

ALASKA LEGISLATURE COMMITTEE FILES, 1989-1990  
5862 HOUSE JUDICIARY

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SB 88

## 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.



ALASKA STATE CHAMBER OF COMMERCE

310 Second Street  
Juneau, Alaska 99801  
(907) 586-2323

April 13, 1989

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

Department of Law

APR 14 1989

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

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

Arthur H. Peterson, Esquire  
April 13, 1989  
Page 2

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.

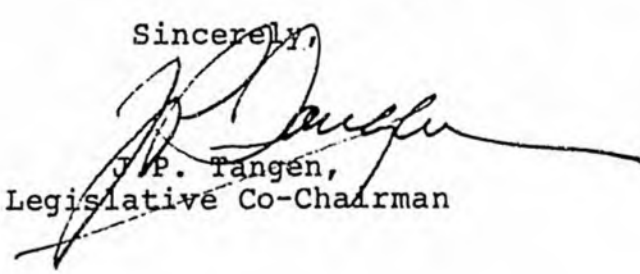
There is no prize for being the first to adopt a proposed uniform state law. In fact, it is well known that many such proposed uniform acts take many years to be adopted, and in some cases, it simply doesn't happen. In a similar vein, it is unlikely in the extreme that any state would be so impressed 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

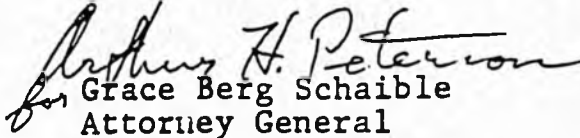
STEVE COWPER, GOVERNOR

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:   
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 Mercurieff, 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

<b>STATE ADOPTIONS:</b>	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 available 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 transferee 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 currently 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

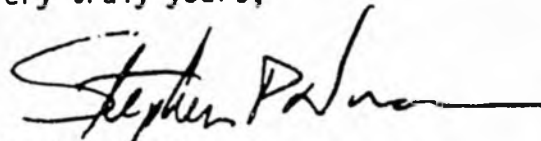
April 25, 1985

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*

## **A Certificateless Article 8? We Can Have It Both Ways**

By MARTIN J. ARONSTEIN

THE BUSINESS LAWYER

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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.<sup>1</sup> 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.<sup>2</sup> 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.<sup>3</sup> 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

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\* 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.<sup>4</sup> 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."<sup>5</sup>

#### **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 pieces 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.<sup>6</sup> 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.<sup>7</sup> 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.

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"<sup>8</sup> of the depository to "a delivery of a security"<sup>9</sup> 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.<sup>10</sup> 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

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,<sup>11</sup> 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.<sup>12</sup> 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.<sup>13</sup> 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.<sup>14</sup> 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 A I & 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 simultaneous 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.<sup>15</sup>

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.<sup>16</sup> 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.<sup>17</sup> 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.

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.<sup>18</sup> 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,

<sup>18</sup> 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.<sup>19</sup> 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 or 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 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 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

<sup>19</sup> 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;<sup>20</sup> to facilitate the establishment of a national system for clearance and settlement,<sup>21</sup> to regulate clearing agencies,<sup>22</sup> to regulate transfer agents<sup>23</sup> and to "end the physical movement of securities in connection with the settlement among brokers and dealers."<sup>24</sup> 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."<sup>25</sup>

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'

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 Article 9 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.<sup>26</sup> 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.<sup>27</sup>

#### 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

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.<sup>28</sup> 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.

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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 explicit and defers to its Commissioner of Corporations, the Securities & Exchange Commission of Congress. And Congress, in section 17A(e) 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;<sup>20</sup> to facilitate the establishment of a national system for clearance and settlement,<sup>21</sup> to regulate clearing agencies,<sup>22</sup> to regulate transfer agents<sup>23</sup> and to "end the physical movement of securities in connection with the settlement among brokers and dealers."<sup>24</sup> 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."<sup>25</sup>

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'

20. *Securities Exchange Act of 1934* § 12(1), 15 U.S.C.A. § 781(1) (Pamphlet 4, 1975).

21. *Id.* § 17A(1)(2), 15 U.S.C.A. § 78q-1(a)(2) (Pamphlet 4, 1975).

22. *Id.* § 17A(1)(b), 15 U.S.C.A. § 78q-1(b) (Pamphlet 4, 1975).

23. *Id.* § 17A(1)(c), 15 U.S.C.A. § 78q-1(c) (Pamphlet 4, 1975).

24. *Id.* § 17A(1)(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.<sup>26</sup> 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.<sup>27</sup>

#### 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

<sup>26</sup> 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).

<sup>27</sup> 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.<sup>28</sup> 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 important 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 of Congress. And Congress, in section 17A(e) 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

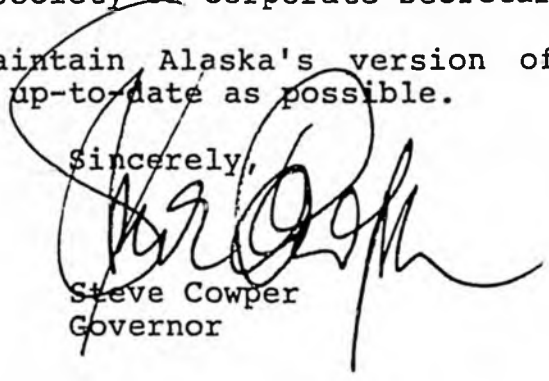
Dear Senator Kelly:

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

### 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 MSL*

Prepared by: Richard L. Peques, Director  
Division: Administrative Services  
Approved by Commissioner: Grace Berg Schaible, Attorney General  
Agency: Department of Law

Phone: 465-3672  
Date: November 10, 1988  
Date: November 10, 1988

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

## 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.

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
<b>OPERATING</b>						
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
<b>TOTAL OPERATING</b>	0	0	0	0	0	0
<b>CAPITAL</b>	0	0	0	0	0	0
<b>REVENUE</b>	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
<b>TOTAL</b>	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  
Agency: Department of Revenue

Date: December 29, 1988

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

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

### FISCAL NOTE

**REQUEST:**

Revision Date: \_\_\_\_\_  
Title: UCC investment securities  
Sponsor: Rules Committee  
Requestor: Governor Cowper

Agency Affected: Natural Resources  
BRU: Management and Administration  
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						
<b>TOTAL OPERATING</b>	-0-	-0-	-0-	-0-	-0-	-0-

<b>CAPITAL</b>	-0-	-0-	-0-	-0-	-0-	-0-
----------------	-----	-----	-----	-----	-----	-----

<b>REVENUE</b>						
----------------	--	--	--	--	--	--

**FUNDING:** (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
<b>TOTAL</b>	-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 projections continue through 1996. MCL 1/4/90*

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

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

STEVE COWPER, GOVERNOR

REPLY TO:

1031 W 4th AVENUE  
SUITE 200  
ANCHORAGE, ALASKA 99501-1994  
PHONE: (907) 276-3550

1st NATIONAL CENTER  
100 CUSHMAN ST.  
SUITE 400  
FAIRBANKS, ALASKA 99701-4579

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

## 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.

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HOUSE COMMITTEE REPORT

(7)

Date Referred: February 8, 1989

FURTHER REFERRALS:

Date of Committee Action: 5-6-90

The JUDICIARY Committee considered:

SB 89

SENATE BILL NO. 89 [LIABILITY OF ZOOS & ZOO OPERATORS]  
"An Act relating to civil liability of zoos and zoo operators."

RECOMMENDS:

- replacing with HCS SB 89 (Jud)  the same title  a new title
- the attached amendment(s)
- do pass
- do not pass
- no recommendation
- individual recommendations
- additional referral to the \_\_\_\_\_ Committee

ADOPTS: \_\_\_\_\_ letter of intent

ATTACHES NEW FISCAL NOTE(s):

APPROVES PREVIOUS:

- fiscal impact
- zero fiscal note
- zero with analysis

- fiscal note(s) published: \_\_\_\_\_
- zero fiscal notes(s) published: \_\_\_\_\_

SIGNING DO PASS:

SIGNING OTHER THAN DO PASS:

(Do Not Pass, No Recommendation, Amend)

Mr. Greenberg Greenberg

Peter Goll no rec Goll  
Clay Davidson no rec Davidson  
Larry Martin no rec Martin  
Michael Davis NO REC DAVIS

Mr. Greenberg Peter Goll  
Chairman's signature

FISCAL NOTE

REQUEST:

Revision Date: \_\_\_\_\_

Affected Agency: Alaska Court System

Title: Civil liability of zoos and  
zoo operators

BRU: \_\_\_\_\_

Sponsor: \_\_\_\_\_

Components: \_\_\_\_\_

EXPENDITURES/REVENUES: (THOUSANDS OF DOLLARS)

OPERATING	FY 91	FY 92	FY93	FY 94	FY 95	FY 96
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants, Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	0.00	0.00	0.00	0.00	0.00	0.00

CAPITAL						
---------	--	--	--	--	--	--

REVENUE						
---------	--	--	--	--	--	--


FUNDING: (THOUSANDS OF DOLLARS)

General Fund						
Federal Fund						
Other						
<b>TOTAL</b>	0.00	0.00	0.00	0.00	0.00	0.00

POSITIONS:

Full-Time						
Part-Time						
Temporary						

ANALYSIS: (ATTACH A SEPARATE PAGE IF NECESSARY)



Prepared By: Senator Jan Faiks, Chairman  
Division: Senate Judiciary Committee

Phone: 465-4523

Date: 5/6/90

Approved By: \_\_\_\_\_  
Agency: \_\_\_\_\_

Date: \_\_\_\_\_

DISTRIBUTION (BY PREPARER)  
LEGISLATIVE FINANCE  
LEGISLATIVE SPONSOR

REQUESTOR  
OFFICE OF MANAGEMENT & BUDGET  
AGENCY(IES)



ALASKA STATE LEGISLATURE  
HOUSE OF REPRESENTATIVES  
RESEARCH AGENCY

SB89 in H Jud

P.O. Box Y, State Capitol  
Juneau, Alaska 99811-3100  
Mail Stop 3100  
(907) 465-3991

April 24, 1989

**COPY**

MEMORANDUM

TO: Representative Peter Goll  
FROM: Karen Oakley *KO*  
Legislative Analyst  
RE: Liability of Zoo Operators  
Research Request 89.356

You asked whether any states had enacted laws similar to SB 89, which would limit the liability of zoo operators. You also asked whether governments operating zoos are liable for damages caused by animals in the zoo.

I found that no states have laws modifying the liability of zoo operators and that the case law on the liability of governments operating zoos is variable. Some governments have been held strictly liable while others have been held liable only on a showing of negligence.

Background

Alaska has one zoo, the Alaska Zoo, located in Anchorage. The zoo is relatively small, and most of the animals exhibited there are endemic to Alaska. (They do have a couple of elephants, however.) The zoo is owned and operated by a private, nonprofit group.

Several years ago, the Alaska Zoo was held strictly liable for injuries suffered by a man who was gored in the leg by a reindeer in the zoo. According to Sammie Seawell, current director of the Alaska Zoo, the zoo had sold one of their reindeer to someone in another state, and this man was hired by the owner of the reindeer to transport the reindeer to its new home. The zoo director told the man to wait for her at the reindeer cage while she got the paperwork ready. Failing to wait, the man entered the cage, approached the reindeer and was gored. The court that heard the resultant case held that the common law rule that the owners of wild animals are strictly liable for damages caused by the animals applied. As a result of this case, the zoo operators have had difficulty obtaining liability insurance, and they had to pay over \$50,000 in annual premiums after the accident. The zoo currently pays about \$25,000 per year for liability insurance.

After the finding in the reindeer case, the Alaska Zoo decided to seek a legislative solution. At their request, Senator Jan Faiks introduced a bill in the

Representative Goll  
April 24, 1989  
Page 2

15th legislature specifying that zoos operated by nonprofit organizations and governments were liable only upon a showing of negligence. This bill was passed by the senate but died in the house. In the 16th legislature, Senator Faiks has introduced a similar bill, SB 89, which is provided as Attachment A. The bill would amend the chapter of the code of civil procedure which specifies the limits on civil liability by adding a new section concerning the civil liability of zoos. The law would provide that a person could not recover damages from a zoo owned by the government or a nonprofit organization if the damages occurred as a result of the "inherent risk of attendance at a zoo." The zoo operators would be required to post signs within the zoo and at each entrance to the zoo stating that the zoo is not liable for injuries occurring as a result of dangers inherent in attending a zoo.

#### No Similar Laws in Other States

To the best of my knowledge, no states have laws similar to SB 89. Using Westlaw, a computerized legal database, I searched the statutes of 25 states and found no laws addressing the liability of zoos. In addition, I spoke with Brenda Trolin, of the National Conference of State Legislatures, who has been tracking insurance and liability issues nationwide for several years. She was not aware of any states passing laws concerning the liability of zoos. I also spoke with representatives of the American Association of Zookeepers, the American Association of Zoological Parks and Aquariums, and with the government affairs coordinator for the San Diego Zoo. None were aware of any state laws modifying the civil liability of zoo operators.

#### Government Liability from Operation of a Zoo

Under common law, owners of wild animals are generally considered strictly liable for damages caused by those animals.<sup>1</sup> The rule is that a wild animal is a dangerous instrumentality which subjects the public to an abnormal risk of harm. Thus, mere ownership is enough to impose liability, regardless of whether the animal escapes or causes injury as a result of the owner's negligence.

This general rule of strict liability has in some cases been applied to governments that operate zoos; more often, however, governments operating zoos have been held liable only upon a showing of negligence. Because there is no statutory law expressly addressing liability of government zoo operators, courts in different jurisdictions have been able to fashion rulings which give variable weight to the general rule of strict liability for the owners of wild animals and to the general rules of governmental tort immunity (which are currently undergoing change).

---

<sup>1</sup>Common law imposes less stringent liability on the owners of domestic animals. Dogs, for example, are given "one free bite." See House Research Memorandum 887.246 for further information on liability for dog bites.

Representative Goll  
April 24, 1989  
Page 3

Attachment B is an American Law Reporter annotation summarizing cases involving government liability from operation of zoos. The authors stated:

Many of the cases involving claims for personal injury against a governmental agency operating or maintaining a zoo have involved questions of governmental tort immunity. In several of these cases, such immunity has been denied either because of a general rejection of the rules of governmental tort immunity or because the defendant's activity in connection with the zoo was regarded as "proprietary" rather than "governmental." Other cases, however, have held that tort immunity applied to zoo-keeping activities.

They included this caution:

In view of the unsettled state of the law as to the doctrine of governmental immunity, the authority of any of these zoo cases must be assessed in the light of the general law of the jurisdiction, including cases involving tort claims not concerning zoos.

I hope this information is helpful. If I can provide any further information, please let me know.

Attachments

ATTACHMENT A  
Senate Bill 89 (1989)

1 IN THE SENATE

BY FAIKS

2

SENATE BILL NO. 89

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

SIXTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6

For an Act entitled: "An Act relating to civil liability of zoos and zoo operators."

7

8

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9

\* Section 1. AS 09.17 is amended by adding a new section to read:

10

Sec. 09.17.100. CIVIL LIABILITY OF ZOOS. (a) A person may not

11

recover damages for injury to person or property from a zoo or a zoo

12

operator, if the damages occurred as a result of an inherent risk of

13

attendance at a zoo, notice of the inherent risk was posted as re-

14

quired under (b) of this section, and the zoo operator exercised

15

reasonable care to prevent the injury.

16

(b) A zoo operator shall post signs at prominent places within a

17

zoo and at each zoo entrance. Each sign shall include a statement

18

warning that the zoo is not liable for injuries to person or property

19

occurring as a result of dangers or conditions inherent in attending

20

the zoo.

21

(c) In this section

22

(1) "inherent risk of attendance" means the dangers or

23

conditions that are an integral part of a zoo and the physical prox-

24

imity of wild animals;

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(2) "zoo" means a place where wild animals are kept for

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exhibition to the public that is

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(A) owned by the state or a municipality; or

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(B) owned and operated by a nonprofit organization.

ATTACHMENT B

92 ALR3d 832

Government Liability from Operation of

ANNOTATION

GOVERNMENTAL LIABILITY FROM OPERATION OF ZOO

by

William E. Shipley, J.D. and Sonja A. Soehnel, J.D.

TABLE OF JURISDICTIONS REPRESENTED  
Consult POCKET PART in this volume for later cases

US: §§ 4[a]	Kan: §§ 3[b], 4[a], 5, 6[b]
Ala: §§ 3[a, b], 5, 7	La: §§ 6[a]
Cal: §§ 3[b], 4[a], 6[b]	Mich: §§ 3[a], 7
Colo: §§ 4[a], 6[a]	Miss: §§ 4[b], 6[a]
DC: §§ 4[a]	NJ: §§ 3[a], 4[b], 6[a]

TOTAL CLIENT-SERVICE LIBRARY® REFERENCES

- 4 Am Jur 2d, Animals §§ 80-84, 121-128; 56 Am Jur 2d, Municipal Corporations, Counties, and Other Political Subdivisions §§ 680 et seq.; 57 Am Jur 2d, Municipal, School, and State Tort Liability §§ 149, 306 et seq.; 59 Am Jur 2d, Parks, Squares, and Playgrounds §§ 38-45, 49; 62 Am Jur 2d, Premises Liability § 116
- 1 Am Jur Pl & Pr Forms (Rev Ed), Animals, Forms 101-103; 19 Am Jur Pl & Pr Forms (Rev Ed), Municipal Tort Liability, Forms 1-14; 19 Am Jur Pl & Pr Forms (Rev Ed), Parks, Squares, and Playgrounds, Forms 1-15
- 1 Am Jur Proof of Facts 597, Animals, Proofs 3, 4
- 20 USCS §§ 81-85
- US L Ed Digest, Animals §§ 5-7; Claims § 12; Counties § 22; Municipal Corporations §§ 80-82; States § 84
- ALR Digests, Animals §§ 5, 21; Counties § 15; Municipal Corporations §§ 206, 215, 259; Parks, Squares, and Commons §§ 1, 4, 7
- L Ed Index to Annos, Animals; Claims Against Government; Privileges and Immunities
- ALR Quick Index, Governmental Immunity or Privilege; Zoos
- Federal Quick Index, Animals; Privileges and Immunities; Zoological Park

Consult POCKET PART in this volume for later cases

NY: §§ 3[a, b], 4[a, b], 6[a, b]  
Ohio: §§ 3[a], 4[b], 5, 6[a]  
Okla: §§ 4[a, b], 5, 6[a]

Tex: §§ 3[a], 4[b]  
Wis: §§ 6[b]

§ 1. Introduction

[a] Scope

This annotation<sup>1</sup> collects the cases in which an attempt was made to impose liability upon a governmental agency in its capacity as the operator or maintainer of a zoo, for personal injury<sup>2</sup> allegedly caused by such operation.<sup>3</sup>

[b] Related matters

Zoo as nuisance. 58 ALR3d 1126.

Owner's or keeper's liability for personal injury or death inflicted by wild animal. 21 ALR3d 603.

Liability for injury inflicted by horse, dog, or other domestic animal exhibited at show. 80 ALR2d 886.

Liability or indemnity insurance carried by governmental unit as affecting immunity from tort liability. 68 ALR2d 1437.

Nature and status of rule as to municipal immunity from liability for torts. 60 ALR2d 1198.

Liability for injury to property inflicted by wild animal. 57 ALR2d 242.

Rule of municipal immunity from liability for acts in performance of

governmental functions as applicable to injury or death as result of nuisance. 56 ALR2d 1415.

§ 2. Summary and comment

[a] Generally

Many of the cases involving claims for personal injury against a governmental agency operating or maintaining a zoo have involved questions of governmental tort immunity. In several of these cases, such immunity has been denied either because of a general rejection of the rules of governmental tort immunity or because the defendant's activity in connection with the zoo was regarded as "proprietary" rather than "governmental."<sup>4</sup> Other cases, however, have held that tort immunity applied to zoo-keeping activities.<sup>5</sup>

At the other extreme of tort immunity, several of these cases have involved claims that the zoo operator should be held as an insurer against injuries caused by the zoo animals, under the doctrine, recognized in many jurisdictions, that one keeping wild animals is absolutely liable for

1. Section 17 of the Annotation at 21 ALR3d 603 is hereby superseded.

2. While the discussion includes cases presenting claims for personal injury on the basis that the condition complained of constituted a nuisance, no attempt has been made to treat cases presenting the general claim that establishment or maintenance of a zoo constituted a nuisance interfering with plaintiff's enjoyment of property. That question is treated at 58 ALR3d 1120.

3. No attempt has been made to include cases where the cause of injury seemed to

be connected in no way with the fact that a zoo rather than some other type of enterprise was involved.

4. § 3[a], *infra*.

5. § 3[b], *infra*. In view of the unsettled state of the law as to the doctrine of governmental immunity, the authority of any of these zoo cases must be assessed in the light of the general law of the jurisdiction, including cases involving tort claims not concerned with zoos. See 57 Am Jur 2d Municipal, School, and State Tort Liability §§ 65-68.

injury caused by them.<sup>6</sup> Several courts have refused to hold the governmental agency keeping a zoo absolutely liable, taking the view that to so hold would be inappropriate in view of the cultural and educational purposes for which the zoo was kept. This has been especially so where the defendant was charged by the legislature with the duty of keeping the zoo.<sup>7</sup> Some courts have, however, held the operator of the zoo to be an insurer, although in several of these cases the courts also used the language of negligence so that it is not altogether clear upon what theory liability was imposed.<sup>8</sup>

These various theories, and the ordinary rules of negligence, have been applied in a number of fact situations, resulting in the imposition or denial of liability in cases involving escaped zoo animals,<sup>9</sup> or caged or otherwise restrained animals.<sup>10</sup> A few cases have involved injury not caused by zoo animals, but by other alleged defects in the zoo property. Aside from questions of governmental immunity, the courts in these cases have looked to ordinary principles of premises liability in making their decisions.<sup>11</sup>

The few cases involving animal injuries to zoo employees indicate that they will have more difficulty in recovering than zoo visitors or patrons.<sup>12</sup>

### [b] Practice pointers

As in any suit against a governmental entity or agency, counsel pressing a case concerning injury at a zoo should carefully research the appropriate law on the issue of governmental immunity and also the requirements for filing notice of claim, with particular attention to statutes of limitations.<sup>13</sup>

Counsel may wish to frame counts in his complaint on theories of absolute liability and nuisance as well as negligence.<sup>14</sup>

In jurisdictions where it is necessary to do so, plaintiff's complaint should also negative contributory negligence or assumption of risk, even as to the absolute liability claim, since there is some indication in the cases that the courts have looked to this as a defense.<sup>15</sup>

Where a fee is paid to enter the zoo or to use its facilities, recovery may be urged upon the claim that the defendant contracted to provide safe facilities.

### § 3. Governmental tort immunity as applied to zoos

#### [a] Held not applicable

Several cases involving injury claims against a governmental entity or agency in connection with its maintenance of a zoo have held that

6. See 4 Am Jur 2d, Animals § 80.

7. § 4(a), *infra*.

8. § 4(b), *infra*.

9. § 5, *infra*.

10. § 6, *infra*. Several of these cases have involved the situation where the injured party was attempting to feed the animal.

11. § 7, *infra*.

12. §§ 4(a), 6(b), *infra*.

13. As to notice of claim, see 56 Am Jur 2d Municipal Corporations, Counties, and Other Political Subdivisions § 680 et seq. As to the status of the doctrine of governmental immunity, see 57 Am Jur 2d Municipal, School, and State Tort Liability § 65 et seq. For relevant forms, see 18 Am Jur Pleading & Practice Forms (Rev ed) Municipal Tort Liability, Forms 1-14.

14. See § 4, *infra*.

15. See § 4, *infra*.

the doctrine of governmental tort immunity would not bar recovery.<sup>16</sup>

In *Walker v Birmingham* (1976, Ala) 342 So 2d 321, 92 ALR3d 827, the court held that the doctrine of municipal tort immunity (later abolished in the jurisdiction) did not apply to an injury sustained because of a defect in a zoo sidewalk, in view of a statute expressly providing that immunity did not cover injuries arising out of defects in highways.<sup>17</sup>

The court in *Matthews v Detroit* (1939) 291 Mich 161, 289 NW 115, divided equally on the issue whether the defendant was acting in a governmental or proprietary capacity in operating a miniature railroad in its zoological park, with the result that the jury verdict below for a woman injured when she fell in leaving the train was sustained.

The doctrine of state immunity from tort liability was abolished in *Willis v Department of Conservation & Economic Development* (1970) 55 NJ 534, 264 A2d 34, an action brought by a child whose arm was taken off by caged bears in a state recreational facility.

See also *Hyde v Utica* (1940) 259 App Div 477, 1057, 20 NYS2d 335, indicating, *arguendo*, that where a city kept a zoo under a legislative charter, it would not be liable for

injury caused by one of the animals, absent negligence, but that if there were no such charter it would be absolutely liable.

Noting that there was no obligation upon defendant city to maintain the zoo, it was maintained largely for the comfort and convenience of the citizens, the city was indirectly compensated through growth and increased prosperity, these benefits incurred primarily to the city and its inhabitants, and fees were charged for use of the zoo, the court in *Moloney v Columbus* (1965) 2 Ohio St 2d 219, 31 Ohio Ops 2d 447, 208 NE2d 141, concluded that the city was acting in a proprietary capacity so that it could be sued for injuries to a child who, while attending the zoo, was bitten by a guanaco which was part of a barnyard exhibit.

Holding that maintenance by a city of a zoo in a public park was a proprietary function, since the zoo was kept primarily for the benefit of the city's own inhabitants, the court in *Ft. Worth v Wiggins* (1928, Tex Com App) 5 SW2d 761, held that it was error to sustain a demurrer to a complaint alleging that a vicious bear was maintained in a cage adjacent to a public walk in the zoo and that the cage was so defective that the bear could and did reach through a large

16. The doctrine of governmental tort immunity has been under attack in recent years and has been abolished or modified in many jurisdictions. See 57 Am Jur 2d Municipal, School, and State Tort Liability §§ 65-68. Zoo cases cited here on the matter should not be relied upon without checking the current state of the law in the jurisdiction in question, since their authority may be affected by non-zoo cases.

17. The abolition of governmental tort immunity presumably vitiates the authority of *Smith v Birmingham* (1960) 207 Ala

681, 121 So 2d 867, holding that defendant's demurrer was properly sustained since the face of the complaint showed that the employees were acting in a governmental rather than a corporate or ministerial capacity where a complaint alleged that city employees, acting within the scope of their authority, were transporting a deer owned by a private organization to a zoo which was maintained in a public park by the owner of the deer under contract with the city and that they negligently permitted the deer to escape and it injured plaintiff.

ing and injured plaintiff, who using the walk. The court indicated that even if the city were held as acting in its governmental capacity, it could be held liable on the ground that to maintain the bear in those circumstances amounted to a nuisance.

**held applicable**

Recovery for zoo-related injuries has been denied in several cases on the ground that the defendant enjoyed governmental immunity from liability.<sup>19</sup>

Maintenance of a zoo was held to be a governmental function in *McKinney v San Francisco* (1952) 109 Cal 2d 844, 241 P2d 1060, in view of the educational and recreational purposes it served. A statute waiving immunity as to injuries from defects in a gently maintained zoo was held not applicable since the evidence indicated that the polar bear which bit the plaintiff was maintained in a cage and that the accident occurred when plaintiff strained through a barrier and brought his face close to the bear's mouth.

A zoological garden maintained by a defendant city as part of a park was held to be immune under the same theory as parks in *Hibbard v Wichita* (1918) 98 Kan 498, 159 P 399, the court saying that the city was not held to have received any profit from the operation which was maintained for the pleasure and education of the entire public. Accordingly, a claim for a child bitten by a caged bear when she approached and entered their cage was reversed.

Referring to a zoo as a part of a city park being operated and maintained for the benefit and welfare of

the public generally and not primarily for the inhabitants of the city, the court in *Grover v Manhattan* (1967) 198 Kan 307, 424 P2d 256, held that the city was acting in a governmental and not a proprietary capacity in maintaining the zoo and that there could be no recovery by a child bitten by a coyote which had escaped from its cage and was running loose in the area frequented by visitors. The fact that under the state statute the city was only permitted and not required to maintain the zoo was held not to affect the question. And the further claim that the escaped coyote amounted to a nuisance to which the doctrine of municipal immunity did not apply was also rejected, the court saying that no nuisance was shown since the case involved only an isolated instance of a temporary nature.

In *Gartland v New York Zoological Soc.* (1909) 135 App Div 163, 120 NYS 24, although holding that the defendant was not a governmental agency, the court said, *arguendo*, that the city would be liable for its negligence in connection with maintenance of a zoo, since there is no governmental duty put upon the municipality to provide parks and pleasure grounds with wild animals or fish, except in the large sense that a great city may with propriety consider the aesthetic.

And see *Hyde v Utica* (1940) 259 App Div 477, 1057, 20 NYS2d 335, indicating that governmental immunity would apply where the zoo was maintained by the city under a legislative charter.

See also *Smith v Birmingham* (1960) 207 Ala 681, 121 So 2d 867, *supra* § 3[a], holding governmental immunity applicable.

See the caveat, § 3[a] *supra*, as to the doubtful status as authority of cases on the point.

**§ 4. Absolute liability for wild animal injury; nuisance**

**[a] No absolute liability**

In a number of jurisdictions, keepers or harborers of wild animals are held absolutely liable for injury caused by the animals. This is sometimes based upon the ground that the keeping of such animals amounts to maintenance of a nuisance.<sup>20</sup> This rule has often been advanced as a basis for liability in cases involving injury caused by zoo animals.

In several cases the courts have refused to impose absolute liability for animal-caused injuries upon governmental agencies maintaining zoos.<sup>21</sup>

The argument that maintenance of a caged polar bear gave rise to a nuisance *per se* as to which absolute liability should be imposed was rejected in *McKinney v San Francisco* (1952) 109 Cal App 2d 844, 241 P2d 1060, on evidence that the bear was properly caged and that the injury occurred when plaintiff strained against the barrier and brought his hand close to the bear's mouth in trying to feed it sugar.

The rule that one who harbors a wild animal is absolutely liable for injuries caused by the animal was held in *Denver v Kennedy* (1970) 29 Colo App 15, 476 P2d 762, later app 31 Colo App 561, 506 P2d 764, *infra* § 6[a], not to be applicable to the maintenance of wild animals in a public zoo, the court saying that the rationale for that rule was that the keeping of the animal is an unreasonable act done in defiance of the safety and desires of society, and that this

reasoning did not apply to a municipal zoo maintained for the benefit of the public and in response to the public's obvious desires. The court accordingly held that in order to recover for injuries to a five-year-old girl bitten by a zoo zebra, negligence must be shown. The further basis of the wild animal rule that one who exposes the public to the risk of a very dangerous thing is absolutely responsible for resulting injuries was also held inapplicable, the court saying that in the context of today's society and present zoological techniques, it would be unrealistic to hold that operation of a municipal zoo exposes the public to inordinate risk.

A complaint alleging that defendant, superintendent of the National Zoological Park, was a keeper of a wild wolf which escaped from his custody and seriously injured plaintiff, was held subject to demurrer in *Jackson v Baker* (1904) 24 App DC 100. Noting the absence of any allegation of negligence on defendant's part, the court referred to the rule that keepers of a wild animal are ordinarily liable for injuries inflicted by it, even in the absence of fault, but noted that the National Zoological Park had been established by Congress and it was the duty of the defendant to receive and care for such animals as were sent to him by the properly constituted authority. The court said that the ordinary rule of absolute liability was not applicable where the keeping of the animal was not only lawful but obligatory.

In *Grover v Manhattan* (1967) 198

is pursuant to a duty imposed upon the possessor as a public officer or employee. In a caveat the Institute expresses no opinion as to the situation where possession is not required but merely authorized or sanctioned by legislation.

19. See 4 Am Jur 2d, Animals § 80.

20. The Restatement (Second) of Torts § 517 takes the view that rules as to strict liability for dangerous animals do not apply where the possession of the animal

in 307, 424 P2d 256, an action for injuries to a child bitten by a coyote running loose in a part of the zoo frequented by visitors, the court rejected the argument that the facts showed a nuisance to which the doctrine of municipal immunity did not apply, holding that since only an isolated, temporary condition was shown, no nuisance was involved.

Holding that since defendant maintained the zoo and the caged bear therein under legislative authority for public educational and entertainment purposes, it could not be charged with a nuisance in keeping a wild animal, the court in *Guzzi v New York Zoological Soc.* (1920) 192 App v 263, 182 NYS 257, affd 233 NY 1, 135 NE 897, held that her complaint was properly dismissed since there was no claim that defendant had been negligent.<sup>21</sup>

◆ Absolute liability has been held not apply in an action by a zoo employee.

Instructions allowing recovery on the theory of absolute liability in an action by a zoo employee who had been mauled by lions while cleaning their cages were held error in *Oklahoma City v Hudson* (1965, Okla) 15 P2d 178, the court saying that the doctrine had no application to a case where the plaintiff was defendant's employee rather than a member of the public.

#### ◆ Absolute liability imposed

A number of cases seem to have held that the rule imposing absolute liability upon the keeper of wild ani-

mals applies to a governmental agency maintaining a zoo.<sup>22</sup>

The rule making it the duty of a city to exercise reasonable care to make its parks reasonably safe places for visitors and making the city liable for negligence is the better rule, and it would not be wise to permit a city to fill its parks with dangerous animals without making it subject to a high degree of care, if not absolute liability, in keeping them safely confined, said the court in *Byrnes v Jackson* (1925) 140 Miss 656, 105 So 861, 42 ALR 254.

And see *Byrnes v Jackson* (1925) 140 Miss 656, 105 So 861, 42 ALR 254, where the court referred to the strict duty of keeping wild animals safely confined and said that a city maintaining a zoo would be held to that strict duty, but also said that it was the city's duty to exercise reasonable care and that it was negligent under the facts alleged in the complaint.

Absolute liability for keeping of caged bears was also alleged in *Willis v Department of Conservation & Economic Development* (1970) 55 NJ 534, 264 A2d 34, where a child's arm was taken off as she attempted to feed caged bears. The court, abolishing state tort immunity, recognized a cause of action.

In *Hyde v Utica* (1940) 259 App Div 477, 1057, 20 NYS2d 335, where a child at the zoo was bitten by a caged bear which he attempted to feed, although the complaint charged only negligence and not that the harboring of the bear constituted a nuisance,

holding have also used language indicating reliance upon negligence theories, or indicated that contributory negligence might have been considered, so that there may be some question as to how "absolute" the liability imposed actually was.

sance, the court noted that the rule in New York is that one who keeps wild animals on his premises must see to it at his peril that they do no injury to others. While the rule is different where wild animals are kept for the education and entertainment of the public by an institution which holds a charter from the legislature for that purpose, said the court, the defendant city had no such charter and the maintenance of the zoo was purely a private undertaking so that the ordinary rule applied to it.<sup>23</sup>

In *Moloney v Columbus* (1965) 2 Ohio St 2d 213, 31 Ohio Ops 2d 447, 208 NE2d 141, allegations that defendant maintained wild animals in its zoo, the guanaco which bit plaintiff was part of a barnyard exhibit enclosed in a fence with large openings, there was nothing to keep patrons from feeding the animals, and plaintiff was bitten while attempting to do so were held to be sufficient to state a cause of action for absolute liability or nuisance.

In *Tonkawa v Danielson* (1933) 166 Okla 241, 27 P2d 348, affirming judgment for a child who was injured by defendant's bear, although the court spoke of the doctrine of absolute liability, it also said that the question of defendant's exercise of proper care and caution had properly been submitted to the jury.

In the later case of *Mangum v Brownlee* (1938) 181 Okla 515, 75 P2d 174, the court said that the doctrine of absolute liability had been established by the *Tonkawa Case*, supra. The court held that the doctrine of absolute liability for injury caused by wild animals was applicable in an action against a city for injury

caused by a bear which had escaped from its cage, but apparently assumed also that contributory negligence would have been a defense.

And in *Oklahoma City v Hudson* (1965, Okla) 405 P2d 178, although holding the doctrine of absolute liability inapplicable in a case involving injury to a zoo employee, the court apparently assumed that it would have applied but for the employment relationship.

In *Ft. Worth v Wiggins* (1928, Tex Com App) 5 SW2d 761, the court indicated, as one of the grounds upon which a city could be held liable for injury by a caged bear which reached through holes in the cage and seized a child on the adjacent walk, that keeping the bear under such circumstances amounted to a nuisance for which a city would be liable even if it were acting in a governmental capacity in maintaining the zoo.

#### § 5. Injury caused by escaped animal

In some cases where injury to a visitor at a zoo was caused by an escaped animal, the courts have indicated that the governmental agency operating the zoo could be held liable.

Where an elephant being used to give zoo patrons, for a fee, rides on the zoo grounds escaped from the control of its keeper and, in attempting to return to its elephant house, scraped the howdah which carried the passengers from its back, injuring them, and there was evidence that the keeper in charge of the elephant at the time had little experience with such animals and was unable to control it when it started to escape, it was held in *Newman v Cleveland Museum of Natural History* (1944) 143 Ohio

to find absolute liability where the zoo was kept under legislative charter.

21. See, however, *Hyde v Utica* (1940) 259 App Div 477, 1057, 20 NYS2d 335, (ra § 4(b), indicating that absolute liability would be imposed where the zoo was kept under charter.

22. The courts in several of the cases so

23. See *Guzzi v New York Zoological Soc.* (1920) 192 App Div 263, 182 NYS 257, affd 233 NY 511, 135 NE 897, refus-

St 369, 28 Ohio Ops 321, 55 NE2d 575, that the trial court properly found that the defendant was negligent in selecting the agents and servants to have charge of the elephant in that they were not trained or qualified to control the elephant nor to deal with it if it became nervous, excited, or uncontrollable.

Where a bear had escaped from its pit, the only entry to which was through the nearby swimming pool bathhouse, and a visitor to the zoo who captured the bear was leading it back through the bathhouse when it attacked plaintiff, a patron of the swimming pool, it was held in *Man-gum v Brownlee* (1938) 181 Okla 515, 75 P2d 174, that judgment was properly found for plaintiff. Stating that the owner or keeper of a dangerous animal such as a bear is an insurer against injury caused by it, the court rejected the contention that the act of the third party in leading the bear into the bathhouse was an intervening act for which defendant was not responsible, since that act was one which the city had a duty to perform. There was held to be no evidence of contributory negligence.

But it has been held that a zoo employee injured by an escaping animal cannot recover absent negligence.

Plaintiff in *Oklahoma City v Hudson* (1965, Okla) 405 P2d 178, was an employee engaged in cleaning a lion pit who was attacked by the lions when they escaped from an adjacent restraining cage. It was held error to submit the case on the doctrine of absolute liability of one harboring a wild animal. The court noted that the complaint alleged negligence in failing to provide proper locks on the cage door, but also noted that, from plaintiff's testimony, there was some

doubt whether he had properly latched the door.

In a few cases involving escaping zoo animals, recovery has been denied because of governmental tort immunity.

See *Smith v Birmingham* (1960) 270 Ala 681, 121 So 2d 867 (deer being transported by city employees to a zoo escaped); and *Grover v Manhattan* (1967) 198 Kan 307, 424 P2d 256 (child at the zoo bitten by a coyote which had escaped) both sup a § 3(b).

#### § 6. Injury by caged or restrained animal

##### [a] Recovery justified

In several cases where a zoo visitor was injured by a caged or otherwise restrained animal, the courts have indicated that recovery would be justified, usually under circumstances indicating that the defendant could be found guilty of negligence.

Recovery could be had for injuries suffered by a five-year-old girl when her hand was bitten by a zebra at the defendant's zoo only on a showing of negligence, said the court in *Denver v Kennedy* (1970) 29 Colo App 15, 476 P2d 762, later app 31 Colo App 561, 506 P2d 764, holding further that in view of her age, the child could not have been guilty of contributory negligence and was not barred by any negligence of her parents. On later appeal, in *Kennedy v Denver* (1972) 31 Colo App 561, 506 P2d 764, it was held error for the trial court to rule that no prima facie case of negligence had been shown, where there was testimony that the zebras were kept in a pit with a low retaining wall so constructed that children could reach over the wall and feed the zebras directly, hand to mouth; other children were feeding the animals as plaintiff approached, and plaintiff was

able to do so by lying on the wall with her mother holding her skirt; and a zebra gripped one of her fingers in its teeth and bit it off when the mother attempted to free her. There was further expert testimony that zebras are wild and dangerous animals, their propensity to do harm is greater in captivity, and they never should be allowed to come in contact with untrained persons.

On evidence that (1) a chimpanzee was housed in a cage constructed for a lion from which he could reach out for a distance of from two and one-half to three feet, (2) the animal had a few weeks before bitten off the thumb of an employee who was feeding him and had gotten excited and enraged on other occasions when he was teased, and (3) members of the public frequently climbed the protective fence and went to the cages and fed him, it was held in *Brown v Alexandria* (1969, La App) 225 So 2d 157, mod (La App) 226 So 2d 600, application den 254 La 844, 227 So 2d 591, that the defendant was properly held liable for injuries to a boy who approached the cage to feed the animal and was bitten. The court said that the city was negligent in failing to provide wire mesh on the sides of the cage and in failing to provide a fence which would effectively restrain the public from approaching the cage. The boy's father was held not negligent in leaving his 9-year-old son at the park, and the boy was held not contributorily negligent in climbing over the fence.

On allegations that plaintiff, who was attacked by a wild bear, came to defendant's zoo and attempted to feed the bear which had been removed from its cage and chained to a stake or tree by a 6-to-10 foot chain, and that although the defendant knew of the bear's dangerous propensities

there were no warning signs or barriers to protect visitors to the zoo, it was held in *Byrnes v Jackson* (1925) 140 Miss 656, 105 So 861, 42 ALR 254, that it was error to sustain the defendant's demurrer, which was based on the claim that the city was acting in its governmental capacity in conducting the zoo. Noting the general rule imposing absolute liability upon keepers of dangerous animals, the court said that while the city might be maintaining the zoo for educational purposes, it was under no mandate to keep the zoo; that when it undertook to do so, it would be held to the strict duty of keeping the animals safely; and that it was negligence to keep the zoo in the manner described.

In *Willis v Department of Conservation & Economic Development* (1970) 55 NJ 534, 264 A2d 34, where the doctrine of state immunity from tort liability was abolished for New Jersey, the complaint alleged that the arm of a three-year old child was traumatically amputated when she attempted to feed sugar to a caged bear at a state recreational facility. Liability was alleged both on the theory of absolute liability and negligence in failing to maintain suitable screens and barriers around the cage.

On evidence that the seven-year-old plaintiff, at a city zoo, attempted to feed a caged bear with grass and, while his hand was two to three inches from the cage, the bear thrust his nose through a hole in the cage and bit the plaintiff's finger, and that there was no fence or guard rail around the cage, no sign or warning notifying visitors of the danger of approaching the cage, and two or three spectators were feeding him at the time plaintiff approached, no keeper or guard being present, the

court in *Hyde v Utica* (1940) 259 App Div 477, 20 NYS2d 335, held that it was error to enter a nonsuit at the close of plaintiff's case, since the defendant could have been found to be negligent and the plaintiff not to have been contributorily negligent under the circumstances.

Allegations that defendant city maintained a large collection of animals on exhibit in its zoo, the animal which bit plaintiff was enclosed by a wire fence having large openings, members of the public were permitted to feed the animals, and there were no guards or signs to keep them from doing so were held in *Moloney v Columbus* (1965) 2 Ohio St 2d 213, 31 Ohio Ops 2d 447, 208 NE2d 141, to show a cause of action either on the theory of absolute liability for injuries inflicted by wild animals, or on the theories of negligence or nuisance. The absence of specific allegations that defendant knew or should have known that the public would feed the animal, that it was dangerous, or that feeding it was hazardous were said to be immaterial, since defendant, in maintaining the wild animal, was presumed to know its vicious nature.

In *Tonkawa v Danielson* (1933) 166 Okla 241, 27 P2d 348, it appeared that defendant city owned a young grizzly bear which was kept caged on a vacant lot in the business section of the town. The 14-year-old plaintiff, playing near the bear's cage, was injured when the bear reached through the bars and seized her foot. The defense was that the animal was not vicious, having been in captivity since very young, and that plaintiff was contributorily negligent. Affirming judgment for plaintiff, the court said that the city was charged with general knowledge that a bear by nature is a dangerous and vicious animal, and

that children would be attracted to the vicinity of the cage, and that the question whether it was negligent under the circumstances had properly been submitted to the jury as had the issue of plaintiff's contributory negligence.

#### [b] Recovery denied

In some cases of injury to a zoo visitor by a caged or restrained animal, the courts have indicated that there could be no recovery, on evidence showing no negligence on defendant's part and that plaintiff had been contributorily negligent or had assumed the risk of injury.

Upon evidence that a polar bear in defendant's zoo was kept in a cage with bars three inches apart, a four-foot fence was maintained three-feet and eleven inches outside the cage, and above this at the same distance were three strands of galvanized wire seven inches apart, and that the bear could move his paws sideways through the bars to less than six inches outside the cage and its claws were nonretractile so that it could not use them to draw anything into the cage, the court in *McKinney v San Francisco* (1952) 109 Cal App 2d 844, 241 P2d 1060, held that verdict was properly directed against plaintiff who claimed that, in feeding sugar to the bear, he leaned over one of the protective wires with his right hand near the cage and the bear grabbed his arm with its paw and swept his hand into its mouth. Stating that it was doubtful whether the accident could have happened in the manner described by plaintiff if plaintiff did not bring his hand within direct reach of the bear's mouth, the court said that even accepting plaintiff's version of the accident, there was no liability in view of a statute which waived immunity only as to injuries from

dangerous or defective conditions of which the city or its agents had knowledge or notice and failed to take reasonable steps to correct. Noting evidence that the bear had been kept in the same cage under the same condition for six years, during which the zoo had been visited by an average of 50,000 persons a week without injury, and that it was impossible for a person not straining against the fence to reach the dangerous zone, the court said that no intrusion of visitors into the danger zone was reasonably to be anticipated even though the defendant permitted visitors to feed the bears by throwing food in the direction of the cage. Maintenance of the zoo was held to be a governmental function in view of its instructional and recreational purpose. The claim for recovery on the basis of absolute liability for maintaining a public nuisance was also rejected, the court noting that there was no allegation in the complaint to support such a claim and saying that in any event no public nuisance was shown in view of the careful manner in which the bear was kept and the public service which the zoo offered.

*Guzzi v New York Zoological Soc.* (1920) 192 App Div 263, 182 NYS 257, affd 233 NY 511, 135 NE 897, was an action for injuries to a 13-year-old girl who, playing ball near a bear cage at the defendant's zoo, climbed through a fence designed to keep the public away from the cages and, in attempting to retrieve the ball which had rolled under the cage, brought her head near the cage and was mauled by the bear. Recovery was sought on the ground that defendant, in harboring a wild animal, was maintaining a nuisance, but the court rejected this claim on the basis that defendant was keeping the zoo under a legislative charter for purposes of

public education and entertainment. The court further indicated that there was nothing to show that defendant was negligent under the facts alleged and, while expressly stating that it did not base its decision upon this ground, pointed out that the evidence showed that plaintiff unnecessarily and voluntarily, with full knowledge of the danger to her, placed herself in a position where the bear was able to reach her.

And see *Hibbard v Wichita* (1916) 98 Kan 498, 159 P 399, reversing a judgment for damages for a child bitten by caged coyotes, the court holding that the city was immune from tort liability since a governmental function was involved.

Assumption of risk has been held to bar recovery by a zoo employee injured, in the course of his employment, by a confined animal.

A zoo employee who was attacked by deer when he entered their enclosure in the course of his duties was held in *Boremann v Milwaukee* (1896) 93 Wis 522, 67 NW 924, not to be entitled to recover against the city, the court saying that in undertaking the employment he was assumed to have known of the possibly dangerous nature of the work and to have assumed the risk thereof.

#### § 7. Injury not caused by animal

In the few cases which have involved claims of negligence in connection with injuries to zoo visitors other than from animals, the courts have indicated that recovery might be had on facts showing negligence.

Allegations that plaintiff, after purchasing an admission ticket to defendant's municipal zoo, fell in a hole in the walkway maintained therein, was held in *Walker v Birmingham* (1976, Ala) 342 So 2d 321, 92 ALR3d 827,

r appearing on the cover of this supplement.

92 ALR3d 807-814

Attorneys at law: fee collection practice as ground for disciplinary action. 91 ALR3d 583.

Attorney's failure to report promptly receipt of money or property belonging to client as ground for disciplinary action. 91 ALR3d 975.

Conduct of attorney in connection with settlement of client's case as ground for disciplinary action. 92 ALR3d 288.

Conduct of attorney in capacity of executor or administrator of decedent's estate as ground for disciplinary action. 92 ALR3d 655.

Failure to pay creditors as affecting applicant's moral character for purposes of admission to the bar. 4 ALR4th 436.

Falsehoods, misrepresentations, impersonations, and other irresponsible conduct as bearing on requisite good moral character for admission to bar. 30 ALR4th 1020.

Sexual misconduct as ground for disciplining attorney or judge. 43 ALR4th 1062.

Defending lawyers in disciplinary proceedings. 31 AM JUR TRIALS 633.

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92 ALR3d 822-826

Conduct of attorney in connection with settlement of client's case as ground for disciplinary action. 92 ALR3d 288.

Damages recoverable for real-estate mortgagee's refusal to discharge mortgage or give partial release therefrom. 8 ALR4th 853.

Usury in connection with loan calling for variable interest rate. 18 ALR4th 1068.

Validity and effect of "wrap-around" mortgages whereby purchaser incorporates into agreed payments to grantor latter's obligation on initial mortgage. 36 ALR4th 144.

Validity and enforceability of due-on-sale real-estate mortgage provisions. 61 ALR4th 1070.

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Mortgagee's relinquishment of its right to exercise due-on-sale clause in exchange for increased interest rate, although it could not be exercised until property was sold or conveyed, constituted adequate consideration for modification of mortgage agreement. *Frets v Capitol Federal Sav & Loan Assoc.* (1986) 238 Kan 614, 712 P2d 1270.

Defendant bank could not withhold its consent to sale of real property on which it held mortgage lien and declare it due unless purchaser agreed to pay increased rate of interest on unpaid balance of mortgage, where defendant had agreed that plaintiff would have right to sell property subject to mortgage, upon condition that defendant approve of purchaser and defendant agreed that it would not unreasonably withhold such approval, and where it appeared that economic status of proposed purchaser was unobjectionable to bank and that bank wanted increased interest rate solely to upgrade interest to current mortgage interest rates. *Silver v Rochester Savings Bank* (1980) 73 App Div 2d 81, 424 NYS2d 943.

Optional acceleration clause in deed of trust which conditioned approval of transfer by lender on transferee's agreement to increase in interest rate, and which provided for exercise of optional acceleration clause if transferee did not agree was not inherently evil, unreasonable, or oppressive, and served valid business purpose, and thus was valid and enforceable. *Sonny Arnold, Inc. v Senury Sav. Asso.* (1982, Tex) 633 SW2d 811.

Neither due-on-sale clause in mortgage nor mortgagee's requirement of increase in interest rate as condition of not accelerating under clause constituted unreasonable restraint on alienation. *Casey v Business Men's Assur. Co.* (1983, CA5 Tex) 706 F2d 559 (applying Tex law).

Purchaser's 1979 agreement to assume primary personal liability for remaining principal balance of 1975 purchase money mortgage at increased interest rate of 12½ percent per annum, which agreement relieved former property owners of primary liability, acknowledged existence of due-on-sale clause in original 1975 mortgage, and provided for monthly payments to mortgagee-loan association in lieu of exercise of due-on-sale clause, did not violate Wisconsin usury statute prohibiting interest rate exceeding 12 percent per annum where assumption agreement involved "forbearance" by mortgagee of enforcement of due-on-sale clause within meaning of 1978 statute excepting certain loans or forbearances in amount of \$150,000 or more if made after May 26, 1978; further, due-on-sale clause permitting mortgagee to increase interest rate in event mortgagor transfers property is not inequitable. *Weick-*

*hardt v Wauwatosa Sav. & Loan Asso.* (1981, App) 103 Wis 2d 608, 309 NW2d 865.

92 ALR3d 832-844

92 ALR3d 832 § 1(b) [p. 833]

State's liability for personal injuries from criminal attack in state park. 59 ALR4th 1236.

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92 ALR3d 832 § 3(a) [p. 834]

Board of commissioners of park district which voluntarily owns and operates zoological park primarily for benefit and accommodation of those citizens who might be interested in that activity does so in exercise of proprietary function and is answerable for its tortious conduct. *Schenkolewski v Cleveland Metroparks System* (1981) 67 Ohio St 2d 31, 21 Ohio Ops 3d 19, 426 NE2d 784.

92 ALR3d 832 § 3(b) [p. 836]

In view of facts that constitutional, statutory, and city charter provisions authorized maintenance and operation of zoo, so that city was engaged in governmental function in operating zoo, that ostrich pit in zoological park was not a building within building exception of state's governmental tort liability act, and that fees collected from zoo only represented portion of zoo's operating cost, so that zoological park was not operated primarily for pecuniary profit and thus was not proprietary in nature, city was entitled to governmental immunity in action arising out of fall of two-year-old boy into ostrich pit. *O'Keefe v Detroit* (1985, ED Mich) 616 F Supp 162 (applying Mich law).

92 ALR3d 832 § 4(b) [p. 838]

In action alleging both negligence and strict liability for injuries from bite of tiger owned by defendant city, it was reversible error to refuse instruction on assumption of risk as requested by plaintiff, since contributory negligence is defense to claim of negligence but not to claim of strict liability and since assumption of risk is defense to claim of strict liability but is not available as separate defense in negligence case if contributory negligence is available, since court did not limit application of defense of contributory negligence to plaintiff's negligence

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division, did not clearly state that jury could consider strict liability without regard to contributory negligence, instructed jury that if it found contributory negligence "your verdict will be for the defendant," and since court's one-sentence reference to "knowingly" placing oneself in position of danger did not adequately or correctly define its terms. *Franken v Sioux Center* (1978, Iowa) 272 NW2d 422.

92 ALR3d 832 § 6[a] [p. 840]

In action by two-year-old boy and his mother against zoo director and zoo employee who had responsibility to prevent animals from harming people, based on negligence, and against city on basis, inter alia, of indemnity for negligence of zoo director and zoo employee, general verdict for plaintiffs against all three defendants was proper where there was evidence that either zoo director or employee or both were negligent in not fulfilling their duty to make all reasonable inspections to discover possible defective or dangerous conditions so as to assure safety of visitors to zoo, especially to that part of zoo housing wild and ferocious animals, which required their taking precautions equal to "coiled spring danger" that lurked within cage, and that such negligence was proximate cause of boy's injury and of his mother's medical expenses. *Blanchard v Bridgeport* (1983) 190 Conn 798, 463 A2d 553.

92 ALR3d 832 § 6[b] [p. 842]

City park commission was not liable for damages sustained by two-year-old child who was bitten by caged ape at zoo, where, although commission employee had originally returned to zoo with mother and child to perform employment task, his conduct in taking child beyond guard rail into close proximity of wild animals was such significant and unpredictable deviation and departure from his duties and so unrelated to service of employer as to remove his conduct from scope of his employment. Thus, commission exculpated itself from liability under code by showing that harm was caused by fault of third persons, employee and mother, and that commission was not responsible for fault of either. *Normand v New Orleans* (1978, La App) 363 So 2d 1220, cert den (La) 366 So 2d 573.

92 ALR3d 832 § 7 [p. 843]

In action to recover for injury sustained by 12-year-old girl who collided with support column in zoo's nocturnal exhibit building which had reserved lighting to create illusion of nighttime, city operating zoo was liable where ease with which support columns could have been made visible to even unwary by lighting

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or reflectors, or padded to eliminate risk of injury, without affecting utility of nocturnal nature of exhibit supported conclusion that failure to take such precautions constituted breach of city's duty to zoo patrons, and where, since possibility that child would act carelessly or thoughtlessly was within foreseen risks encompassed by duty, city could not be relieved of liability by pleading contributory negligence on part of child. *Berry v Monroe* (1983, La) 443 So 2d 597.

92 ALR3d 866-889

92 ALR3d 866 § 1[b] [p. 868]

Modern status of admissibility, in forcible rape prosecution, of complainant's prior sexual acts. 94 ALR3d 257.

Constitutionality of "rape shield" statute restricting use of evidence of victim's sexual experiences. 1 ALR4th 283.

Adequacy of defense counsel's representation of criminal client regarding right to and incidents of jury trial. 3 ALR4th 601.

Entrapment defense in sex offense prosecutions. 12 ALR4th 413.

Modern status of rule regarding necessity for corroboration of victim's testimony in prosecution for sexual offense. 31 ALR4th 120.

Admissibility, at criminal prosecution, of expert testimony on rape trauma syndrome. 42 ALR4th 879.

Necessity or permissibility of mental examination to determine competency or credibility of complainant in sexual offense prosecution. 45 ALR4th 310.

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92 ALR3d 866 § 3 [p. 870]

Also supporting view that it is improper to instruct jury that charge is easy to make and difficult to disprove and that they should view complainant's testimony with caution:

US—United States v Vik (1981, CA8 Mo) 655 F2d 878.

Alaska—Burke v State (1980, Alaska) 624 P2d 1240.

Fla—Marr v State (1985, Fla App D1) 470 So 2d 703, 10 FLW 1505, review dismd (Fla) 475 So 2d 696.

Mont—State v Liddell (1984, Mont) 685 P2d

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For lat

# Alaska State Legislature

Chairman  
(907) 465-4523



Jan Faiks  
Post Office Box V  
Juneau, Alaska 99811

## Senate Judiciary Committee

April 12, 1989

### MEMORANDUM

TO: Representative Max Gruenberg, Co-Chairman  
Representative Peter Goll, Co-Chairman  
House Judiciary Committee

FROM: Senator Jan Faiks, Chairman  
Senate Judiciary Committee

SUBJECT: SB 89 "An Act relating to civil liability of zoos  
and zoo operators."

SB 89 has been heard once by the House Judiciary Committee, and is currently awaiting a second hearing. This memo will address questions that have been raised about the bill, and provide additional information that the committee may find useful in its deliberation.

1. Should the bill specifically require the installation of protective devices to safeguard visitors from the animals?

This is not necessary. Under the legislation, zoos would be liable for acts of negligence. The failure to provide adequate safety devices would constitute negligence, and whether a plaintiff's injury resulted from such a failure would be a question for the jury.

It is not necessary to require that protective devices, such as barriers, be specifically designed to protect children, since the common law of negligence requires a defendant to take the plaintiff as he finds him; that is, a zoo is obligated to provide safeguards adequate to protect any type of person who may reasonably be expected to visit, whether that person be a child, an adult, or handicapped in some way. If it does not, and a person is injured, the zoo's failure is considered negligent.

#### Members

Mike Szymanski, Vice-Chairman • Rick Halford • Drue Pearce • Pat Rodey

#### Out of Session

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2. Should the bill define the "reasonable care" which it requires zoo operators to exercise?

"Reasonable care" is a term of art which the common law has defined. Essentially, it involves the level of prudence which an ordinary person would exercise under the same circumstances. A jury would determine if the injury to a zoo visitor was caused by an action or inaction of the zoo operator that a person of ordinary prudence under the same circumstances would have avoided.

3. Does current law subject zoos to strict liability only for the acts of wild animals, or also to strict liability for the defective design or construction of cages?

The common law imposes strict liability for injuries caused by wild animals, whether those injuries were the result of an improperly designed cage or barrier (such as a barrier too close to the cage bars), a careless act by the plaintiff, or a defective cage that allows an animal to escape.

A review of the case law shows that most often, injuries at zoos are caused by careless acts of a plaintiff. If such an act was accompanied by negligence on the part of the zoo, such as designing a barrier that allowed children to walk underneath or adults to be reached by an animal in the cage, the plaintiff could still recover under SB 89.

A review of various sources indicates that no model legislation in this area has been prepared in at least the last fifteen years.

If you have any additional questions or comments, please feel free to contact my office.

Thank you.



STATE OF ALASKA  
THE LEGISLATURE

POUCHY - STATE CAPITOL  
JUNEAU, ALASKA 99811  
907-465-3800

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Mary Van Nimwegen

HOUSE Labor & Commerce CmTE  
February 7, 1989 3:00 pm  
SB 89

STATE OF ALASKA  
1989 LEGISLATIVE SESSION

BILL VERSION: SB 89  
PUBLISH DATE: 1/20/89

**FISCAL NOTE**

REQUEST: \_\_\_\_\_

REVISION DATE: \_\_\_\_\_  
TITLE: Civil liability of zoos  
and zoo operators  
SPONSOR: Faiks  
REQUESTOR: Senate Judiciary Cmte

AGENCY: Alaska Court System  
BRU: Trial Courts  
COMPONENTS: \_\_\_\_\_

**EXPENDITURES/REVENUES: (THOUSANDS OF DOLLARS)**

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
OPERATING						
PERS. SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND/BUILD.						
GRANTS/CLAIMS						
MISCELLANEOUS						
TOTAL	0	0	0	0	0	0

CAPITAL \_\_\_\_\_

REVENUE \_\_\_\_\_

**FUNDING: (THOUSANDS OF DOLLARS)**

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

**POSITIONS:**

FULL-TIME						
PART-TIME						
TEMPORARY						

**ANALYSIS:**

PREPARED BY: Jan Faiks  
Senator Jan Faiks, Chairman  
Senate Judiciary Committee

DATE: 1/19/89  
PHONE NO.: 465-4523

1 IN THE SENATE

BY FAIKS

2

SENATE BILL NO. 89

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

SIXTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6

For an Act entitled: "An Act relating to civil liability of zoos and zoo operators."

7

8

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9

\* Section 1. AS 09.17 is amended by adding a new section to read:

10

Sec. 09.17.100. CIVIL LIABILITY OF ZOOS. (a) A person may not

11

recover damages for injury to person or property from a zoo or a zoo

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operator, if the damages occurred as a result of an inherent risk of

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attendance at a zoo, notice of the inherent risk was posted as re-

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quired under (b) of this section, and the zoo operator exercised

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reasonable care to prevent the injury.

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(b) A zoo operator shall post signs at prominent places within a

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zoo and at each zoo entrance. Each sign shall include a statement

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warning that the zoo is not liable for injuries to person or property

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occurring as a result of dangers or conditions inherent in attending

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the zoo.

21

(c) In this section

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(1) "inherent risk of attendance" means the dangers or

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conditions that are an integral part of a zoo and the physical prox-

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imity of wild animals;

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(2) "zoo" means a place where wild animals are kept for

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exhibition to the public that is

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(A) owned by the state or a municipality; or

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(B) owned and operated by a nonprofit organization.

Original sponsor(s): SEN. FAIKS

1 IN THE SENATE BY THE JUDICIARY COMMITTEE  
2 HOUSE CS FOR SENATE BILL NO. 89 (Judiciary)  
3 IN THE LEGISLATURE OF THE STATE OF ALASKA  
4 SIXTEENTH LEGISLATURE - SECOND SESSION

5 A BILL

6 For an Act entitled: "An Act relating to civil liability of zoos and zoo  
7 operators."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 \* Section 1. AS 09.17 is amended by adding a new section to read:

10 Sec. 09.17.100. CIVIL LIABILITY OF ZOOS. (a) Except as pro-  
11 vided in (b) of this section, a person who owns or operates a zoo is  
12 strictly liable for injury to a person or property if the injury is  
13 caused by an animal owned by or in the custody of the zoo.

14 (b) A person who owns or operates a zoo is not strictly liable  
15 as provided in (a) of this section if

16 (1) the animal that caused the injury was within the  
17 animal's normal place of confinement at the time the injury occurred;

18 (2) the zoo owner or operator had posted signs at prominent  
19 places within the zoo, including at each entrance, warning that the  
20 liability of the zoo for injuries caused by animals within their  
21 normal place of confinement is limited by law; and

22 (3) the enclosure within which the animal was confined at  
23 the time of the injury was constructed and maintained in a manner that  
24 prevents a person who exercises ordinary care customary for a person  
25 of similar age, intelligence, and experience from contacting the  
26 animal or entering the enclosure.