairman

cc: George Krusz

0412ascc

MEMORANDUM

State of Alaska
Department of Law

TO: Andy Hemenway
Staff Assistant
Representative Max
Gruenberg's Office

DATE: March 6, 1989

FILE NO.: 773-89-0062

TEL. NO.: 465-3600

SUBJECT: Senate Bill 88 (UCC, Investment Securities)

FROM: Arthur H. Peterson
Assistant Attorney General
Department of Law

In response to your question last Friday, regarding possible problems having developed with regard to the 1977 UCC article 8 amendments, I phoned John McCabe, General Counsel and Legislative Director for the National Conference of Commissioners on Uniform State Laws. He indicated that there has been virtually no litigation under article 8, certainly not with regard to the 1977 amendments. He is not aware of any problems that have arisen in any of the 35 states that have enacted those amendments. He did mention an early Harvard Law Journal article, by a Peter Coogan, criticizing the article 8 amendments with regard to their relationship to article 9 on secured transactions. That article was then answered in another article, by Robert Haydock and Martin Aronstein, and, I gather, the point has not been pursued and the article 8 amendments have not proven troublesome in connection with article 9.

I hope that this information is of some help to you and the legislature. Thanks for your help in the effort to bring article 8 up-to-date.

AP:prm

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

STEVE COWPER, GOVERNOR

P.O. BOX K—STATE CAPITOL
JUNEAU, ALASKA 99811-0300
PHONE: (907) 465-3600

October 11, 1988

M E M O R A N D U M

TO: Honorable Steve Cowper
Governor

FROM: Arthur H. Peterson for Grace Berg Schaible
Attorney General

RE: Attached draft bill on investment securities under the Uniform Commercial Code
Our file: 773-89-0062

Attached is a draft bill, requested by this department, to enact the 1977 amendments to Article 8 (investment securities) of the Uniform Commercial Code (AS 45.08 in Alaska's version). This is one of two major steps offered this year for updating Alaska's Uniform Commercial Code (UCC), the other being our file 773-89-0061 to enact the new Article 2A on leasing.

As originally written, Article 8 of the UCC deals with investment securities in a way that relies on pieces of paper to represent those securities. The new Article 8 contemplates the elimination of the paper. These amendments, already enacted in 35 states, are essential to recognize modern financial transactions.

Also attached are a draft transmittal letter to the legislature and materials mentioned in it.

When you have approved this draft, please let us know, and we will prepare the bill for introduction. Into which house would you prefer to have it introduced?

GBS:AHP:cb

Minimum Distribution by Governor's Office:

Honorable Larry Merculieff, Acting Commissioner, DCED
Honorable Hugh Malone, Commissioner, DOR
David A. Rose, Executive Director
Alaska Permanent Fund Corporation
Alison Elgee, Director
Division of Budget Review
Mary Halloran, Director
Division of Policy
Office of Management and Budget

D R A F T

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill to enact the 1977 amendments to Article 8 of the Uniform Commercial Code, on investment securities. These amendments were developed by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in cooperation with the American Law Institute and the American Bar Association. These amendments, already enacted in 35 states, are essential to update Alaska's version of the Uniform Commercial Code (UCC) and recognize modern methods and necessities of financial transactions.

The basic change proposed in this 58-page bill is the introduction of the concept of uncertificated securities. In other words, the new Article 8 (AS 45.08 in Alaska's version of the UCC) contemplates the elimination of the paper (i.e. "instrument") that identifies the obligation that the security manifests. The term "instrument" will no longer imply the existence of specific pieces of paper that act as evidence of obligations between people. There are many reasons for this, as explained in the material I am attaching to this letter, as furnished by the National Conference of Commissioners on Uniform State Laws. You will find the following attached: a fact sheet for these Article 8 amendments, a four-page summary of the amendments, a two-page item labeled "Why Every State Needs The Article 8 Amendments -- Now!", four pages of questions and answers on the amendments, and a 1985 endorsement of the amendments by the Securities Industry

Committee of the American Society of Corporate Secretaries. In addition to that material, my staff will make available to the legislature the pamphlets containing the 1977 amendments, published in 1978 by West Publishing Company, including the official commentary by the NCCUSL, and a 1976 article by Martin J. Aronstein, entitled "A Certificateless Article 8? We Can Have It Both Ways," from the American Bar Association's The Business Lawyer.

It is necessary to maintain Alaska's version of the Uniform Commercial Code as up to date as possible. This bill is one of the ones I am proposing to do just that.

Sincerely,

Steve Cowper
Governor

A Few Facts About

THE ARTICLE 8 AMENDMENTS TO THE UNIFORM COMMERCIAL CODE

PURPOSE: To provide states with a legal framework for the transfer of uncertificated securities, similar to the rules for certificates found in the original Article 8.

ORIGIN: Completed by the Uniform Law Commissioners in 1977, in cooperation with the American Bar Association and the American Law Institute.

ENDORSED BY: New York Stock Exchange
Securities Industry Association
American Society of Corporate Secretaries

STATE ADOPTIONS:

Arkansas	Kentucky	Ohio
California	Maine*	Oklahoma
Colorado	Maryland	Oregon
Connecticut	Massachusetts	Rhode Island*
Delaware	Michigan	South Dakota*
Florida	Minnesota	Tennessee
Hawaii	Montana	Texas
Idaho	Nevada	Virginia
Illinois*	New Hampshire	Washington
Indiana	New Mexico	West Virginia
Kansas	New York	Wisconsin
	North Dakota	Wyoming

1988 INTRODUCTIONS: District of Columbia
New Jersey

NEED A SPEAKER? These persons are avaible to provide testimony or give presentations on the Article 8 Amendments:

Martin J. Aronstein Univ. of Pennsylvania Permanent Editorial Board for the UCC	Robert Haydock Boston, Mass. Permanent Editorial Board for the UCC
William E. Hogan New York University Permanent Editorial Board for the UCC	Donald Scott Philadelphia, PA Permanent Editorial Board for the UCC

For information on arranging a speaker, contact John McCabe or Katie Robinson at 312-915-0195.

* 1988 Adoptions

ARTICLE 8 AMENDMENTS TO THE

UNIFORM COMMERCIAL CODE

Article 8 of the Uniform Commercial Code is entitled "Investment Securities." A "security" is broadly defined as an instrument which:

(1) is issued in bearer or registered form;

(2) 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;

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

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

The commonest examples are stocks and bonds. They have a market and are bought and sold, as are "goods" under Article 2 of the UCC, and negotiable instruments under Article 3. The UCC sought to cover all the major kinds of markets in its conception of "commercial transactions." Thus, Article 8 provided a fundamental law for the buying and selling of securities.

Note, however, one aspect of this basic definition. It states that a security is an "instrument." It implies a piece of paper with appropriate writing to identify the obligation the security manifests. Therein lies the kernel for the present revision - paper. The new Article 8 contemplates the elimination of the paper. The term instrument will no longer imply the existence of specific pieces of paper which act as evidence of obligations between people.

There are a number of reasons for this anti-paper revolution. In the late 1960s, the brokers and the exchanges became overburdened with paper. The sheer load hampered the markets. Also, automation has progressed far enough to make the revolution feasible. It is easier and faster to record transfers in the computer. It is efficient and more economical. Thus, the nature of the transactions in securities is fundamentally changing.

Under the revised Article 8, an immediate distinction is made between types of securities. There are "certificated" securities and "uncertificated" securities. The "certificated" security is the one we have long known, represented on and by a piece of paper, an instrument. That piece of paper has been, and remains, the means of transfer and the evidence of obligation - when it exists. But it no longer always exists.

The "uncertificated" security is not evidenced by any piece of paper at all. It exists on its issuer's records. Its key characteristics are found in the definition. It "is not represented by an instrument and the transfer of which is registered upon books maintained for the purpose by or on behalf of the issuer.. ." Without the instrument, the mechanics of a transfer change. Also changed are the manners in which obligations are manifested.

Where there is a certificate, it physically participates in any transfer of the obligations it contains. A security passes upon proper endorsement and physical delivery of the instrument. The instrument takes part in pledges made by owners of the security to secure their own debts. It is also the foundation of the warranties each of the parties gives in a transaction involving a security. The paper is fundamental, and when it is eliminated, some changes commensurate with its elimination must take place.

When a transfer, or registration of a pledge, occurs in the case of an "uncertificated" security, it does so only on the books of the issuer. This means that an "instruction" must be given to the issuer by the appropriate person. The "instruction" normally will be in writing, and obligates the issuer to make the necessary entry on the books. The evidence of completion is a statement back from the issuer within two business days after the registration occurs. It goes to transferror, transferee, and any pledgee.

These two items are the only pieces of paper involved in the transfer, and are designed to be much simpler than the "certificated" security. The last of the two, the "Initial Transaction Statement," is the most important. It provides notice of terms, restrictions, and adverse claims to the addressee, and runs against the issuer if it does not. This is a similar function to the written instrument which constitutes a "certificated" security. The rights of purchasers which depend on this information are affected almost exactly as a purchaser's rights are affected by a "certificated" security.

There are differences, however. A purchaser of an "uncertificated" security, in general, can rise no higher than his transferror in terms of his rights. He takes as if he had his transferror's knowledge, even if he doesn't. A "certificated" security does not hold a purchaser to the knowledge of his transferror, but bases his rights on his own

knowledge. That is a distinct difference between the two forms of security.

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

It is perhaps anomalous to think of security interests in a security, which itself may represent a debt of the issuer. People who own securities, which are valuable property, may pledge them for their debts. They create a security interest in the creditor by so doing.

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

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

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

Signature guarantees, an essential part of the transfer process for widely held securities, also cannot be the same for "certificated" and "uncertificated" securities. The guarantor of

WHY EVERY STATE NEEDS THE ARTICLE 8 AMENDMENTS -- NOW!

In each of the 50 states, the trading of corporate securities, typically stocks and bonds, is governed by transfer rules found in Article 8 of the Uniform Commercial Code.

The transfer system established by the original Article 8 is based on the "certificate"; transfer takes place when the certificate is endorsed and delivered by one party to another. The original Article 8 provides:

- Rules for endorsement and delivery of the certificate;
- "Warranties of transfer", or guarantees of the transfer's validity;
- Rules for the use of securities to secure debts.

While the certificated system still dominates securities transfers, electronic transfers may ultimately make the certificate obsolete. The 1977 Amendments to Article 8 were therefore drafted to establish regulations for the newer system that is evolving -- one which eliminates certificates and instead accomplishes transfers by entry on the issue books and appropriate notices to the parties involved.

The Amendments include the same features as the original Article 8, with the important exception of the certificate requirements, and have been carefully integrated into the older Article. They parallel the legal framework the original Article 8 established for certificates, and give priority in the law to neither system of transfer.

But the practical advantages of an uncertificated system are clear: they allow issuers to take advantage of the efficiency and speed of computer technology that can eliminate the sea of paper that afflicts the securities market.

A majority of states have already recognized the need to adopt the Amendments. They include New York, the nation's trading capitol; Delaware, the state of incorporation for large businesses across the country, and most recently Massachusetts. In states which do not adopt the amendments:

- Traders will be less equipped to do business with uncertificated companies.

(over)

QUESTIONS AND ANSWERS ON THE 1977 AMENDMENTS TO ARTICLE 8 OF THE UNIFORM COMMERCIAL CODE

Q: What do the 1977 Amendments to the Uniform Commercial Code (UCC) provide?

A: They permit entities creating investment securities (stocks and bonds are the commonest examples) to issue "uncertificated" securities. This kind of security would not be represented by a "certificate" and would not be transferred by passing a certificate from one person to another. Transfer would take place when the issuer creating the security records the transfer on its books.

Q: How does such a transfer take place?

A: In most instances transfers of uncertificated securities will require computerized records and electronic communications systems. In small corporations that have limited numbers of stockholders and are not publicly traded, uncertificated securities might be created without these technical advances. Under the Amendments, a transfer of any kind follows this basic sequence:

1. The current owner (transferor) of the uncertificated security sends an instruction to the issuer to record a transfer to another person (transferee). The instruction must be in the form required by the issuer.

2. The issuer records the transfer on its records.

3. The issuer returns an identical document to both the transferor and transferee confirming the transfer. This document, called an Initial Transaction Statement (ITS), must be returned within two days after the receipt of instruction. Receipt of the ITS assures that the transaction is complete.

Q: How are uncertificated securities pledged as collateral for a debt?

A: A pledge is a type of transfer under the Amendments. It requires the same sequence as any other transfer, such as a sale or a gift, except that the effect is to preserve on the issuer's books the rights of the creditor in the securities as collateral. A pledge can be recorded in two ways. The creditor can be shown on the issuer's records as the owner of the securities, as collateral for the debt. The pledge, itself, can also be recorded without an actual transfer of ownership, In either case, the creditor's

There are issuers, such as mutual funds, that have never made certificates available - their customers do not expect what has never been offered. Most investors who deal through brokers maintain accounts and never see certificates, even though the large bulk of stocks and bonds are currentl certificated. The majority of investors don't expect certificates anymore, and it is likely that the demand will be rare, though they will be available.

Q: Aren't computerized records and electronic transfers more open to fraud and deception than certificated transfers?

A: Securities are valuable property and targets of the unscrupulous and dishonest. Certificates are stolen, signatures are forged; paper may be counterfeited, even after the most elaborate precautions. In short, there are risks inherent for certificated securities, and issuers, financial institutions, brokers, and investors have to take precautions to protect rights represented by certificates. The UCC was never concerned with these problems, except to establish certain basic liabilities. The practices of the securities industry, bolstered by the establishment of these liabilities. The practices of the securities industry, the criminal law, have been primarily responsible for protecting these valuable interests. The system has worked very well, though never perfectly.

The Amendments treat uncertificated securities the same way the UCC has treated certificated securities. Certain basic liabilities are established, but the practices of the securities industry, backed by the criminal law, is the primary defense against fraud and deception. The risks are different with computers and electronic transfer systems, but they are not insurmountable. The banking system already operates largely on electronic transfers of money and while no system of transfers will ever be perfect, it appears that a high level of safety is possible and probable. Indeed, if the market place did not have a high level of safety, nobody would enter the market. That is the best guarantee that systems adopted will be very safe before they are utilized.

Q: Do the 1977 Amendments to the UCC affect securities regulation at the state or federal level?

A: The short answer is no. The UCC has provided the basic transfer rules for investment securities. It has never been concerned with issues of regulation, such as registration of securities issues or disclosure to investors. The Amendments make no change in this pattern. Uncertificated securities are subject to the same regulatory requirements as certificated securities, and the existence or non-existence of the certificate makes no difference whatsoever.

AMERICAN SOCIETY OF CORPORATE SECRETARIES, INC.

1270 AVENUE OF THE AMERICAS • NEW YORK 10020 • TELEPHONE: 212-765-2620

April 25, 1985

Mr. John M. McCabe
Legislative Director
National Conference of Commissioners
on Uniform State Laws
645 North Michigan Avenue
Suite 510
Chicago, Illinois 60611

Dear Mr. McCabe:

The Securities Industry Committee of the American Society of Corporate Secretaries endorsed the 1977 Amendments to Article 8 of the Uniform Commercial Code at its meeting in New York on October 18, 1983. The Society supports the adoption of these Amendments by all states in the near future so that the laws of the various states pertaining to the transfer of securities can be made wholly uniform.

Very truly yours,

Stephen P. Norman
Chairman
Securities Industry Committee
American Society of Corporate
Secretaries Inc.

SPN:ldk

The Business Lawyer

THE BUSINESS LAWYER

A Certificateless Article 8? We Can Have It Both Ways

By MARTIN J. ARONSTEIN

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A Certificateless Article 8? We Can Have It Both Ways

By MARTIN J. ARONSTEIN*

IN THE aftermath of the "Paperwork Crunch" which seriously impaired the operation of the securities markets during the late 1960s, the air was filled with proposals for reform. Not surprisingly, many of these proposals focused on the elimination of the most visible manifestation of paperwork problems—the negotiable stock certificate. But it was correctly perceived that "The Certificateless Society" was incompatible with an existing legal regime firmly based on the assumption that shares of corporate stock must inevitably be represented by indispensable instruments. In an effort to resolve this incompatibility, the American Bar Association's Section of Corporation, Banking and Business Law organized a Committee on Stock Certificates. The Committee was charged with the duties of determining what legislation, if any, would be needed to facilitate the elimination of negotiable stock certificates and of drafting such legislation. The Committee issued its Report on September 15, 1975.[1] The author served as the Committee's Reporter.

This article is intended to be neither a summary of nor a substitute for the Committee's Report. Rather, its primary objective is to call the Bar's attention to the Committee's project and to enlist the cooperation of the Bar in the implementation of the Committee's recommendations. Its secondary, and somewhat selfish, objective is to permit the Reporter to express some personal views which are outside the scope of the Report and which are not necessarily shared by the Committee or its other individual members.

At the risk of sacrificing the element of surprise, it should be stated at the outset that the Committee's principal recommendations are two. The first is the relatively minor amendment of state corporation statutes to validate the issuance of stock not represented by certificates.[2] The second is a major and comprehensive revision of Article 8 and related sections in other Articles of the Uniform Commercial Code intended to govern the attributes of uncertificated shares.[3] The Committee does not recommend the adoption of general federal legislation at this time but recognizes that such legislation may be required in the future. One of the circumstances that would seem almost certain to lead to federal intervention would be the failure of the state legislatures

* Professor of Law, University of Pennsylvania.

1. Copies of the Report may be obtained by writing to the Chairman, Donald A. Scott, Esq., The Fidelity Building, Philadelphia, PA 19109. There is a charge of $5.00 per copy.

2. Report of the Committee on Stock Certificates, Appendix A (Proposed Amendments to the Model Business Corporation Act).

3. *Id.*, Appendix B.

to act within a reasonable time. The role that the Bar can play in expediting necessary state adoption is apparent.

The Committee's Objective

The Committee's first order of business was to define the scope of its mission. Amid urgent pleas to legislate the stock certificate out of existence, it was tempting to envision the Committee as identifying or, perhaps, even inventing the ideal certificateless system and then proceeding to draft legislation that would both compel that system's universal adoption and regulate its operation. That vision was soon abandoned in favor of a more limited goal.

Initially it was recognized that any viable system had to be (1) technologically feasible, (2) legally permissible and (3) commercially acceptable. Further analysis revealed, however, that the first two of these elements did not really constitute limitations. We quickly came to the view that, given adequate time and resources, the technology was up to achieving whatever results the industry demanded. The important question was not whether a particular system could be devised but, rather, whether it could be implemented at a cost its users would be willing to pay—in short, whether it was commercially acceptable. Similarly, the drafting of legislation to permit the institution of certificateless systems was a relatively simple task requiring, in the main, amendments of a minor nature to the typical corporation statutes. At least two states have already adopted such amendments.[4] The real burden on the legislative draftsman, as we saw it, was to provide a legal environment within which parties could deal with uncertificated stock with that same high degree of confidence that the present certificate-based law now affords. Or, to phrase it somewhat differently, we attempted to create a legal framework that would not merely permit the issuance of uncertificated stock but would make its use commercially acceptable.

Thus, despite some early notions that we might re-invent the wheel, the Committee wisely decided that the industry and its related technologists were the most logical source of system development. The appropriate task for us lawyers was to assure that the law could accommodate whatever systems the industry devised. The statutory changes recommended by the Committee and set forth in the Appendices to its Report neither compel the adoption of certificateless systems nor prescribe the form such systems should take. Rather, we attempted to construct a law, as did the draftsmen of Article 9, designed to "make it possible for new [systems] . . . as they develop, to fit comfortably under its provisions."[5]

The Legal Basis of Certificatelessness

In the years before and since the Committee's organization, the world has

4. *Michigan Business Corporation Act* § 335, 15 Mich. Stat. Ann. § 21.200(335) (1974); *California Corporations Code* § 416(b).

5. *Uniform Commercial Code* § 9-101, Comment.

not stood still. Out in the marketplace, where stock is actually dealt with, the development of certificateless transfer has proceeded—apace, in the view of some, and with too deliberate speed, in the opinion of others. As the Report describes in some detail, significant strides toward "The Certificateless Society" have already been made without the benefit of any substantial statutory change. Existing certificateless systems, which may be broadly defined as methods to transfer stock without the physical movement of indispensable prices of paper, masquerade under a variety of appellations. The common legal basis of each of these systems, however, is that somewhere a certificate exists and that someone is holding it as the shareholder's agent-bailee.

The most rudimentary form of certificatelessness is the street name brokerage account.[6] In this arrangement, the broker acts as the agent of the customer, a single undisclosed principal, and holds the certificate as the customer's bailee. Certificate movement is eliminated between customer and broker when the customer buys or sells through his broker-agent. Certificates continue to be used for transactions with the issuer, like presentment for registration of transfer, redemption or exchange, and for transfers for value to or from third party buyers, sellers and pledgees. There is, however, one common transfer for value, the customer's pledge to secure a margin loan from the broker, which, by virtue of the broker's prior possession, can be effected without certificate movement. There is also the comparatively rare transfer for value between two customers of the same broker, when, at the same time, one buys and the other sells the same security. This transfer is effected simply by the entries on the broker's books.[7] By and large, common law principles of agency, reinforced by safeguards imposed by the federal securities law and the self-regulatory organizations, have proved adequate to govern the relationship between the customer and his broker. Article 8's certificate-based law continues to govern the relationships with issuers and other third parties.

The independent securities depository is, in legal effect, an extension of the brokerage account model, but with one important exception. Like the broker, the depository holds certificates in its name and deals with the issuer and other outsiders as the agent of an undisclosed principal. The principal is the aggregate of the depository's customers, usually referred to as participants. Unlike the typical brokerage situation, however, transactions between participants are neither rare nor fortuitous but, rather, are commonplace and by design. Indeed, the primary objective of the depository is to permit transfers between the principals of a common agent without certificate movement.

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6. For the purposes of this analysis, the custody or agency accounts, maintained by the trust departments of banks for their customers, are functionally equivalent to the brokerage account.

7. *Uniform Commercial Code* § 8-313(1)(c). By its terms this section would appear to apply only when there is "a specific security in the broker's possession." It would in no event apply to a bank custodian.

As early as 1962, it was thought desirable to define expressly the legal consequences of intra-depository transfer. This was accomplished by adding section 8-320 to the official text of the Uniform Commercial Code. That section equates "the making of appropriate entries on the books"[8] of the depository to "a delivery of a security"[9] and thereby establishes the rights and duties of the respective participants between themselves and with others with whom they might deal. The developing depository system, with several depositories each maintaining accounts with the others, may be comfortably viewed as an aggregate of agents and sub-agents representing the aggregate of participants in all of them and holding the participants' certificates as bailees or sub-bailees. For the purpose of governing transactions with issuers and non-participants, which are normally effected by certificate delivery, the rest of present Article 8 continues to provide an acceptable legal framework.

The agency rationale is pushed still further, and, we believe, too far, in those systems which conceptualize the issuer or its transfer agent as the agent-bailee of all the shareholders. Existing systems premised on that rationale include the mutual funds, the increasingly popular dividend reinvestment plans and an almost wholly certificateless system which parades under the anomalous description of Transfer Agent Depository.[10] When the issuer is viewed as the bailee of its shareholders' certificates, the situation is functionally identical to that where no certificates exist. It is, so to speak, "The Certificateless Society" built on a legal foundation which was never intended to accommodate it.

The substantial disappearance of certificates from the mutual fund universe is a consequence of the commercial needs of the issuers and shareholders. In open-end mutual funds, the model transactions, the purchase of shares from the issuer and the redemption of shares by the issuer, do not involve third parties. In these two-party transactions which typically involve small numbers of shares and do not require simultaneous exchanges of money, the certificate's utility is reduced to no more than that of a simple statement from the issuer or letter of instructions from the shareholder. The commercial requirements of both parties are better and more economically satisfied without certificates than with them. Outright transfers for value between shareholders are rare, particularly in the no-load funds where the issuer stands always ready to sell or redeem shares at their net asset value.

In pledge transactions of mutual fund shares, however, the certificate continues to be demanded because it performs a necessary function. One could

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8. *Uniform Commercial Code* § 8-320(1).

9. *Id.* § 8-320(3).

10. The "Transfer Agent Custodian" concept should also be included in this group. That relationship arises when, by agreement between a particular shareholder and the issuer, certificates are not delivered to the shareholder but are held in the transfer office subject to the shareholder's instructions for further registration of transfer. It is commonly used by some brokers who have a continuing need for both customer name certificates and certificates of specific denominations to be used in making settlements.

argue, of course, that a security interest in uncertificated mutual fund shares could be perfected under section 9-305 by simply giving notice to the transfer agent in his imagined capacity as the bailee of the debtor's certificate. It is highly doubtful, however, that a prudent lender or his counsel could be persuaded to advance the loan under those circumstances. Furthermore, few, if any, transfer agents would have any institutionalized procedure for dealing with such a notice even if one were received. In the pledge situation, therefore, both the lender and the issuer take refuge in the only procedure now expressly validated by statute—the issuance of a certificate to the shareholder and the delivery of that certificate to the lender. Reliance on the agency-bailment rationale is just not commercially acceptable under the present law.

The dividend reinvestment plans, in which the typical transaction is the purchase of small numbers of shares for participating shareholders,[11] operate without certificates for essentially the same reasons that have led to certificatelessness in the mutual funds. When, however, the participant wishes to deal with his shares in another transaction, issuers respond, in almost every case, by issuing certificates.[12] Unlike mutual fund shares, however, the shares accumulated in the dividend reinvestment plan accounts are the very same intangible interests that are commonly traded in normal market transactions and used as collateral for secured loans. Officials of American Telephone & Telegraph Co., which operates the largest of such plans, are confident that they could develop adequate procedures to deal with both the outright transfer and the pledge of uncertificated shares by book-entry if only a satisfactory legal framework could be provided. The potential demand for such procedures is foreshadowed by the fact that, after only slightly more than two years of operation, AT&T was "holding," as the nominal agent-bailee for some 541,000 shareholders, more than 9 million uncertificated shares.

The Transfer Agent Depository concept differs from the dividend reinvestment plans in two important respects. First, it envisages a system where certificates are issued to a shareholder only when they are expressly requested.[13] Secondly, it contemplates that shares will not only be held in uncertificated form but may be transferred or pledged to third parties by the making of appropriate entries on the issuer's books.[14] The name, "depository," and the

11. The earliest plans and the majority of existing plans pool the dividends payable to the participants and purchase outstanding shares on the market. Each participant's account is then credited with an appropriate portion of the shares purchased. An increasing number of the newer plans use the dividends to purchase newly-issued shares directly from the issuer. AT&T gives participants a 5% discount from the market price.

12. Some corporations now handle so called "legal" transfers, *e.g.*, decedent to personal representative, without first issuing a certificate in the name of the decedent.

13. Conversion from the traditional certificated system to a Transfer Agent Depository would, in fact, require shareholders to "deposit" outstanding certificates with the issuer. A new corporation without certificates outstanding, however, would issue no certificates unless requested to do so.

14. The transfer or pledge by book-entry, validated by section 8-320, is available only to a "clearing corporation." The definition of "clearing corporation" in section 8-102(3) does not include an individual issuer or transfer agent.

contrived rationale imply that the issuer or its transfer agent is holding a certificate as the agent-bailee of the several shareholders. That certificate is either a useless formality or a patent fiction. We are told, for example, that somewhere in the AT&T transfer office there reposes a certificate representing the 9 million shares beneficially owned by those 541,000 dividend reinvestment plan participants. It seems almost ludicrous to imagine that important legal consequences would turn on whether or not that certificate is really there.

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

In short, the uncertificated share needs a governing statute to provide clear answers to those dozens of questions that existing law now provides with respect to the certificate. Without such answers, it is unreasonable to expect the expansion of wholly certificateless transfer to the kinds of transactions which account for the bulk of the industry's paperwork problems. The Committee concluded that the requisite degree of confidence, and, hence, commercial acceptability, is unlikely to be reached in the present legal framework that does not even acknowledge the existence of uncertificated shares and, therefore, utterly fails to deal with them.

The Future of System Development

It has been frequently stated that a major roadblock to the elimination of certificates would be the unsophisticated individual investor. Such an assumption is not in accordance with the facts. Holders of mutual fund shares and participants in dividend reinvestment plans have, in preponderant numbers, cheerfully foregone the possession of certificates that were unnecessary to satisfy their commercial requirements. Under existing rules of law, however, certificates are and will continue to be demanded for those transactions which they were originally developed to facilitate—the simultaneous exchange of stock for money between unrelated parties neither of which is prepared to extend unsecured credit to the other. Any system that can successfully displace stock certificates in the typical transfer for value must provide a commercially acceptable alternative to precisely that kind of exchange.

The securities depository is one such alternative. By holding its participants' stock in the depository's name, the depository assures itself that a purported transferor is the owner of the stock to be transferred and has entrusted the transfer power to the depository. By crediting the transferee's account,

the depository, in effect, represents to the transferee that the subject matter of the transfer exists and has been transferred to him. Thus, the transferee receives the same assurance that the receipt of a clean, duly indorsed certificate would afford him. It is in reliance on the depository's representation that the transferee parts with his consideration with confidence that he has received the benefit of his bargain.

The depository concept was a logical outgrowth of the clearing facilities maintained by the various stock exchanges. For years these facilities were utilized to monitor and expedite the transfer of funds and the delivery of securities between exchange members. Although these simultanous exchanges were nominally between individual members, they were made through the clearinghouse which became a de facto intermediary in the exchange. Viewing the clearinghouse as an independent party, dealing with all members, was a transition more in form than substance. The clearinghouse's function as a depository of both funds and securities followed quite naturally from its function as a mere record-keeper.

The statutory validation of book-entry transfer was initially limited, by the terms of section 8-102(3), to entities wholly-owned by a securities exchange or association. The growth of the depository concept in the United States has, therefore, taken place almost exclusively in conjunction with the exchanges. There is general agreement that the Depository Trust Co., the New York depository which now controls over 2 billion shares of stock, has served its broker participants well. It should be remembered, however, that these brokers were already participating in a system which settled the money side of transactions with essentially the same mechanism by which the securities side is now settled.

The exchange-related depository has also provided a mechanism to facilitate another kind of transfer for value—the broker's loan. In these transactions, lending banks, participating as "pledgees," are satisfied to advance funds to borrowing brokers on the strength of the depository's representation that the broker's stock, by virtue of the depository's book-entry, has been as effectively pledged as would be the case if certificates had been delivered to them by the brokers. The demonstrable saving that can be achieved by eliminating certificate delivery upon pledge and re-delivery upon release has resulted in the substantial use of this procedure by the banks.[15]

The expansion of the exchange-related depositories to include significant participation by banks (other than as pledgees), insurance companies, pension funds and other institutional investors is far from foreordained. These investors are not, as are the brokers, under a constant obligation to make daily settlements with their counterparts through an institutionalized clearing facility. They have typically made independent arrangements for C.O.D. settlements directly or through bank agents. For them, the use of a depository

15. The procedure has also made it feasible for banks located in areas remote from the financial centers to compete with the local banks for the brokers' loan business.

constitutes a departure from their traditional settlement procedures rather than an extension of an already established *modus operandi*.

Thus far, despite the intensive use of depositories by brokers, participation by non-broker eligible entities has been quite limited. There are a number of factors that have militated against bank participation and some of them have been only recently corrected. Nevertheless, there is currently very little hard evidence that the exchange-related depositories are destined to expand into a national comprehensive depository system that will obviate the need for continuing efforts to eliminate the stock certificate and its attendant problems. It should also be observed that the impact of the exchange-related depositories, even in the context of broker-to-broker settlements, is itself a function of the part to be played in the securities markets of the future by the exchanges themselves. To the extent that the exchanges become less significant in the total picture—a distinct possibility in the light of recent events—the ameliorating effect of their depository facilities will be correspondingly reduced.

As a step to encourage the use of depository facilities by non-brokers, the Banking & Securities Industry Committee sponsored an amendment to section 8-102(3) which has already been adopted by more than forty states.[16] The effect of this amendment is to permit the distribution of the capital stock of depositories among their users. This is intended to create a cooperate rather than a proprietary form of ownership and control. Depository Trust Co. has already announced plans to distribute its stock to its users during 1975. Whether this will achieve the objective of increased non-broker participation remains to be seen.

Another effect of the 8-102(3) amendment, however, is to permit the organization of depositories which are not related to a securities exchange. One such depository was organized in 1974 under the sponsorship of a group of bank transfer agents and has already achieved substantial growth.[17] Unlike the exchange-related entities, this depository sees itself only as a communications network which will permit rapid transmittal of transfer instructions to issuers and rapid acknowledgment of registration to prospective buyers and pledgees. Facilities for clearing the money side of transactions are not encompassed within the system and will have to be provided independently. Thus, for non-broker participants, the use of this system will be much less of a departure from their current practices than would be participation in an exchange-related depository. It is much too early for even its own managers to predict the extent to which such a depository will be commercially acceptable.

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16. The text of this amendment does not appear in the Official Text of the Uniform Commercial Code. It is set forth in Appendix B of the Report of the Committee on Stock Certificates.

17. By June 1975, the TAD Depository Corp. had on deposit over 12 million shares in more than 1600 different issues.

What the foregoing discussion suggests is that the concept of certificate immobilization in independent depositories is far from certain to result in a satisfactory reduction in the paperwork problems of the securities industry. The elimination of stock certificates, or, in the current fictionalized parlance, the use of the issuer or its transfer agent as a "depository," may prove to be at least a significant part of the ultimate solution. If that be the case, the burden of developing the mechanisms that will be commercially acceptable alternatives to the simultaneous certificate-for-money exchange rests upon the industry. It is our function, as lawyers, to make sure that the governing law will provide an environment in which industry-developed systems can be implemented with confidence in their legal consequences. Our proposed revision of Article 8 is an attempt to create that environment.

Drafting the Statute

Professor Jolls has suggested that a statute governing the attributes of uncertificated shares need not be nearly so complex as Article 8 and might take the form of an additional article of the Uniform Commercial Code, perhaps denominated Article 8A.[18] Our initial attempts to draft such a separate statute convinced us, for several reasons, that an integration of the rules for certificated and uncertificated shares and, necessarily, a complete revision of present Article 8 would be the more fruitful approach.

The process of putting pencil to paper for the first time exposed a number of problems that would have to be dealt with in a separate article. Parties dealing with uncertificated shares should be able to find, in the governing statute, the answers to all questions answered by present Article 8 except where the question, by its nature, has no application in the absence of a certificate. Could an issuer's lien exist? What is the effect of an issuer's restriction on transfer? Who, if anyone, could be a bona fide purchaser? Were there exceptions to the statute of frauds? Was there a statute of frauds? The dozen or so basic sections that Professor Jolls suggested might constitute an adequate statute grew quickly and substantially in number.

Even more important, our observation of what was taking place in the industry convinced us that the total elimination of stock certificates, even if ultimately realized, was a very long way off. What we saw was a system in which both certificated and uncertificated shares would continue to co-exist, in many cases, within the same issue of securities. Under those circumstances, the rules for each form of stock would, in many instances, require exceptions in the corresponding rules for the other form. For example, the seller's duty to perform, stated in section 8-314, might be satisfied not only by the delivery of a certificate but also by the transfer of an equivalent uncertificated security. Even assuming the ultimate elimination of certificates for a particular issue,

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18 Jolls, *The Uniform Commercial Code and the Certificateless Society*, 26 Bus. Law. 627 (1971).

the transitional period until all certificates arrive at the transfer office for cancellation and are replaced by uncertificated shares will require coordinate rules and alternative performance.

The decision to have a single, integrated Article 8 brought with it another decision, perhaps not compelled, but highly desirable, that the rules governing certificated and uncertificated shares should be the same except to the extent that the inherent differences in the form of the shares required distinctions. And, finally, we decided that it would be unwise to complicate our task and, perhaps, to jeopardize prospects for adoption by proposing any changes in the rules for certificated shares. The end result of this series of decisions is a statute which restates the existing rules for certificated shares and conforms the new rules for uncertificated shares to the present law as closely as possible. We do not imply that we necessarily oppose changes in the present law, but only that, if such changes are to come, they should be equally applicable to certificated and uncertificated shares wherever the nature of the change permits. To illustrate, it has been suggested that section 8-403 be amended to eliminate the issuer's duty to make certain inquiries before registering the transfer of stock on the indorsement of a corporation.[19] If that view is ultimately to become generally accepted, it should apply to transfers of all securities, whether or not certificated.

The determination of what new rules for uncertificated stock would, in fact, conform to the present rules for certificated stock was not always clear. For example, our revision provides for the perfection of a security interest in uncertificated shares by registration of pledge by the issuer. The consequences of a registered pledge, set forth in new section 8-207, are that the registered owner continues to be recognized as the owner by the issuer for purposes of dividends, notices, voting rights and the like but that only the registered pledgee, and not the registered owner, has the power to cause the registration of a transfer. To that extent, the situation exactly parallels that when a pledgor delivers a certificate to the pledgee and the pledgee does not undertake to have the transfer registered. If, during the continuance of the pledge of a certificate, the issuer should distribute additional stock as a dividend or stock split, the certificates representing the new shares would be sent to the registered owner. Although the additional shares would normally be subject to the pledge, the certificates permit the pledgor to dispose of them, free of the pledge, to a bona fide purchaser. It has been argued that complete parallelism would require that uncertificated shares, issued pursuant to a dividend on or split of uncertificated shares subject to a registered pledge, should be similarly registered free of the pledge thus permitting the pledgor to make a similar wrongful transfer. It was our conclusion that this "loophole" for the dishonest pledgor exists in the present statute not as a matter of policy but, rather, because commercial lending practices produce that result. In new

[19] *See* A.B.A. Committee Report, *Developments in Simplification of Transfer of Fiduciary Securities*, 9 Real Prop., Prob. & Tr. J. 611, 614 (1974).

section 8-207(7) we provide that the new shares "shall also be subject to the rights of the registered pledgee."

In one instance, and only one, we departed from our general approach of merely restating the law with respect to certificated shares and purposely extended the coverage of the statute. The rule of present section 8-317, requiring certificate seizure for a valid creditor's lien, is eminently rational when certificates are issued in shareholder name and held by the shareholder. The apparent exclusivity of this remedy is inconsistent with modern security holding practices. To give an extreme, but not uncommon, example, assume that Debtor is the owner of 100 shares of Issuer stock and has asked Broker to hold the stock in street name. Broker has, in turn, deposited certificates for 5,000 shares of Issuer stock with Depository which has credited Broker's account. Depository has then delivered these certificates, together with certificates received from other brokers, to Issuer which has issued to Depository a jumbo certificate, in Depository's name, for 200,000 shares. According to section 8-317, Creditor, wishing to levy upon Debtor's interest in Issuer, can acquire no lien without seizing Debtor's certificate. But Debtor has no certificate unless one conceives that Debtor has an undivided interest in that 200,000 share certificate reposing serenely in Depository's well guarded vault. It is hard to imagine that Depository will voluntarily surrender that certificate to the sheriff or that a court would compel it to do so. Indeed, it is unlikely that Depository will be aware of Debtor's existence. Debtor's interest is known only to Broker. In revised section 8-317, Creditor obtains his lien by garnishment of Broker, thus assuring, as present section 8-317 intends, that Debtor will not be able to transfer his interest to a bona fide purchaser free of Creditor's lien.

It was with some reluctance that we failed to incorporate in the statute provisions for a certified transfer order, suggested by Professor Jolls and others. Such an order would be an instrument, analogous to a certified check, which an issuer would have agreed to honor if timely presented and which could be used in C.O.D. settlements. It was not adopted for two reasons. First, it seemed that a wholly certificateless environment would necessarily have developed commercially acceptable procedures to accomplish the equivalent of the C.O.D. settlement by electronic communication or otherwise. Such mechanisms would make the certified transfer order unnecessary. Secondly, pending the development of the procedures described, it appeared that certificates would necessarily continue to be available to effectuate C.O.D. settlements when they were required.

The Role of the SEC

The Securities Acts Amendments of 1975, for the first time, expressly involve the Securities and Exchange Commission in the regulation of clearance and settlement systems. By amendment to the Securities Exchange Act of 1934, the Commission is empowered to prescribe the form and format of

securities;[20] to facilitate the establishment of a national system for clearance and settlement,[21] to regulate clearing agencies,[22] to regulate transfer agents[23] and to "end the physical movement of securities in connection with the settlement among brokers and dealers."[24] By these amendments, Congress has assuredly not legislated the stock certificate out of existence. Nor has it, expressly or by implication, provided for any system not already sanctioned under existing law. It has, at the most, empowered the Commission to compel broker-dealers to participate in some form of certificateless system without prescribing either what that system should be or setting a time limit for participation. Beyond that, it has merely invited the Commission to submit "its recommendations, if any, for legislation to eliminate the securities certificate."[25]

The newly-granted regulatory powers of the Commission, wisely exercised, could do much to encourage the voluntary adoption and expansion of certificateless systems. The establishment of both financial and operational standards for clearing agencies, which are defined to include depositories, should have the effect of instilling confidence in potential participants in that form of certificateless transfer. SEC supervision is not the equivalent of a government guarantee against operational or financial failure, but it may, to some degree, tip the scales toward participation by some. So long as participation is voluntary, however, it will be the depositories' burden, by means of satisfactory performance and demonstrated economy, to attract additional participants.

The Commission's power to prescribe uniform standards for transfer agent capability is particularly crucial to the development of wholly certificateless systems. When certificates exist, the registration of transfer merely confirms the legal relationships already established by delivery. Without certificates, however, the completion of many transactions will necessarily await registration on the books of the issuer. Inadequate transfer agent performance can be injurious to a system based on certificates. In a system without certificates, it could be fatal.

It is apparently the view of Congress that the industry, motivated by incentives of cost minimization and increased efficiency, gives promise of producing satisfactory clearance and settlement systems without mandatory federal legislation. In effect, Congress views the Commission as a stimulus to facilitate systems development and to encourage participation, but not as a designer of particular systems or an agent to compel participation therein. It goes without saying that if the industry does not measure up to Congress'

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20. *Securities Exchange Act of 1934* § 12(1), 15 U.S.C.A. § 781(1) (Pamphlet 4, 1975).
21. *Id.* § 17A(a)(2), 15 U.S.C.A. § 78q-1(a)(2) (Pamphlet 4, 1975).
22. *Id.* § 17A(b), 15 U.S.C.A. § 78q-1(b) (Pamphlet 4, 1975).
23. *Id.* § 17A(c), 15 U.S.C.A. § 78q-1(c) (Pamphlet 4, 1975).
24. *Id.* § 17A(e), 15 U.S.C.A. § 78q-1(e) (Pamphlet 4, 1975).
25. *Id.* § 23(b)(4)(E), 15 U.S.C.A. § 78W(b)(4)(E) (Pamphlet 4, 1975).

expectations, the propensity for further federal intervention is certain to increase.

The Prospects for Adoption

In the course of its deliberations, the Committee was divided on the issue of whether to recommend legislation by Congress or by the state legislatures. In the end, the state route was espoused on the general principle that corporate and commercial law were areas in which the state legislatures traditionally acted and that this tradition should not be lightly disturbed. The countervailing argument was that federal legislation was the only way to achieve absolute uniformity and probably the best way to assure reasonable promptness. The several years taken by Congress to enact even the limited approach of the 1975 Securities Acts Amendments indicates that promptness at the federal level is far from assured. And, indeed, with respect to amendments to the Uniform Commercial Code, it is possible that promptness, with reasonable uniformity, can be achieved at the state level.

The Permanent Editorial Board for the Uniform Commercial Code provides a unique mechanism for drafting, editing and promulgating commercial statutes at the state level which is perhaps unparalleled in any other area of the law. It is contemplated that a revised Article 8, bearing the imprimatur of the Permanent Editorial Board, might be before the state legislatures as early as 1976. As to the promptness with which the state legislatures will act there is less predictability. On the one hand, the recent amendment to section 8-102(3), proposed initially in 1972, has already been adopted by more than forty states. On the other hand, the current official text which substantially revises Article 9, promulgated in the same year, has been adopted by only fourteen. If the operative distinction between these two proposals is their relative complexity, the prospects for prompt adoption of proposed Article 8 are dim.

There is, however, another important distinction between the two proposals. The 1972 version of Article 9 is intended to displace an entire statute which addresses the same problems and, in some instances, solves them differently. Secured transactions can, however, still proceed with assurance under the earlier, unamended version. New section 8-102(3) provides for an institution, the non-exchange-owned securities depository, which could not exist under prior law. It was recognized that such an institution might significantly promote the development of comprehensive depository systems and members of the securities industry got behind the amendment and pushed the legislatures for its adoption.

If that is the explanation, the prospects for the prompt adoption of proposed Article 8 are more optimistic. At present there is no statute to govern the attributes of uncertificated stock. By its terms, present Article 8 applies only to "securities" and securities are defined, in section 8-102(1), as "instruments." A share of stock not evidenced by an instrument is without any

legal foundation in the Uniform Commercial Code with the single exception that it would be classified as a "general intangible" for purposes of Article 9.[26] If, as we believe, there is a real need for uncertificated stock the attributes of which will be governed by statutory law rather than by fictitious analogy the impetus for pushing the legislatures should materialize. If it does, the Committee's recommendation to amend the commercial law at the state level is justified both by practicality and by principle.

The situation with respect to the corporate law is different. The Model Business Corporation Act does not enjoy the almost uniform acceptance accorded to the Uniform Commercial Code's official text. State corporation statutes vary widely in both form and content and substantive non-uniformity is the rule rather than the limited exception. Each state corporation statute requires an independent analysis and revision, in sharp contrast to the Uniform Commercial Code for which amendments can be centrally drafted and packaged for export. In short, the prospects for the prompt and uniform adoption of the proposed corporate law amendments by the state legislatures are less than great.

Happily, the necessity for the prompt and uniform adoption of our recommended corporate law amendments is not nearly so pressing. The adoption of enabling legislation in just a few major commercial states would permit the issuance of certificateless stock by a large number of corporations. If only a handful of enterprising corporations incorporated in the adopting jurisdictions could successfully implement the issuance of uncertificated shares to the mutual benefit of themselves and their shareholders, similarly situated corporations in non-adopting jurisdictions can be counted on to urge adoption by their respective legislatures. Furthermore, on the basis of demonstrated successful implementation, it would be neither unexpected nor unwarranted for the Securities & Exchange Commission to recommend that Congress provide this power for all or some categories of corporations registered under the Securities Acts, thus making state adoption irrelevant.[27]

Conclusion

However illogical it may seem, I am convinced that the prompt and uniform adoption of a carefully drafted and rigorously edited commercial statute to govern the attributes of uncertificated shares is of far greater importance than the adoption of statutes to authorize their issuance. Even now, uncertificated shares, without express statutory authorization, are being voluntarily

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26. Uniform Commercial Code § 9-106. The result of that classification is to require the filing of a financing statement as the exclusive means of perfecting a security interest in uncertificated shares. *Id.* § 9-302(1).

27. Significantly, the two state legislatures that have acted have not granted the power to issue uncertificated shares to all corporations. Michigan has limited the power to issuers of "shares or other securities . . . listed on a national securities exchange" and California to "a corporation which is the issuer of securities registered under the United States Securities Exchange Act of 1934." See note 4 *supra*.

issued in the guise of certificated shares held by the issuer. The adoption of the proposed Uniform Commercial Code amendments will permit these systems to develop with that confidence in the legal consequences of transactions that is so essential to commercial acceptability.

There is an even more critical consideration. A recurrence of a paperwork crisis in the securities industry is likely to evoke demands to abolish the stock certificate by law and thereby, in effect, compel the issuance of uncertificated shares. I fear that mandatory legislation, enacted under panic conditions, may fail to provide an adequate framework for dealing with the artifacts it creates.[28] It would be far better to be prepared for uncertificated shares before they exist than to have them thrust upon us before we are ready for them.

28. Draftsmen of corporate statutes properly do not concern themselves with the solution of nitty gritty commercial problems. The Michigan statute, note 4 *supra*, delegates that unpleasant task to the securities exchange on which the uncertificated shares are listed. The California statute, note 4 *supra*, is more cautious and defers to its Commissioner of Corporations, the Securities & Exchange Commission or Congress. And Congress, in section 17A(c) of the 1934 Act, blithely tells the SEC to "end the physical movement of securities certificates in connection with the settlement among brokers and dealers."

securities;[20] to facilitate the establishment of a national system for clearance and settlement,[21] to regulate clearing agencies,[22] to regulate transfer agents[23] and to "end the physical movement of securities in connection with the settlement among brokers and dealers."[24] By these amendments, Congress has assuredly not legislated the stock certificate out of existence. Nor has it, expressly or by implication, provided for any system not already sanctioned under existing law. It has, at the most, empowered the Commission to compel broker-dealers to participate in some form of certificateless system without prescribing either what that system should be or setting a time limit for participation. Beyond that, it has merely invited the Commission to submit "its recommendations, if any, for legislation to eliminate the securities certificate."[25]

The newly-granted regulatory powers of the Commission, wisely exercised, could do much to encourage the voluntary adoption and expansion of certificateless systems. The establishment of both financial and operational standards for clearing agencies, which are defined to include depositories, should have the effect of instilling confidence in potential participants in that form of certificateless transfer. SEC supervision is not the equivalent of a government guarantee against operational or financial failure, but it may, to some degree, tip the scales toward participation by some. So long as participation is voluntary, however, it will be the depositories' burden, by means of satisfactory performance and demonstrated economy, to attract additional participants.

The Commission's power to prescribe uniform standards for transfer agent capability is particularly crucial to the development of wholly certificateless systems. When certificates exist, the registration of transfer merely confirms the legal relationships already established by delivery. Without certificates, however, the completion of many transactions will necessarily await registration on the books of the issuer. Inadequate transfer agent performance can be injurious to a system based on certificates. In a system without certificates, it could be fatal.

It is apparently the view of Congress that the industry, motivated by incentives of cost minimization and increased efficiency, gives promise of producing satisfactory clearance and settlement systems without mandatory federal legislation. In effect, Congress views the Commission as a stimulus to facilitate systems development and to encourage participation, but not as a designer of particular systems or an agent to compel participation therein. It goes without saying that if the industry does not measure up to Congress'

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20. *Securities Exchange Act of 1934* § 12(1), 15 U.S.C.A. § 781(1) (Pamphlet 4, 1975).
21. *Id.* § 17A(a)(2), 15 U.S.C.A. § 78q-1(a)(2) (Pamphlet 4, 1975).
22. *Id.* § 17A(b), 15 U.S.C.A. § 78q-1(b) (Pamphlet 4, 1975).
23. *Id.* § 17A(c), 15 U.S.C.A. § 78q-1(c) (Pamphlet 4, 1975).
24. *Id.* § 17A(e), 15 U.S.C.A. § 78q-1(e) (Pamphlet 4, 1975).
25. *Id.* § 23(b)(4)(E), 15 U.S.C.A. § 78W(b)(4)(E) (Pamphlet 4, 1975).

legal foundation in the Uniform Commercial Code with the single exception that it would be classified as a "general intangible" for purposes of Article 9.[26] If, as we believe, there is a real need for uncertificated stock the attributes of which will be governed by statutory law rather than by fictitious analogy the impetus for pushing the legislatures should materialize. If it does, the Committee's recommendation to amend the commercial law at the state level is justified both by practicality and by principle.

The situation with respect to the corporate law is different. The Model Business Corporation Act does not enjoy the almost uniform acceptance accorded to the Uniform Commercial Code's official text. State corporation statutes vary widely in both form and content and substantive non-uniformity is the rule rather than the limited exception. Each state corporation statute requires an independent analysis and revision, in sharp contrast to the Uniform Commercial Code for which amendments can be centrally drafted and packaged for export. In short, the prospects for the prompt and uniform adoption of the proposed corporate law amendments by the state legislatures are less than great.

Happily, the necessity for the prompt and uniform adoption of our recommended corporate law amendments is not nearly so pressing. The adoption of enabling legislation in just a few major commercial states would permit the issuance of certificateless stock by a large number of corporations. If only a handful of enterprising corporations incorporated in the adopting jurisdictions could successfully implement the issuance of uncertificated shares to the mutual benefit of themselves and their shareholders, similarly situated corporations in non-adopting jurisdictions can be counted on to urge adoption by their respective legislatures. Furthermore, on the basis of demonstrated successful implementation, it would be neither unexpected nor unwarranted for the Securities & Exchange Commission to recommend that Congress provide this power for all or some categories of corporations registered under the Securities Acts, thus making state adoption irrelevant.[27]

Conclusion

However illogical it may seem, I am convinced that the prompt and uniform adoption of a carefully drafted and rigorously edited commercial statute to govern the attributes of uncertificated shares is of far greater importance than the adoption of statutes to authorize their issuance. Even now, uncertificated shares, without express statutory authorization, are being voluntarily

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issued in the guise of certificated shares held by the issuer. The adoption of the proposed Uniform Commercial Code amendments will permit these systems to develop with that confidence in the legal consequences of transactions that is so essential to commercial acceptability.

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28. Draftsmen of corporate statutes properly do not concern themselves with the solution of unity commercial problems. The Michigan statute, note 4 *supra*, delegates that unpleasant task to the securities exchange on which the uncertificated shares are listed. The California statute, note 4 *supra*, is more circumspect and defers to its Commissioner of Corporations, the Securities & Exchange Commission or Congress. And Congress, in section 17A(c) of the 1934 Act, blithely tells the SEC to "end the physical movement of securities certificates in connection with the settlement among brokers and dealers."

STEVE COWPER
GOVERNOR

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

88

January 9, 1989

The Honorable Tim Kelly
President of the Senate
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Dear Senator Kelly:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill to enact the 1977 amendments to Article 8 of the Uniform Commercial Code, on investment securities. These amendments were developed by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in cooperation with the American Law Institute and the American Bar Association. These amendments, already enacted in 35 states, are essential to update Alaska's version of the Uniform Commercial Code (UCC) and recognize modern methods and necessities of financial transactions.

In trading securities, electronic transfers have become quite common and may, ultimately, make paper certificates obsolete. This bill proposes to keep up with these changes in the securities industry by introducing the concept of uncertificated securities. In the new Article 8 (AS 45.08 in Alaska's version of the UCC), the term "instrument" will no longer imply the existence of specific pieces of paper that act as evidence of obligations between people. These amendments have been endorsed by the Securities Industry Committee of the American Society of Corporate Secretaries.

This bill proposes to maintain Alaska's version of the Uniform Commercial Code as up-to-date as possible.

Sincerely,

Steve Cowper
Governor

No. 6

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: SB 88 (a)
PUBLISH DATE: 1/9/89

FISCAL NOTE

REQUEST:

Revision Date:
Title: "An Act relating to investment securities under the Uniform Commercial Code."
Sponsor: Rules Committee
Requestor: Governor

Agency Affected: Department of Law
BRU: Legal Services
Components: Operations

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND	-0-	-0-	-0-	-0-	-0-	-0-
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME	-0-	-0-	-0-	-0-	-0-	-0-
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

Please see attached

The zero fiscal projection continues through 1996. 1/11/90 MEL

Richard L. Peques

Prepared by: Richard L. Peques, Director
Phone: 465-3672
Division: Administrative Services
Date: November 10, 1988

Richard L. Peques/FOR

Approved by Commissioner: Grace Berg Schaible, Attorney General
Date: November 10, 1988
Agency: Department of Law

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

No. 6

CONTINUATION of FISCAL NOTE ANALYSIS

For Bill/Resolution No. _____

This bill substantially amended Article 8 of the Uniform Commercial Code (AS 45.08 in Alaska's version) in accordance with recommendations of the National Conference of Commissioners on Uniform State Laws (NCCUSL) in cooperation with the American Law Institute and the American Bar Association. This amended version of Article 8 modernizes the regulation of investment securities by recognizing the existence of uncertificated securities that have resulted from computerized securities transactions. Many of the investment securities financial transactions that take place today are accomplished by electronic means, without the issuance of certificates, because of the shear load of paper certificates that have hampered and burdened the financial markets. The amendments to Article 8 contemplate the elimination of much of the paper certificates formerly used in financial transactions. These amendments have been endorsed by the Securities Industry Committee of the American Society of Corporate Secretaries, and they have already been adopted by 35 states. It is not anticipated that the changes proposed in the UCC will have any direct fiscal impact on the Department of Law, because they deal with private sector transactions.

No. 6

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: SB 88 (b)
PUBLISH DATE: 1/9/89

FISCAL NOTE

REQUEST:

Revision Date:
Title: Investment Securities under the Uniform Commercial Code
Sponsor: Rules
Requestor: Governor

Agency Affected: Department of Revenue
BRU: Treasury

Components:

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
OPERATING						
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LANDS & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: (Attach a separate page if necessary)

Prepared By: Milt Barker MB
Division: Treasury

Phone: 465-2350
Date: December 29, 1988

Approved by Commissioner: Hugh Malone Roger Wilson for
Agency: Department of Revenue

Date: December 29, 1988

The zero fiscal projection continues through 1996. MB 1/11/90

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

No. 6

STATE OF ALASKA
1989 LEGISLATIVE SESSION

BILL VERSION: SB 88 (c)
PUBLISH DATE: 1/9/89

FISCAL NOTE

REQUEST:

Revision Date:
Title: UCC investment securities

Agency Affected: Natural Resources
BRU: Management and Administration

Sponsor: Rules Committee
Requestor: Governor Cowper

Components:

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-
CAPITAL	-0-	-0-	-0-	-0-	-0-	-0-
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	-0-	-0-	-0-	-0-	-0-	-0

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

This bill does not affect the Department of Natural Resources.
The zero fiscal projection continues through 1996. MJL 1/11/90

Prepared by: Carol Wilson
Phone: 465-2400
Division: Commissioner's Office
Date: 11/23/88

Approved by Commissioner: Dennie Gorsuch
Date: 11-28-88
Agency: Natural Resources

Distribution (by preparer):
Legislative Finance
Legislative Sponsor
Requestor
Office of Management and Budget
Impacted Agency(ies)

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

STEVE COWPER, GOVERNOR

REPLY TO:

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PHONE: (907) 276-3550

☐ *1st NATIONAL CENTER*
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SUITE 400
FAIRBANKS, ALASKA 99701-4579

☐ *P.O. BOX K—STATE CAPITOL*
JUNEAU, ALASKA 99811-0300
PHONE: (907) 465-3600

April 25, 1990

Hon. Max Gruenberg, Co-chair
House Judiciary Committee
Alaska State Legislature
P. O. Box V
Juneau, Alaska 99811

Re: SB 88 -- UCC art. 8, investment securities
(Our file 773-89-0062)

Dear Max:

At this morning's House Judiciary Committee subcommittee meeting on this bill, you asked for the names of the states, in addition to those 35 listed in that 1988 information sheet furnished to you and the Judiciary Committee, that have enacted these Uniform Commercial Code article 8 amendments. You also asked for the names of those states where a bill proposing these amendments is now pending.

Upon checking the 1989-90 Reference Book of the National Conference of Commissioners on Uniform State Laws, and talking with the Conference staff at the Chicago office, this morning, I find the following:

Additional enactments: Iowa, Louisiana, Nebraska, New Jersey, North Carolina, and Utah, for a total of 41.

Pending bills (as of 4/16/90): Arizona, Missouri, and Pennsylvania (in addition to Alaska).

I am also attaching a one-page article from the Conference's Winter 1989 newsletter, entitled "Federal Preemption Remains a Serious Threat to the UCC." The gist of the article is that federal law might be enacted if the states do not complete enactment of the UCC article 8 amendments.

Yours truly,

DOUGLAS B. BAILY
ATTORNEY GENERAL

By:
Arthur H. Peterson
Assistant Attorney General

AHP:ahp

03-C5LH

Federal Preemption Remains a Serious Threat to the UCC

Article 8 of the Uniform Commercial Code once again faces a serious threat from the Federal Government. The Market Reform Act of 1989, which has been proposed to the U.S. Congress jointly by the Securities and Exchange Commission (SEC) and the Treasury Department, would, if enacted, amend the Securities Exchange Act of 1934 and preempt an undetermined portion of Article 8 and affect Article 9 as well.

The Market Reform Act (Senate Bill 648) will most likely move to the floor sometime in the coming year. The bill has four principal provisions dealing with: large stock and options trader reporting; risk assessment for holding company systems of securities firms; coordinated clearing and settlement of securities transactions, including federal preemption of UCC Article 8; and emergency market trading suspensions.

The threat of preemption actually started with the stock market crash of October 1987. The huge market movements that occurred created margin and other settlement obligations within the stock, option, and futures markets that involved extremely large cash payments. Because many of the participants in each of these markets also participate in other markets, the size of these cash flows were larger than would have been required if clearance and settlement of products in these markets were coordinated. The tremendous cash flows necessitated by the lack of coordinated settlements placed great strains on our nation's payment systems, and deprived the trading markets of liquidity at a time when it was most needed.

Several reports noted this problem and suggested that improvements in clearance and settlement, and specifically increased intermarket coordination, are among the important reforms needed. The SEC report cites the lack of uniformity between the states in the area of transfers and pledges of uncertificated securities as a contributing factor. The report specifically notes that not all the states have adopted the Article 8 Amendments to the UCC.

Section 17A(f)(1) of the Securities Exchange Act, as amended, would authorize the SEC to promulgate rules concerning the transfer and pledge of certificated and uncertificated securities. Paragraph (f)(1) would authorize the SEC to preempt state commercial laws (such as Article 8 of the Uniform Commercial Code) governing transfer and pledge of securities, but only upon making three affirmative findings: (1) that the rule is necessary or appropriate for the protection of investors or in the public interest and is reasonably designed to promote the prompt, accurate, and safe clearance and settlement of securities transactions; (2) that in the absence of a uniform rule, the safe and efficient operation of the national system for clearance and settlement of securities transactions will be, or is, substantially impeded (for example, due to the lack of scope or inconsistent standards of such state laws); and (3) that to the extent such rule will impair or diminish directly or indirectly rights of investors under state law concerning transfers of securities, that the benefits of such rule exceed the detriment to investors.

Obviously this is a serious threat to Article 8 of the UCC. The Article 8 Amendments have still not been adopted in ten states and the District of Columbia. Five states picked up the legislation in 1989, but this is not enough. The only sure way to stop federal preemption is to complete adoptions of UCC-8 everywhere.

The Market Reform Act of 1989 is likely to go to the floor for discussion early in the new year. With 11 jurisdictions still without Article 8, federal preemption is a real possibility, but one that can certainly be avoided with prompt action on our part.

To maintain the UCC as the preeminent work of the Conference will require diligent effort on all our parts. Changes in business practices and technological developments have assured changes in the UCC. It must evolve as business practices do. Commissioners cannot be slow in pressing for adoption of UCC amendments as they are completed.