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domicile in the traditional sense is less important than that the nexus be established before recognition is accorded.

THE STATUS OF AN INVESTMENT SECURITY HOLDER UNDER ARTICLE 8

With the adoption of Article 8 of the Uniform Commercial Code,[1] a considerable step has been taken by the Legislature to add clarity and cohesion to the New York law of investment securities. Commensurate with the objectives enumerated for the Code in its entirety, the enactment of Article 8 should do much to "simplify, clarify and modernize the law governing commercial transactions" and "to permit the continued expansion of commercial practices through custom, usage and agreement of the parties . . . ."[2] One area of law which should feel the full impact of the Code's clarifying effect is that relating to the status of a security holder. The Code has definitively set forth the rights and obligations of such a party.

It should be noted at the outset that Article 8 does not concern itself with the fundamental validity of a security[3] but deals primarily with the problems created by its transfer. It is in many respects a negotiable instruments law of investment securities.

I. Introduction

The Uniform Commercial Code has revised and reworded much of the Negotiable Instruments Law.[4] The Code creates two broad categories, commercial paper[5] and investment securities, under which provision is made for all

abroad." Id. at 255, 331 P.2d at 644. However, he continued: "The public policy of California may not permit the recognition of a foreign divorce decree when the foreign jurisdiction has no legitimate interest in the marital status of the parties, when the sole purpose of seeking the divorce in a foreign court is to evade the laws of this state [citing California's statute incorporating the Uniform Divorce Recognition Act] . . . ." Id. at 256, 331 P.2d at 645. See also Note, Domicile as a Constitutional Requirement for Divorce Jurisdiction, 44 Iowa L. Rev. 765, 777 (1959), in which it is suggested that where a divorcing forum lacks a sufficient interest in the marriage res, but has personal jurisdiction over both parties, the law of their domicile be applied.

1. Uniform Commercial Code—Investment Securities. The Uniform Commercial Code took effect in New York on September 27, 1964. New York Uniform Commercial Code § 10-105 (hereinafter cited as N.Y.U.C.C.).

2. N.Y.U.C.C. § 1-102 (2) sets forth the underlying purposes and policies of the Code.

3. The provisions of the Code do not, to any substantial degree, invade the area presently covered by the various state corporation codes, e.g., N.Y. Bus. Corp. Law, blue sky laws, e.g., N.Y. Gen. Bus. Law §§ 352-59h, or the federal securities regulations, Securities Act of 1933, 48 Stat. 74, 15 U.S.C. §§ 77a-aa (1958), as amended, 15 U.S.C. § 77d (Supp. V, 1964). An exception is N.Y.U.C.C. § 8-104, which recognizes the invalidity of an overissue of securities.

4. The Negotiable Instr. Law, N.Y. Sess. Laws 1897, ch. 612, §§ 1-341, was repealed on the effective date of the Code. N.Y.U.C.C. § 10-102.

5. Uniform Commercial Code, Art. 3: Commercial Paper.

those instruments commonly treated by the commercial world as negotiable paper.[6] It provides for separate treatment of each,[7] with each article endowing specific classes of instruments with the character of negotiability in dealing with the rights and liabilities arising between the original obligor and the holder, and among successive holders.[8] This comment will delineate the rights which a holder of a security can assert under Article 8 against the original obligor, *i.e.*, the issuer, and against prior holders claiming some right to, or interest in, the instrument.[9]

II. General Concepts

A. *Definition of Investment Security*

In order to provide for less restrictive negotiability, securities are given a functional rather than a formal definition.[10] The Code breaks away from the

6. Israels, Investment Securities as Negotiable Paper—Article 8 of the Uniform Commercial Code, 13 Bus. Law 676 (1958). It should be noted that there are certain specialized negotiable instruments which are included under the article on documents of title. N.Y.U.C.C. §§ 7-101 to -603.

7. By providing these separate classifications, the Code recognizes the commercial incorrectness of including short term credit devices (e.g., checks) and long term financing arrangements (e.g., bonds) within the legal provisions governing negotiable instruments. N.J. Commission on the Uniform Commercial Code, Second Report on the Uniform Commercial Code for New Jersey 573 (1960). Any instrument which would qualify as commercial paper under Article 3 will be excluded from the operation of that Article if it also comes within the definition of an investment security under Article 8. Article 8 will control where both articles might be applicable. N.Y.U.C.C. § 8-102(1)(b).

8. The new classification will not, however, remedy all the problems currently facing the commercial lawyer. In one area it has created a new problem where none previously existed. Prior to the adoption of the Code, New York lending institutions were permitted to charge any rate of interest agreed upon where they advanced $5000 or more upon a pledge of stock certificates, bonds, bills of exchange, warehouse receipts and other enumerated instruments as collateral security. Such transactions were exempted from the usury laws. N.Y. Sess. Laws 1882, ch. 237, § 1, formerly N.Y. Gen. Bus. Law § 379. N.Y. Gen. Obligations Law, which became effective with the N.Y.U.C.C., repealed the General Business Law provision authorizing the above mentioned loans. N.Y. Gen. Obligations Law § 19-101(5).

The Legislature has enacted a corresponding section of the Gen. Obligations Law permitting the same high interest rates on advances, but limiting their scope to loans made upon pledges of documents of title within Article 7 or negotiable instruments within Articles 3 or 7. N.Y. Gen. Obligations Law § 5-523. No mention is made of either stock certificates or the new term, investment securities, and therefore it must be assumed that lenders will no longer be completely free to contract as to interest rates when they accept stocks and bonds as security. It is doubtful whether such result was intended. The notes to McKinney's codification state that the second mention of article seven "probably should read 'article eight.'" N.Y. Gen. Obligations Law 5-523 n.2.

9. A discussion of Article 8 would not treat priorities involved in the use of investment securities as collateral in a secured transaction. This would properly be discussed in conjunction with Article 9.

10. Uniform Commercial Code § 8-102, comment. Basically, the Code definition provides that any securities regarded or dealt with as negotiable on the markets and exchanges will be negotiable as a matter of law. See N.Y.U.C.C. §§ 8-102(1)(a), -105(1).

strict requirements of the Negotiable Instruments Law[11] and adopts instead the concept of the "law merchant"[12] which is the theory of "permitting business to originate for itself the methods and instrumentalities that may be found by experience to be helpful to its free development . . . ."[13] Thus, businessmen are no longer hampered by the rigid rules of the Negotiable Instruments Law and may use the more flexible doctrine of the law merchant to develop new negotiable instrument devices as commercial necessity may dictate.[14]

While it is said that securities are defined in a functional rather than a formal manner, it must be borne in mind that the Code has not done away with all formal requisites. In addition to the general provision that the security must be of a type commonly dealt with upon securities markets or commonly recognized as a medium of investment in any area in which it is issued,[15] it is also necessary that the instrument: (1) be issued in bearer[16] or registered form;[17] (2) be one of a class or series, or divisable into a class or series;[18] and (3) evidence an interest in property, participation in an enterprise or obligation of the issuer.[19]

11. Section 20 of the Negotiable Instruments Law provided that: "An instrument to be negotiable must conform to the following requirements: 1. It must be in writing and signed by the maker or drawer; 2. Must contain an unconditional promise or order to pay a sum certain in money; 3. Must be payable on demand, or at a fixed or determinable future time; 4. Must be payable to order or to bearer; and 5. Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty." N.Y. Sess. Laws 1897, ch. 612, § 20.

12. N.Y.U.C.C. § 1-103 provides: "Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant . . . shall supplement its provisions."

13. Manhattan Co. v. Morgan, 242 N.Y. 38, 52, 150 N.E. 594, 598-99 (1926).

14. N.J. Commission on the Uniform Commercial Code, Second Report on the Uniform Commercial Code for New Jersey 574 (1960).

15. N.Y.U.C.C. § 8-102(1)(a) contains the definition of the term security.

16. A security is in bearer form, under Code terminology, when it is issued payable to bearer. As with a security issued in registered form, the fact that it was originally issued in bearer form must be apparent from the face of the instrument. It is not possible to change an investment security payable to order into an instrument payable to bearer by means of a blank indorsement. N.Y.U.C.C. § 8-102(1)(d). Cf. N.Y.U.C.C. § 3-111 determining when an instrument regarded as commercial paper is payable to bearer.

17. "A security is in 'registered form' when it specifies a person entitled to the security or to the rights it evidences and when its transfer may be registered upon books maintained for that purpose by or on behalf of an issuer or the security so states." N.Y.U.C.C. § 8-102(1)(c).

18. This would exclude a situation where a corporation issues a single certificate representing a single share, but not a certificate representing multiple shares. On its face, this would not achieve the result suggested by the Law Revision Commission, which presumed that "this qualification was inserted to narrow the application of Article 8 to types of securities which are widely held." N.Y. Leg. Doc. No. 65(I), p. 12 (1955).

19. New York law contains no standard definition of the term security. It is variously defined in statutes and case law. See, e.g., N.Y. Gen. Bus. Law § 359-m; In the Matter of

B. *Statute of Frauds*

One factor which must always be borne in mind when considering the relationship between the parties is the Statute of Frauds. It applies to all contracts for the purchase or sale of securities, and failure to comply with its provisions renders the contract unenforceable against a party asserting the Statute of Frauds as a defense.[20]

Under the investment securities Statute of Frauds no contract is enforceable unless it is in writing and signed by the party to be charged.[21] The writing itself must be sufficient to show: (1) the fact that a contract has been made; (2) a description of the security; (3) a stated quantity; and (4) a definite or stated price.[22]

Exceptions to the writing requirement are made when delivery of the security has been accepted,[23] when payment has been made,[24] or when the party against whom enforcement is sought "admits in his pleading . . . or otherwise in court that a contract was made . . . ."[25] Also, in recognition of the fact that many contracts between broker and customer are made over the telephone, a signed writing will not be necessary to charge the customer where the broker sends him a written confirmation of the sale (which confirmation would be sufficient to charge the sender) and the customer fails to make a written objection within ten days after its receipt.[26]

Waldstein, 160 Misc. 763, 766-67, 291 N.Y. Supp. 697, 700 (Sup. Ct. 1936); In re Gillis, 117 N.Y.S.2d 454, 457 (Surr. Ct. 1952); In re Budd, 107 N.Y.S.2d 971, 973 (Surr. Ct. 1951).

The Code definition is narrower than the definition found in the Securities Act of 1933, § 2, 48 Stat. 74 (1933), 15 U.S.C. § 77b(1) (1958). A particular instrument, although not subject to the provisions of Article 8, may well be subject to federal regulation. See, e.g., SEC v. W. J. Howey Co., 328 U.S. 293 (1946).

20. N.Y.U.C.C. § 8-319 sets forth the investment security statute of frauds. The section is essentially derived from the provisions of the Uniform Sales Act § 4, N.Y. Sess. Laws 1911, ch. 571, § 85, formerly N.Y. Pers. Prop. Law § 85, repealed by N.Y.U.C.C. § 10-102, which had previously been held to apply to the sale of both goods and securities. See Agar v. Orda, 264 N.Y. 248, 190 N.E. 479 (1934).

21. N.Y.U.C.C. § 8-319(a).

22. N.Y.U.C.C. § 8-319(a). Unlike N.Y.U.C.C. § 2-201, the Article 8 Statute of Frauds does not require that any minimum amount be involved before the Statute becomes a defense.

23. Acceptance would seem to require some affirmative act by the buyer whereby he consents to become the owner. Mere failure to object to a delivery will not suffice. N.Y. Leg. Doc. No. 65(I), p. 106-07 (1955). Acceptance may be made by someone acting as agent for the buyer. Strelsin v. Central Trust Co., 164 Misc. 702, 299 N.Y. Supp. 579 (Sup. Ct. 1937).

24. N.Y.U.C.C. § 8-319(b). The contract will be enforceable only to the extent that payment or delivery was made. Under N.Y. Sess. Laws 1911, ch. 571, § 85(1) formerly N.Y. Pers. Prop. Law § 85(1), partial payment or delivery validated the entire contract.

25. N.Y.U.C.C. § 8-319(d).

26. N.Y.U.C.C. § 8-319(c). The reason for this provision cuts wider than the securities field as is evidenced by the fact that a similar provision is found in the Article 2 Statute of Frauds, N.Y.U.C.C. § 2-201(2).

C. *The Purchaser for Value Without Notice*

Throughout Article 8 special status is accorded to the purchaser for value[27] without notice who is confronted with a defense of the issuer. In this respect, it is imperative to determine when a party has notice of a defense. Aside from prior knowledge, a person will have notice of a particular fact when such fact comes to his attention[28] or when notification "is duly delivered at the place of business through which the contract was made or at any other place held out by him as the place for receipt of such communications."[29] Notice of a defense will also be imputed to a party if "from all the facts and circumstances known to him at the time in question he has reason to know that it exists."[30]

Recognizing the fact that overdue bonds and stocks called for redemption are quite often traded on the market after maturity, the Code makes a departure from the Negotiable Instruments Law in providing that mere maturity will no longer put a purchaser on notice of defenses.[31] A purchaser will be put on notice only where he takes the security one year after the date designated for payment or performance where the issuer has made provision for performance of his obligations under the security; or, two years after the due date where the issuer was in default at maturity.[32]

III. The Holder's Status in Relation to the Issuer

A. *Issuer Defined*

Part 2 of Article 8 defines a holder's rights against the issuer of the security. In dealing with the issuer, the holder's chief concern is enforcement, his object being to cut off any defenses to liability on the security which might be asserted by the issuer. His success will depend on the particular status which he occupies.

27. It is generally provided that a party gives value for rights if he acquires them "in return for any consideration sufficient to support a simple contract." N.Y.U.C.C. § 1-201(44)(d).

28. N.Y.U.C.C. § 1-201(26)(a).

29. N.Y.U.C.C. § 1-201(26)(b).

30. N.Y.U.C.C. § 1-201 (25)(c). Subdivision 25 also states that "the time and circumstances under which a notice or notification may cease to be effective are not determined by this Act." This sentence preserves the rule of "forgotten notice" enunciated in Graham v. White-Phillips Co., 296 U.S. 27, 32 (1935). A party who has previously received notice of a defense will not be charged with such notice if at the time of the transaction he did not have the fact of the notice in mind.

31. N.Y. Sess. Laws 1897, ch. 612, § 91(2), formerly N.Y. Negotiable Instr. Law § 91(2), requires that a person take the instrument before it was overdue in order to qualify as a holder in due course. N.Y.U.C.C. § 3-302(1)(c) requires a holder in due course to take the instrument "without notice that it was overdue." Chaffee, Rights in Overdue Paper, 31 Harv. L. Rev. 1104, 1121 (1918), criticized this rule, stating that an instrument which has matured "is like a red flag which gives warning of every conceivable kind of danger and puts the purchaser on inquiry as to all infirmities without distinction."

32. N.Y.U.C.C. § 8-203.

The use of the term "issuer"[33] brings a new expression into the statutory law of New York.[34] In its application, the term would most clearly correspond to the maker, drawer[35] or accommodation party[36] of a negotiable instrument—terms which have been retained in the language of the Code article on commercial paper.[37] However, the term issuer is much broader than its Negotiable Instruments Law counterparts, since the types of instrument covered by Article 8 are of a much greater variety. Included in the Code definition[38] of issuer are: (1) One who signs a security to evidence an interest in his property or a duty on his part to perform an obligation as evidenced by the security; or (2) One who creates fractional interests in his property, which interests are evidenced by securities; or (3) One who succeeds to the responsibilities of another issuer;[39] or (4) A guarantor, to the extent of his guarantee; and (5) With respect to registration of transfer, one in whose behalf transfer books are kept.[40]

B. *The Issuer's Defenses*

The defenses which the issuer may assert to escape payment on the security when it becomes due fall into two main categories: first, a real defense which can be asserted against any holder, and second, personal defenses which cannot be asserted against a purchaser for value without notice of the defense.

33. Although Article 8 clearly defines "issuer," N.Y.U.C.C. § 8-201, there is no precise definition of "issue." Since the entire article revolves around negotiations and transfers and applies only to securities recognized as a medium of investment, it has been speculated that an issue would involve first putting the security into circulation as a medium of investment, i.e., the initial delivery. See, Guttman, Investment Securities Under the Uniform Commercial Code, 11 Buffalo L. Rev. 1, 9 (1961); N.J. Commission on the Uniform Commercial Code, Second Report on the Uniform Commercial Code for New Jersey (1960). As far as liability between a corporation and its shareholder is concerned, the issue of the security is of little importance since the stock certificate is merely evidence of ownership and need not be issued for liability to arise. Richardson v. Shaw, 209 U.S. 365, 378 (1908).

34. The term "issuer" is new to the statutory law of many Code states. See, e.g., N.Y.U.C.C. § 8-201, New York Annotations; N.J. Commission on the Uniform Commercial Code, Second Report on the Uniform Commercial Code for New Jersey 587 (1960).

35. N.Y. Sess. Laws 1897, ch. 612, § 20(1), formerly N.Y. Negotiable Instr. Law § 20(1), demanded that an instrument be signed by the maker or drawer as a requisite to negotiability.

36. N.Y. Sess. Laws 1897, ch. 612, § 55, formerly N.Y. Negotiable Instr. Law § 55, defined an accommodation party as "one who has signed the instrument as maker, drawer, acceptor or indorser, without receiving value therefor . . . ."

37. N.Y.U.C.C. §§ 3-413, -415.

38. N.Y.U.C.C. § 8-201.

39. In the article dealing with commercial paper it is expressly provided that "no person is liable on an instrument unless his signature appears thereon." N.Y.U.C.C. § 3-401(1). It appears that one who takes the place of the original issuer will be liable on an investment security whether or not his signature appears. N.Y.U.C.C. § 8-201(1)(c).

40. This particular definition should be read in conjunction with N.Y.U.C.C. § 8-405 relating to duties of a transfer agent.

1. Signature Invalidity

The main defense of the issuer under Article 8 is that the security lacks genuineness.[41] A security is genuine when it has been properly signed and indorsed, *i.e.*, when it is free from forgery or counterfeiting.[42] Should the security be presented in any condition other than "genuine," the issuer may, barring any estoppel, have a complete defense. This is his sole real defense in that it is the only one which can be asserted to obtain a full discharge[43] of the issuer's obligations without regard to the status of the holder.[44]

However, even where the security lacks genuineness, the Code recognizes the case law exception[45] estopping the issuer from asserting this as a defense. Therefore, an unauthorized signature will not prevent enforcement by a purchaser who took the security for value, without notice of the lack of authority, where the act was committed at or prior to issue by "an authenticating trustee, registrar, transfer agent or other person entrusted by the issuer with the signing of the security or of similar securities . . . ," or by "an employee of the issuer or of any of the foregoing entrusted with responsible handling of the security."[46]

2. Defenses to the Validity of a Security

In treating all defenses other than the invalidity of the issuer's signature, the Code draws a distinction between defects caused by failure to comply with a statutory regulation and those brought about by a constitutional violation. Where the security is issued with a defect caused by failure to comply with a statute regulating its issue,[47] the defect will be ignored and the security declared valid[48] in the hands of any purchaser for value without notice of the defect.[49]

41. N.Y.U.C.C. § 8-202.

42. N.Y.U.C.C. § 1-201(18).

43. The issuer may assert the defense that a security has been altered and may not have to pay more than the original tenor. N.Y.U.C.C. § 8-206(2).

44. Note that this section refers to a forged signature at or prior to issue. N.Y.U.C.C. § 8-311 covers a forged indorsement. The holder for value faced with lack of genuineness as a defense has a right of action against the transferor who warranted at the time of transfer that the security was genuine. N.Y.U.C.C. § 8-306(2)(b).

45. New York & N.H.R.R. v. Schuyler, 34 N.Y. 30 (1865). See also, 11 Fletcher, Private Corporations 472-73 (1958).

46. N.Y.U.C.C. § 8-205. The Code uses objective standards to replace agency rules in determining when the issuer may be precluded from raising a defense. See Hudson Trust Co. v. American Linseed Co., 232 N.Y. 350, 134 N.E. 178 (1922), where it was required that the issuer both entrust certificates to an employee and give him some authority to issue before the signature would be effective against him.

47. See, e.g., N.Y. Bus. Corp. Law §§ 504, 518, providing that present consideration must be given in return for the issuance of stocks and bonds. It should be noted that N.Y.U.C.C. § 8-202(2)(a) does not limit its application to statutory defects but applies to all defects going to the validity of a security other than those caused by constitutional violation.

48. 2 Anderson, Uniform Commercial Code 356 (1961).

49. N.Y.U.C.C. § 8-202(2)(a).

Certain states have constitutional provisions regulating the issue of a security. Included are provisions stating that unless substantial consideration is received by the issuer of the security, the issue will be void.[50] Where the defect in the security involves violation of any constitutional provision, the issuer will be prevented from denying its validity only when the security is presented by a *subsequent purchaser*[51] for value without notice. Therefore, the original purchaser, who may have contributed to the constitutional violation by failing, for example, to provide adequate consideration, is afforded no protection in this situation.[52]

In either of the above situations, the invalidity of the security may be asserted by the issuer against an owner who purchased with notice of the particular defect or did not take for value.

The distinction between purchaser and subsequent purchaser is further qualified where the issuer is a governmental agency, such as a municipality or public authority.[53] Certain additional standards must be met, however, before estoppel will work against the issuer. The governmental issuer will be denied this defense only if *either* substantial consideration[54] was received and a stated purpose of the issue was one for which the issuer had power to borrow money or issue the security[55] *or* where "there has been substantial compliance with the legal requirements governing the issue . . . ."[56] A mere technical deficiency in an issue which on its face seems to be legal will not be a ground for depriving an innocent purchaser of his rights in the security.[57]

50. Pa. Const. art. XVI, § 7 provides: "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received . . . ." New York has no constitutional provisions governing issue of securities by nongovernmental issuers, but N.Y. Const. art. VIII, § 2, prohibits municipalities from giving their money or credit in aid of an individual or corporation. N.J. Const. art. VIII, § 2, prohibits the loan of state monies or credits for private purposes. The validity of a municipal bond issue might be attacked on this ground. Behnke v. New Jersey Highway Authority, 13 N.J. 14, 97 A.2d 647 (1953).

51. A subsequent purchaser is one who takes a security other than by original issue. N.Y.U.C.C. § 8-102(2).

52. N.Y.U.C.C. § 8-202(2)(a). It should be noted that these provisions validating a defective stock issue are subject to N.Y.U.C.C. § 8-104 which would prevent their application if the result would be an issue in excess of the authorized amount.

53. See, e.g., N.Y. Pub. Auth. Law granting specific public authorities power to issue bonds.

54. Consideration may be deemed substantially received for the issue as a whole or for the particular security. N.Y.U.C.C. § 8-202(2)(b).

55. N.Y.U.C.C. § 8-202(2)(b).

56. N.Y.U.C.C. § 8-202(2)(b). The requirements of "substantial consideration" or "substantial compliance" are alternative. If neither requirement is satisfied the governmental issuer can assert the invalidity against any purchaser, original or subsequent. 2 Anderson, Uniform Commercial Code 357-58 (1961).

57. See, e.g., Town of Solon v. Williamsburgh Savings Bank, 114 N.Y. 122 (1889), where it was held that the fact that municipal bonds contained a defective seal would have no

3. Alteration

The issuer's defense that a security has been materially altered will no longer be effective to prevent payment according to its tenor at the time of issuance.[58] An alteration of a completed security[59] has no legal effect regardless of the extent of the change or the intent of the forger.[60] Any holder, without distinction as to his status, can enforce the altered security according to its original tenor.[61]

4. Other Defenses

All other defenses of the issuer, including conditional delivery and non-delivery,[62] are personal defenses, the treatment of which is presumably left to case law. The issuer will be precluded from raising any personal defense against a purchaser for value without notice[63] but such defenses are still available against others who are not within that classification.

C. *Requirements in the Security Itself*

1. Incorporation by Reference

The Code recognizes the accepted practice of drafting an investment security to include reference to other instruments under which the issuance of the security has been authorized,[64] and expressly sanctions such practice.[65] The terms of a document incorporated by reference into a security will be binding against any purchaser, provided that the incorporated terms are not contrary to statements on the security itself.[66] This outside reference, although it constitutes a valid inclusion of the referent, will not of itself be sufficient to charge a purchaser with notice of a defect in the validity of the document.[67] This will

bearing on the enforceable validity of the bonds. The problems involving validity of government issues have been substantially lessened by the practice of requiring an opinion of counsel as to the validity of the issue.

58. N.Y. Sess. Laws 1913, ch. 600, § 177, formerly N.Y. Pers. Prop. Law § 177, was in accord with relation to stock certificates. Prior law as to bonds would avoid liability against all parties except a holder in due course not a party to the alteration. N.Y. Sess. Laws 1897, ch. 612, § 205, formerly N.Y. Negotiable Instr. Law § 205.

59. Excluded from this consideration would be signature alterations which would be covered by N.Y.U.C.C. §§ 8-205, -311.

60. 2 Anderson, Uniform Commercial Code 368 (1961).

61. N.Y.U.C.C. § 8-206(2).

62. N.Y.U.C.C. § 8-202(4). This section extends to all securities the rule of Negotiable Instruments Law § 35, that where an instrument is in the hands of a holder in due course a "valid delivery thereof by all parties prior to him . . . is conclusively presumed," N.Y.U.C.C. § 8-202, N.Y. Annotation (4).

63. N.Y.U.C.C. § 8-202(4).

64. This would include reference in a stock certificate to the certificate of incorporation of the issuer and references in bonds to the authority under which they are issued.

65. N.Y.U.C.C. § 8-202(1).

66. Ibid.

67. Ibid.

be so even if, by accepting the security, the person admits notification.[68] This limitation accentuates the fact that the device of incorporation by reference can be utilized by the issuer for convenience in drafting but cannot be used to transfer to the purchaser the responsibility of insuring that the issuer's security complies with all the regulations governing its issue.[69]

2. Restrictions on Transfer

Any restrictions on transfer, to the extent that such are permitted by case law,[70] must be noted conspicuously on the certificate to be enforceable against a purchaser without actual notice of the restriction.[71] The use of the word "noted" rather than the word "stated"[72] clears up any semantic difficulty that might have arisen under the Negotiable Instruments Law from the use of the latter term.[73] The draftsmen of the Code have made it explicit that the entire content of the restriction need not be set forth, it being sufficient that the certificate indicate the existence of such a restriction.[74] A purchaser who takes a certificate with actual knowledge of some extraneous agreement to restrict alienation, however, will be held to compliance even where notice of such agreement does not appear on the security.[75]

3. The Issuer's Lien

Unlike the restriction on transfer, any lien retained by the issuer must be noted conspicuously on the certificate or it can never be asserted against the holder.[76] A term will be noted conspicuously when "it is so written that a reasonable person against whom it is to operate ought to have noticed it."[77]

4. Overissue

With respect to the problem of overissue, the Code continues the application of long standing case law[78] by refusing to recognize the validity of any issue of

68. A printed statement such as "the holder, by taking this instrument, admits notice of all limitations and restrictions on the instrument incorporated herein by reference," will not be effective to charge a purchaser with notice of a defense.

69. Uniform Commercial Code § 8-202, comment 1.

70. For a general discussion on restrictions on alienation of stock certificates see O'Neal, Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting, 65 Harv. L. Rev. 773 (1952).

71. N.Y.U.C.C. § 8-204. Note that this section refers only to restrictions imposed by the issuer and does not apply to any restrictions which the shareholders may have agreed upon between themselves.

72. N.Y. Sess. Laws 1913, ch. 600, § 176, formerly N.Y. Pers. Prop. Law § 176, provided that a restriction on the transfer of shares had to be "stated" on the certificate.

73. See, e.g., Allen v. Biltmore Tissue Co., 2 N.Y.2d 534, 141 N.E.2d 812, 161 N.Y.S.2d 418 (1957).

74. Uniform Commercial Code § 8-202, comment 1.

75. N.Y.U.C.C. § 8-204. This is a codification of New York case law. See Tomoser v. Kamphausen, 307 N.Y. 797, 121 N.E.2d 622 (1954) (per curiam).

76. N.Y.U.C.C. § 8-103.

77. N.Y.U.C.C. § 1-201(10).

78. The leading New York case is New York & N.H.R.R. v. Schuyler, 34 N.Y. 30 (1865).

securities[79] in excess of the amounts authorized by the certificate of incorporation.[80] Where a party is entitled to either validation or issue of his security,[81] but where such action would result in an overissue, one of two remedies may ensue. Where identical securities are reasonably available for purchase, the wronged party is entitled to replacement in kind and may compel the issuer to purchase and deliver to him the identical security.[82] Where replacement in kind is impossible, the wronged party may seek recovery of damages based upon the price, which he or the last purchaser for value paid for the securities, plus interest from the date of his demand.[83]

III. The Holder's Status in Relation to Prior Holders

Aside from assuring himself that the security purchased is free from defenses which might be imposed by the issuer, the transferee will also wish to determine his status in relation to competing rights or claims of prior holders. The purchaser will want to know whether he is taking the security subject to or free from any adverse claim, *i.e.*, a claim that the transfer was or would be wrongful or that some particular person has a superior interest in the security.[84] The

See New York & E. Tel. Co. v. Great E. Tel. Co., 74 N.J. Eq. 221, 69 Atl. 528 (1908); Jutte v. Hutchinson, 189 Pa. 218, 42 Atl. 123 (1899).

79. N.Y.U.C.C. § 8-104(1).

80. N.Y.U.C.C. § 8-104(2). This section applies not only to the corporate stock, used in the text for illustrative purposes, but to any "issue of securities in excess of the amount which the issuer has corporate power to issue." The use of the term "corporate power" poses some ambiguity. It would seem, however, that the section applies to all securities issued in excess of the authority vested in the issuer.

81. See, e.g., the following sections of the N.Y.U.C.C. which entitle the holder to validation or reissue of a security: §§ 8-202(2)(a) (statutory and constitutional defect), 8-205 (fraudulent or careless issue), 8-206 (completion of an incomplete security), 8-311 (unauthorized indorsement).

82. N.Y.U.C.C. § 8-104(1)(a). New York law allows a corporation to purchase its own securities only out of surplus and only where the corporation is not, or would not thereby become, insolvent. N.Y. Bus. Corp. Law § 513(a).

83. N.Y.U.C.C. § 8-104(1)(b). The New York law as to measure of damages was unclear prior to the adoption of the Code. Commercial Bank v. Kortwright, 22 Wend. 348 (N.Y. Ct. Err. 1839) applied the highest value between the time of the refusal to transfer and the commencement of suit. In re Salmon Weed & Co., 53 F.2d 335 (2d Cir. 1931), applied the highest value at the time of the unauthorized act or the market value within a reasonable time, whichever is higher. Baker v. Drake, 53 N.Y. 211 (1873); Jones v. National Chautauqua County Bank, 272 App. Div. 521, 74 N.Y.S.2d 498 (4th Dep't 1947); Phillips v. Bank of Athens Trust Co., 202 Misc. 698, 119 N.Y.S.2d 47 (Sup. Ct. 1952), all measured damages as the highest market value within a reasonable time after notice of the wrongful act. The Code now offers statutory remedies to the wronged party. The corporation could also amend its charter by vote of the shareholders to authorize additional shares. N.Y. Bus. Corp. Law § 801(7).

84. N.Y.U.C.C. § 8-301 describes an adverse claim. No formal definition is given but it is meant to include within its meaning defects in title, equities, and claims to ownership. Israels, Practice Commentary, McKinney's N.Y.U.C.C. § 8-301. Note that the description in-

answer lies in the status of the particular transferee, who may be either a "purchaser"[85] or a "bona fide purchaser."[86]

As a purchaser, the transferee may be subject to adverse claims depending on the status of his transferor. A purchaser will get all the rights which his transferor had or had actual authority to convey,[87] provided, of course, that he himself was not a party to any fraud or illegality affecting the instrument.[88]

A bona fide purchaser, however, will take the security free from any defenses, claims of ownership or equities that might be asserted by prior holders.[89] All prior rights are cut off by a bona fide purchaser regardless of the status of his transferor. A bona fide purchaser taking even from a thief, or a party with no rights in the security, will take the security free from all adverse claims.[90] Thus, the classification of bona fide purchaser becomes all important in conflicts arising among successive holders. A bona fide purchaser is defined as "a purchaser for value in good faith and without notice of any adverse claim who takes delivery of a security in bearer form or of one in registered form issued to him or indorsed to him or in blank."[91]

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cludes retrospective ("was") as well as prospective ("would be") claims against a transfer. Ibid. See Welland Investment Corp. v. First Nat'l Bank, 81 N.J. Super. 180, 195 A.2d 210 (1963) (issuer's assertion that a proposed transfer of unregistered securities would be in violation of the Securities Act of 1933 was in the nature of an adverse claim).

85. A purchaser is one "who takes by purchase." N.Y.U.C.C. § 1-201(33). A purchase includes "taking by sale, discount, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property." N.Y.U.C.C. § 1-201(32).

86. N.Y.U.C.C. § 8-302. Note that Part 2 of Article 8 makes reference to a purchaser for value without notice, whereas Part 3 refers to the bona fide purchaser adding, inter alia, a specific requirement of good faith.

87. N.Y.U.C.C. § 8-301(1). A purchaser acquires only that interest in a security which his transferor attempted to convey. "A purchaser of a limited interest acquires rights only to the extent of the interest purchased." N.Y.U.C.C. § 8-301(3).

88. "The purchaser acquires the rights in the security which his transferor had . . . except that a purchaser who has himself been a party to any fraud or illegality affecting the security or who as a prior holder had notice of an adverse claim cannot improve his position by taking from a later bona fide purchaser." N.Y.U.C.C. § 8-301(1). This is a carry over of the "shelter provision" of N.Y. Sess. Laws 1897, ch. 612, § 97, formerly N.Y. Negotiable Instr. Law § 97. The Code clarifies one area previously clouded by some doubt by declaring that a purchaser "who as a prior holder had notice of an adverse claim cannot improve his position by" a later purchase from a transferor without notice. See Horan v. Mason, 141 App. Div. 89, 125 N.Y. Supp. 668 (2d Dep't 1910), which held that a holder with notice could transfer the security and then reacquire it from a bona fide purchaser in order to improve his status.

89. N.Y.U.C.C. § 8-301(2).

90. The bona fide purchaser acquires status similar to that enjoyed by the holder in due course. N.Y. Sess. Laws 1897, ch. 612, § 96, formerly N.Y. Negotiable Instr. Law § 96, provided: "A holder in due course holds the instrument free from any defect of title of prior parties . . . and may enforce payment of the instrument for the full amount thereof against all parties liable thereon." A similar provision appears in N.Y.U.C.C. § 3-305 dealing with commercial paper.

91. N.Y.U.C.C. § 8-302.

This definition has several elements which are also defined elsewhere within the Code.[92] Three of these elements—notice, indorsement and delivery—are the subjects of extensive treatment throughout this part of Article Eight and require more detailed consideration.

A. *Notice*

When a party takes a security knowing someone other than his transferor claims an interest in it, his ownership rights will be subject to whatever rights any other claimant[93] may have in the security.

Together with the application of the Code's general provisions as to when a party will have notice of a particular claim or defect,[94] it is expressly provided that a purchaser will have constructive notice of an adverse claim and will be thereby excluded as a matter of law from the classification of bona fide purchaser when: (1) the security contains a restrictive indorsement such as "for collection" or "for surrender";[95] (2) a security in bearer form has on its face an unambiguous statement that it is the property of someone other than the transferor;[96] and (3) the purchaser knows that the transaction is for the personal benefit of a fiduciary.[97]

A purchaser will also be charged with notice of an adverse claim when he takes the security after one year from its maturity date or six months from the date set for payment against presentation if funds were available on that date.[98]

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92. E.g., N.Y.U.C.C. §§ 1-201(19) (good faith), (32), (33) (purchaser), (44) (value).

93. It would appear that a purchaser for value will in most instances be protected where he had no notice of the particular defense asserted by the issuer. Where bona fide purchaser status is sought, a party taking the security with notice of any one claim will be subject to all claims.

94. N.Y.U.C.C. §§ 1-201(25), (26) supply general principles as to when a party will have notice or knowledge of a fact. Their specific application to notice of adverse claims is limited by N.Y.U.C.C. § 8-304(3) which provides that a party must have actual knowledge of a defense or "knowledge of such facts that his action in taking the security amounts to bad faith." See United States Fid. & Guar. Co. v. Goetz, 285 N.Y. 74, 32 N.E.2d 798 (1941), holding it to be a jury question whether defendant brokers were chargeable with notice of a defect in title when they sold stolen bonds which, on their face, appeared to be regular.

95. N.Y.U.C.C. § 8-304(1)(a). This provision follows N.Y. Negotiable Instr. Law § 67 which provided that subsequent indorsees will acquire the title of only the first indorsee under a restrictive indorsement.

96. N.Y.U.C.C. § 8-304(1)(b).

97. N.Y.U.C.C. § 8-304(2). The mere fact that the transferor is acting in a fiduciary relationship is not sufficient to place the purchaser on notice. The purchaser can assume that the fiduciary is acting properly.

The provision that actual knowledge of a misappropriation by a fiduciary will prevent a purchase from being bona fide represents a codification of New York case law. See State Bank of Binghamton v. Bache, 162 Misc. 128, 293 N.Y. Supp. 667 (Sup. Ct. 1937).

98. N.Y.U.C.C. § 8-305. This provision is essentially the same as N.Y.U.C.C. § 8-203 which deals with notice of an issuer's defense. Time limits under § 8-305 are halved on the

B. *Indorsement*

1. Necessity

A holder cannot effectively assert rights in a security until he can prove that he is in fact the owner. Where a security is issued in bearer form or is indorsed in blank, mere possession of the security indicates a claim of ownership. Where a security is delivered in registered form, however, it must be either issued in the party's name or bear the necessary indorsements before he can qualify as a holder.[99] A transfer of registered form securities without the necessary indorsements may be complete as between the parties to the transaction,[100] but the transferee cannot qualify as a bona fide purchaser until a proper indorsement is executed.[101] The transferee, under these circumstances, has a specifically enforceable right to indorsement.[102]

If a party takes delivery of a registered form security lacking proper indorsement, however, and receives notice of an adverse claim before the indorsement is affixed, he will take the security subject to all claims and defenses of all prior holders. Any indorsement executed after the security is transferred will not take effect retroactively with the transfer.[103]

2. Mechanics

An indorsement is made by signing either on the security or on a separate document an assignment or transfer of the security, or a power to do either, or by simply signing one's name on the back of the security.[104] It may be in blank, or special, indicating the person to whom the security is to be transferred.[105]

The indorsement signature must be made by an appropriate person, which classification includes, among others, the registered owner or a special indorsee, a named fiduciary or his successor and an authorized agent.[106]

3. Effect of the Indorsement

Unlike the indorsement appearing on commercial paper,[107] the act of indorsing a security will not amount to a guarantee by the indorser that the issuer will pay

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theory that a purchaser has greater reason to suspect claims of prior owners than to suspect a defense by the issuer.

99. N.Y.U.C.C. § 8-302. Indorsement plus delivery of the security acts to transfer "the transferor's ownership therein to the new owner." 2 Anderson, Uniform Commercial Code 395 (1961).

100. Where circumstances of the delivery indicate an intent to assign, written assignment may not always be necessary to pass title. 1 Christy, Transfer of Stock, § 53 (1964).

101. N.Y.U.C.C. § 8-302.

102. N.Y.U.C.C. § 8-307.

103. Ibid.

104. N.Y.U.C.C. § 8-308(1).

105. N.Y.U.C.C. § 8-308(2).

106. N.Y.U.C.C. § 8-308(3) gives a complete listing of "appropriate persons" to indorse.

107. N.Y.U.C.C. § 3-414(1) provides, "every indorser engages that upon dishonor . . . he will pay the instrument according to its tenor at the time of his indorsement . . . ."

the security when it becomes due.[108] As a transferor, the indorser warrants to a purchaser for value only that: (1) his transfer is effective and rightful; (2) the security is genuine and has not been materially altered; and (3) he knows no fact which might impair the value of the security.[109]

4. Unauthorized Indorsements

Where a signature appearing as an indorsement has been forged or is otherwise unauthorized, the true owner may recover the security from any one who purchased it on the strength of the ineffective indorsement, except a bona fide purchaser for value who has already registered the transfer and received a new security issued in his own name.[110]

The true owner may also assert the ineffectiveness of the unauthorized indorsement against the issuer to prevent him from registering the transfer[111] or to impose liability for an improper registration.[112]

C. *Delivery*

To qualify as a bona fide purchaser one must take delivery of the security.[113] A purchaser of a security not yet delivered to him will take it subject to any adverse claims that might be asserted against his ownership in the interim. Delivery in the Code sense does not necessarily involve physical transfer of possession, but there must be some voluntary parting with control before a valid transfer can be effected.[114]

Where no brokers are involved, transfer of possession to the purchaser, or to an agent designated by him to receive possession, will constitute delivery,[115] as will an acknowledgment by a third party that he holds the security for the purchaser.[116]

In a transfer involving brokers,[117] several stages may be involved before the

108. N.Y.U.C.C. § 8-308(4); see Uniform Commercial Code § 8-308, comment 1.

109. N.Y.U.C.C. § 306(2). Note that an intermediary "warrants only his own good faith and authority . . . ," N.Y.U.C.C. § 8-306(3), while a broker makes all the warranties independent of his customer, N.Y.U.C.C. § 8-306(5).

110. N.Y.U.C.C. § 8-311(a).

111. The true owner can enforce his rights by sending to the issuer a written notice of his adverse claim. Such notice must identify the claimant, the registered owner, the issue of which the security is a part, and provide an address for communications directed to the claimant. The notice must be received by the issuer within a reasonable time before he registers the transfer. N.Y.U.C.C. § 8-403(1)(a).

112. N.Y.U.C.C. § 8-311(b).

113. N.Y.U.C.C. § 8-302. Delivery is the final and definitive step in the transfer of the security. 2 Anderson, Uniform Commercial Code 405 (1961).

114. Uniform Commercial Code § 8-309, comment 1.

115. N.Y.U.C.C. § 8-313(1)(a).

116. N.Y.U.C.C. § 8-313(1)(d).

117. N.Y.U.C.C. § 8-303 defines a broker. Any Code reference to a broker's duties is a reference to his functions when he is acting for a customer and not when he is transacting business on his own behalf.

purchaser actually receives possession. A single sale may involve transfers between seller and seller's broker, from seller's broker to buyer's broker and, thence, to the purchaser. It is not necessary for the ultimate transferee to receive actual possession for the delivery to be deemed completed. Thus, delivery will be effected when possession is transferred to the buyer's broker with the shares specially indorsed to or issued in the name of the buyer.[118]

Delivery will also be considered complete when the purchaser's broker sends to his customer a notice confirming the purchase by the customer, and, at the same time, identifies a specific security in his possession as belonging to the customer.[119]

Where the purchaser is buying on credit and a margin account is involved, transfer of possession will normally not be effected until the stock is completely paid for and the debt is discharged.[120] This is true even though title vests in the purchaser as soon as the stock is purchased by the broker.[121] Rather than surrender his collateral security the broker normally registers the purchased shares in his own name and keeps them among his fungible bulk.[122] The buyer's ownership interest in this lot is protected against claims which might be made against the broker by treating the buyer as the owner of a proportionate interest in the entire lot.[123]

Where the securities are held in this manner by the broker, and either he or the purchaser subsequently receives notice of an adverse claim, such notice will not prevent the purchaser from being a bona fide purchaser, provided that neither party had notice when the broker took delivery, and further, that the purchaser paid value for *his* interest.[124]

Provision is also made for the utilization of a central depositary system for the transfer and pledge of heavily traded securities. The system involves delivering securities to a central agency and then effecting transfers by means of bookkeeping entries on the books of the central depositary as well as the participating brokers.[125] Physical delivery of the shares would no longer be necessary each time a pledge or transfer was made.

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118. N.Y.U.C.C. § 8-313(1)(b).

119. N.Y.U.C.C. § 8-313(1)(c).

120. See Pistell, Deans & Co. v. Obletz, 232 App. Div. 313, 249 N.Y. Supp. 616 (4th Dep't 1931), holding that a margin purchaser can demand delivery only when he tenders the full amount due.

121. Keller v. Halsey, 202 N.Y. 588, 95 N.E. 634 (1911) stated that a customer in a margin transaction becomes the owner of the security and a pledgor to the broker at the same time.

122. N.Y.U.C.C. § 8-107(1). Any one obligated to deliver securities may discharge the obligation by delivery of any securities which are, by usage of trade, equivalent to those he is obligated to deliver.

123. N.Y.U.C.C. § 8-313(2).

124. N.Y.U.C.C. § 8-313(2), (3). The purchaser must also give value to be bona fide.

125. N.Y.U.C.C. § 8-320.

IV. Conclusion

The provisions of Article 8 should have a strong impact on the holder's right to enforcement of his security against the issuer and to protection against adverse claims. In this area in particular, the Code has done much to simplify and clarify the respective rights of the parties.

Its enactment will do much to foster "the concept of a free capital market [which] clearly requires that investment securities be negotiable, so that a bona fide purchaser for value and without notice—even a purchaser from a thief—can take the instrument free of defenses of the issuer and equally free of claims or equities of prior ownership."[126]

126. Israels, Practice Commentary, McKinney's N.Y.U.C.C. § 8-101.