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# Commercial Transactions

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# Commercial Transactions

## Commercial Transactions; investment securities

Code of Civil Procedure §§488.450, 700.130 (amended); Commercial Code §§8101, 8102, 8103, 8104, 8105, 8106, 8107, 8108, 8109, 8201, 8202, 8203, 8204, 8205, 8206, 8207, 8208, 8301, 8302, 8303, 8304, 8305, 8306, 8307, 8308, 8309, 8310, 8311, 8312, 8313, 8314, 8315, 8316, 8317, 8318, 8319, 8320, 8321, 8401, 8402, 8403, 8404, 8405, 8406, 8407, 8408 (repealed); §§8101, 8102, 8103, 8104, 8105, 8106, 8107, 8108, 8109, 8201, 8202, 8203, 8204, 8205, 8206, 8207, 8208, 8301, 8302, 8303, 8304, 8305, 8306, 8307, 8308, 8309, 8310, 8311, 8312, 8313, 8314, 8315, 8316, 8317, 8318, 8319, 8320, 8321, 8401, 8402, 8403, 8404, 8405, 8406, 8407, 8408, 12101, 12102, 12103, 12104 (new); §§1102, 1201, 5114, 9103, 9105, 9203, 9302, 9304, 9305, 9306, 9309, 9312 (amended); Corporations Code §§416, 418 (amended).

SB 1872 (Beverly); 1984 STAT. Ch 927

*Expands definition of security to include certificated and uncertificated securities; changes requirements for an issuer's lien to be effective; establishes applicable conflict of law provisions for uncertificated securities; provides procedures for taking securities interests in uncertificated securities; extends knowledge provisions certificated securities to cover uncertificated securities; modifies provisions relating to transferability of securities to include uncertificated securities; provides procedures for the completion or alteration of initial transaction statements; establishes rights and power of an owner of uncertificated securities; expands provisions for effectuating transfers of securities; modifies attachment and levy provisions to include uncertificated securities; changes the perfection requirements for securities; revises provisions concerning the termination of security interests in securities; expands provisions regarding registration of securities to include those which are uncertificated; modifies issuers duties as to adverse claims to include uncertificated securities; amends provisions governing issuer's liability for registration of securities; establishes exchange requirements of certificated and uncertificated*

*securities; requires the issuance of statements with respect to uncertificated securities; establishes transition provision for securities and interests in securities.*

Chapter 927 enacts the California Commercial Code-Investment Securities Division, which revises California law governing interests in investment securities.<sup>1</sup> The revisions conform, with certain California variations, to the 1977 amendments to the Uniform Commercial Code.<sup>2</sup> Chapter 927 continues to allow existing law to govern certificated securities<sup>3</sup> and adds provisions that control the rights, obligations, and relationships of the issuer<sup>4</sup> and other persons dealing with uncertificated securities.<sup>5</sup> Under prior law, the creation and perfection of security interests in securities was governed by Division 9 of the California Commercial Code.<sup>6</sup> Chapter 927 brings the creation and perfection of securities interest in certificated and uncertificated securities within the scope of Division 8 of the California Commercial Code.<sup>7</sup>

### *General Provisions*

#### *A. Creation of Certificated and Uncertificated Securities*

Chapter 927 provides that a security is either certificated or uncertificated.<sup>8</sup> Chapter 927 specifies that if a security is certificated, the terms security or certificated security mean the intangible interest,

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1. The California Commercial Code, which governs commercial transactions and specifically investment securities, is derived from the Uniform Commercial Code, the California version of which was originally adopted by the Legislature in 1963. 23A CAL. COM. CODE, at III (foreward) (1964).

2. REPORT OF THE UNIFORM COMMERCIAL CODE COMMITTEE ON PROPOSED AMENDMENTS TO DIVISION 8 OF THE CALIFORNIA UNIFORM CALIFORNIA COMMERCIAL CODE 1 (as amended February 13, 1984) (copies available from the California State Bar) [hereinafter referred to as REPORT].

3. CAL. COM. CODE §8102(1)(a) (definition of certificated security). Chapter 927 enacts the definition of a security found in prior Division 8, however, denominates it as a certificated security. WEST'S UNIFORM COMMERCIAL CODE 780 (1978) [hereinafter referred to as CODE].

4. *Id.* §8201 (definition of issuer). The definition of issuer under Chapter 927 includes a person who creates shares, participations, or other interests in their property or in an enterprise, or undertakes obligations in which shares, participations, interests, or obligations are uncertificated securities. *Id.* §8201(1)(b).

5. See REPORT, *supra* note 2, at 1. Chapter 927 does not compel or authorize the issuance of uncertificated securities. Authorization for the issuance of uncertificated securities is governed by section 416(b) of the Corporations Code. *Id.* CAL. COM. CODE §8102(1)(b) (definition of uncertificated security); *infra* notes 12-14 and accompanying text.

6. REPORT, *supra* note 2, at 1. Under the provisions of Chapter 927 creation and perfection of a security interest is governed by sections 8131 and 8321 of the California Commercial Code. REPORT, *supra* note 2, at 5.

7. REPORT, *supra* note 2, at 1.

8. CAL. COM. CODE §8102(1)(c).

the instrument<sup>9</sup> representing that interest, or both, as the context requires.<sup>10</sup>

Chapter 927 provides that an uncertificated security is a share, participation, or other interest in property or an enterprise of the issuer, or an obligation of the issuer that is (1) not represented by an instrument,<sup>11</sup> and the transfer of the security is registered on books maintained for that purpose by or for the issuer, (2) of a type commonly dealt in on securities exchanges or markets,<sup>12</sup> (3) either one of a class or series or by its terms can be divided into a class or series of shares, and (4) not a limited partnership interest.<sup>13</sup> Furthermore, Chapter 927 requires an issuer to treat a certificated security as an uncertificated security whenever the security is retained by or surrendered to the issuer for any reason other than registration of transfer, payment, exchange, or acquisition by the issuer, or any other temporary purpose.<sup>14</sup>

### B. Issuer's Lien

Under prior law, notation on a security of an issuer's lien was not required for the lien to be effective if the transferee had actual knowledge of the lien.<sup>15</sup> With the enactment of Chapter 927, an issuer's lien upon a *certificated* security is valid against a purchaser only if the right to the lien is conspicuously noted on the security.<sup>16</sup> An issuer's lien upon an *uncertificated* security is valid against a purchaser only if the right to the lien is noted on (1) the initial transaction statement<sup>17</sup> sent to the purchaser, or (2) the initial transaction statement sent to the registered owner or the registered pledgee, if the transfer of the uncertificated security interest is by other than registration of transfer, pledge, or release.<sup>18</sup>

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9. Chapter 927 provides that a writing may be an "instrument" under Division 8 of the California Commercial Code even though it is not an "instrument" as defined in Division 3 of the Commercial Code. *Id.* §8102(7). *See also id.* §8105(1) (certificated securities are negotiable instruments).

10. *Id.* §8102(1)(c).

11. Chapter 927 provides that statements or notices sent by an issuer of an uncertificated security are not negotiable instruments. *Id.* §8105(2).

12. The intent of Chapter 927 is to cover interests, such as the stock of closely-held corporations, that are not dealt in on exchanges or markets, but are "of a type" that is dealt in on exchanges. REPORT, *supra* note 2, appendix 1 at 4.

13. CAL. COM. CODE §8102(1)(b).

14. *Id.* §8102(1)(c). *See generally* CODE, *supra* note 3, at 795 (issuer of retained certificated security that is functionally identical to issuer of uncertificated security).

15. 1977 Cal. Stat. c. 235, §23, at 1041 (amending CAL. COM. CODE §8103).

16. CAL. COM. CODE §8103(a).

17. An initial transaction statement is a statement sent to a new registered owner and, if applicable, a registered pledgee. *Id.* §8408(4). *See id.* §8408(1)-(10) (requirements for initial transaction statement); *infra* notes 117-29 and accompanying text.

18. *Id.* §8103(b).

### C. Reissue of Securities

Under existing law, an issuer may not issue, reissue, or validate a security resulting in overissue.<sup>19</sup> With the enactment of Chapter 927, however, an issuer who is compelled to issue or reissue a security has the option of transferring a certificated security or registering the transfer of an uncertificated security to the entitled party.<sup>20</sup>

### D. Applicable Law

Existing law provides that the law of the jurisdiction in which the issuer is organized governs the validity of a *certificated* security, the effectiveness of registration by the issuer, and the rights and duties of the issuer with respect to registration of a transfer.<sup>21</sup> Chapter 927 provides that for *uncertificated* securities, the rights and duties of the issuer with respect to registration of transfer, pledge, or release, and the sending of statements, is controlled by the law of the jurisdiction in which the issuer is organized.<sup>22</sup>

### E. Security Interest in Uncertificated Securities

With the enactment of Chapter 927, a security interest in an uncertificated security may be created by registering, with the issuer, a pledge to the secured party.<sup>23</sup> Only one registered pledge is allowed at a time and the rights of the registered pledgee are terminated by the registration of a release.<sup>24</sup> Additionally, Chapter 927 provides that the registered owner of an uncertificated security is the person in whose

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19. *Id.* §8104(1); *id.* §8104(2) (definition of overissue).

20. *Id.* §8104(1)(a). *But see* CAL. COM. CODE §8407 (providing that if the issuer maintains a system for issuing both certificated and uncertificated securities, the choice of form a security will take is ultimately that of the registered owner or registered pledgee); *infra* notes 113-16 and accompanying text.

21. *Id.* §8106(a). Division 8 does not govern the rights or duties of an issuer, debtor, or secured party with respect to the pledge of a certificated security. Under section 9103(1) of the Commercial Code, the law of the jurisdiction in which the certificated securities are located when the last event for perfecting the security interest occurs controls the validity and effect of perfection. REPORT, *supra* note 2, at 4. *See generally* CODE, *supra* note 3, at 799 (pledge and release of certificated security controlled by Division 9 of California Commercial Code).

22. CAL. COM. CODE §§8106(b), (c). Division 8 does not govern the rights or duties of a debtor or secured party with respect to the pledge of a uncertificated security. Under section 9103(b) of the Commercial Code, the law of the jurisdiction in which the issuer is organized controls the validity and effect of perfection. REPORT, *supra* note 2, at 4.

23. CAL. COM. CODE §8108.

24. *Id.* Compare Coogan, *Security Interests in Investment Securities Under Revised Article 8 of the Uniform Commercial Code*, 92 HARV. L. REV. 1013, 1028-36 (1979) (inadequate protection of junior liens on uncertificated securities) with Aronstein, *Article 8 Is Ready*, 93 HARV. L. REV. 889, 899-907 (1980) (protection adequate to allow for protection of junior liens on uncertificated securities).

name the security is registered, even if the security is subject to a registered pledge.<sup>25</sup>

### *Issue of Securities*

#### *A. Notice to Purchasers*

Under existing law, the purchaser of a certificated security is charged with knowledge of the terms stated on the security, the terms made part of the security by reference, and to any constitution, statute, ordinance, rule, or regulation, to the extent that the terms do not conflict with the security terms.<sup>26</sup> Chapter 927 expands existing law to govern uncertificated securities by charging the purchaser with knowledge of the terms contained on the initial transaction statement, terms made part of the security by reference, and to any constitution, statute, ordinance, rule, or regulation, to the extent that the terms do not conflict with the terms of the security.<sup>27</sup>

#### *B. Transferability*

Existing law provides that a restriction on the transfer of a *certificated* security imposed by the issuer, even if lawful, is not effective against a person without actual knowledge of the restriction, unless the restriction is noted conspicuously on the security.<sup>28</sup> Chapter 927 specifies that a restriction on the transfer of a *uncertificated* security imposed by the issuer, even if lawful, is not effective against a person without actual knowledge of the restriction unless a notation of the restriction is contained on (1) the initial transaction statement sent to the person, or (2) the initial transaction statement sent to the registered owner or the registered pledgee, if the transfer to the person was by other than registration of transfer, pledge, or release.<sup>29</sup>

#### *C. Completion or Alteration of Security or Statement*

Chapter 927 continues existing law governing the completion or alteration of a certificated securities and extends the law to cover initial transaction statements.<sup>30</sup> Chapter 927 provides that if an initial

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25. CAL. COM. CODE §8108.

26. *Id.* §8202(1).

27. *Id.*

28. CAL. COM. CODE §8204(a).

29. *Id.* §8204(b).

30. Compare *id.* §§8206(1),(2) (requirements for completion or alteration of certificated securities) with *id.* §§8206(3), (4) (requirements for completion or alteration of initial transaction statement).

transaction statement contains signatures necessary to be valid, but is incomplete in any other respects (1) any other authorized person may fill in the blanks to complete the statement and (2) if the blanks are incorrectly filled in, the statement is effective in favor of a purchaser of the security referred to on the statement, if the purchaser is without notice of the error made in filling out the statement.<sup>31</sup> A complete initial transaction statement that has been improperly altered is effective in favor of a purchaser to whom the statement has been sent, but only accord with the original terms of the statement.<sup>32</sup>

#### D. Rights and Duties of Issuers

Under existing law, the issuer of a certificated security may treat the registered owner as the person exclusively entitled to exercise the rights and powers of an owner.<sup>33</sup> Under Chapter 927, the issuer of an *uncertificated* security may treat the registered owner as the person entitled to exercise the rights and powers of an owner, with certain exceptions.<sup>34</sup> The owner of an uncertificated security subject to a registered pledge may not register a transfer until the registered pledgee provides the issuer of the security with a release instruction.<sup>35</sup> Upon presentation of transfer instructions from the registered pledgee, the issuer is required to follow the instructions by performing one of the following: (1) registering the transfer of the uncertificated security to the new owner free of the pledge;<sup>36</sup> (2) registering the interest in the uncertificated security to the new owner subject to the pledgee's interest;<sup>37</sup> or (3) registering the release of the uncertificated security from the existing pledgee and registering the pledge of the security to the other pledgee, if the instruction specifies a new owner and the existing pledgee.<sup>38</sup>

Chapter 927 provides that if an uncertificated security is subject to a registered pledge, any uncertificated securities issued in exchange

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31. *Id.* §8206(3).

32. *Id.* §8206(4).

33. *Id.* §8207(1).

34. *Id.* §8207(2) (the exceptions to CAL. COM. CODE §8207(2) are CAL. COM. CODE §§8207(3),(4),(6)).

35. *Id.* §8207(3).

36. *Id.* §8207(4)(a).

37. *Id.* §8207(4)(b).

38. *Id.* §8207(4)(c); *see also id.* §8207(5) (continuity of perfection of security interest not broken by registration of transfer, release, or pledge).

for the pledged security must be registered subject to the pledge.<sup>39</sup> In addition, any certificated securities issued in exchange for the pledged securities are required to be delivered to the registered pledgee,<sup>40</sup> and any money paid in exchange for or redemption of all or part of the security must be paid to the registered pledgee.<sup>41</sup>

### *Purchase of Securities*

#### *A. Transfers to Purchasers*

Under prior law, delivery of certificated securities to a purchaser could be carried out by a broker.<sup>42</sup> Chapter 927 provides that transfer of certificated or uncertificated securities, or an interest in securities, can be carried out by a *financial intermediary*.<sup>43</sup> Specifically, a transfer of a security to a purchaser occurs *only* at the time (1) the purchaser or a party designated by the purchaser acquires possession of the security,<sup>44</sup> (2) a transfer, pledge, or release of an uncertificated security is registered to the purchaser or a person designated by the purchaser,<sup>45</sup> (3) the purchaser's financial intermediary acquires possession of the certificated security specially endorsed to or issued in the name of the purchaser,<sup>46</sup> (4) a financial intermediary<sup>47</sup> sends the purchaser a confirmation of the purchase and also identifies as belonging to the purchaser certain securities,<sup>48</sup> or (5) entries to the account of the

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39. *Id.* §8207(6)(a).

40. *Id.* §8207(6)(b). This contrasts with certificated securities that are delivered to the registered owner, exposing the owner to wrongful transfer until the security is delivered to the pledgee. CODE, *supra* note 3, at 811.

41. CAL. COM. CODE §8207(6)(c). *See generally id.* §8321(3) (providing that security interests in securities are governed, with some exceptions, by Division 9 of the California Commercial Code); *see infra* notes 76-79 and accompanying text.

42. 1967 Cal. Stat. c. 799, §18, at 2213 (enacting CAL. COM. CODE §8313).

43. CAL. COM. CODE §8313(1). A financial intermediary is a bank, broker, clearing corporation, or other person, or the nominee of any of the aforementioned, which in the ordinary course of its business maintains security accounts for its customers and is acting in that capacity. *Id.* §8313(4).

44. *Id.* §8313(1)(a).

45. *Id.* §8313(1)(b).

46. *Id.* §8313(1)(c).

47. The financial intermediary may not be a clearing corporation. *Id.* §8313(1)(d). *Id.* §8102(3) (definition of a clearing corporation).

48. *Id.* §8313(1)(d). The confirmation must identify the security as being one of the following: (1) a specific certificated security in the financial intermediary's possession belonging to the purchaser; (2) a quantity of securities that constitute or are part of a fungible bulk of certificated securities in the financial intermediary's possession or of uncertificated securities registered in the name of the financial intermediary; or (3) a quantity of securities that constitute or are part of a fungible bulk of securities that are shown on the account of the financial intermediary or on the books of another financial intermediary. *Id.*



purchaser or a person designated by the purchaser are made on the books of a clearing corporation.<sup>49</sup> Transfer of a security also occurs when a third person, who is not a financial intermediary, acknowledges holding for the purchaser (1) an identified certificated security,<sup>50</sup> or (2) a specific uncertificated security, the pledge or transfer of which has been registered to that third person.<sup>51</sup> Chapter 927 further provides that a transfer of a security interest occurs at the time (1) new value is given by the secured party, and the transferor has signed a security agreement containing a description of the security,<sup>52</sup> or (2) the transferor has signed a security agreement containing a description of the security, and value is given by the secured party if the secured party is a financial intermediary and the security has already been transferred to the financial intermediary.<sup>53</sup>

Chapter 927 provides that when a security is subject to a signed security interest, transfer of the security occurs when a written and signed notification is received by (1) a financial intermediary on whose books the interest of the transferor in the security appears;<sup>54</sup> (2) a third person, not a financial intermediary, in possession of a certificated security<sup>55</sup> or who is the registered owner of an uncertificated security;<sup>56</sup> or (3) a third person, who is not a financial intermediary, and who is the registered pledgee of an uncertificated security.<sup>57</sup>

### B. Creditor's Rights

Under existing law, no attachment or levy upon a certificated security is valid until the security is actually seized<sup>58</sup> or, if the security is held in escrow, until a copy of the writ and notice that the securities are attached is served upon the escrow holder.<sup>59</sup> Chapter 927 provides

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49. CAL. COM. CODE §8313(1)(g) (transfers made under section 8313(1)(g) of the California Commercial Code subject to the provisions of section 8320 of the California Commercial Code).

50. *Id.* §8313(1)(e).

51. *Id.* §8313(1)(f).

52. *Id.* §8313(1)(i).

53. *Id.* §8313(1)(j) (the transfer must have occurred under section 8313(1)(a), or (b), or (c), or (d), or (g) of the California Commercial Code).

54. *Id.* §8313(1)(h)(i).

55. *Id.* §8313(1)(h)(ii).

56. *Id.* §8313(1)(h)(iii) (uncertificated securities not subject to a registered pledge).

57. *Id.* §8313(1)(h)(iv) (uncertificated securities required to be subject to a registered pledge); *see id.* §8321 (requiring a transfer of a security under section §8313(1) of the California Commercial Code to create an enforceable security interest); *infra* notes 69-85 and accompanying text; CODE, *supra* note 3, at 830-32 (comment on transfer of securities).

58. *Id.* §8317(1)(a).

59. *Id.* §8317(1)(b). The security must be held in escrow pursuant to the provisions of Corporate Securities Law. *Id.*

that a certificated security that has been surrendered to the issuer may be reached by serving the issuer at the issuer's chief executive office in the United States.<sup>60</sup> Furthermore, an uncertificated security registered in the name of a debtor may not be reached by a creditor except through legal process on the issuer at the issuer's chief executive office in the United States.<sup>61</sup>

Chapter 927 specifies that a debtor's interest in a certificated security in the possession of a secured party, who is not a financial intermediary<sup>62</sup> or an uncertificated security registered in the name of a secured party may be reached by a creditor through legal process upon the secured party.<sup>63</sup> Any interest of a debtor in a certificated security in the possession of, or registered in the name of, a financial intermediary, or an uncertificated security registered in the name of a financial intermediary, may be reached by a creditor by legal process upon the financial intermediary.<sup>64</sup> Any interest of a debtor in a certificated security in the possession of, or registered in the name of, an escrow holder and held in escrow, or an uncertificated security registered in the name of an escrow holder and held in escrow may be reached by a creditor by legal process upon the escrow holder.<sup>65</sup>

Additionally, Chapter 927 specifies that, unless otherwise provided by law, a creditor's lien on the interest of a debtor in a security obtained pursuant to specific provisions of the California Commercial Code<sup>66</sup> is not a restraint on the transfer of the security, free of the lien, to a third party for new value.<sup>67</sup> Chapter 927 requires, however, that in the event of a transfer, the lien applies to the proceeds of the transfer in the hands of the secured party, financial intermediary, or escrow holder, subject to any claims having priority.<sup>68</sup>

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60. *Id.* §8317(1)(b). Section 8317(1) of the California Commercial Code is subject to the exceptions specified in section 8317(3), (4), (5) of the Commercial Code. *Id.* See *infra* notes 62-66 and accompanying text.

61. *Id.* §8317(2). Section 8317(2) of the California Commercial Code is subject to the exceptions specified in section 8317(5) of the California Commercial Code. *Id.* See *infra* note 65 and accompanying text.

62. CAL. COM. CODE §8317(3).

63. *Id.*

64. *Id.* §8317(4).

65. *Id.* §8317(5). The security must be held in escrow pursuant to the provisions of Corporate Securities Law. *Id.*

66. The creditor's lien must be obtained under section 8317(3)-(5) of the Commercial Code. CAL. COM. CODE §8317(6).

67. *Id.* §8317(6).

68. *Id.*

### C. Perfection of Security Interests

Chapter 927 provides that an interest in a security is enforceable only if the security is certificated, when the security is in the possession of the secured party pursuant to an agreement, or when the debtor has signed a security agreement that describes the security,<sup>69</sup> and when transfer to the secured party is pursuant to the provisions of the California Commercial Code.<sup>70</sup> In addition, Chapter 927 provides that a security interest is perfected when the interest is transferred pursuant to an agreement and the transferor has received value from the transferee.<sup>71</sup> Chapter 927 requires, however, that if the transfer of the security interest is accomplished solely by the transferor signing a security agreement containing a description of the security,<sup>72</sup> the security interest becomes unperfected after twenty-one days, unless within that time, specified provisions of the California Commercial Code<sup>73</sup> are satisfied.<sup>74</sup> A security interest also may be perfected by possession of a certificated security from the time possession is taken and continues as long as the security is retained, unless otherwise specified in the law governing investment securities.<sup>75</sup>

Under existing law, security interests are subject to the law governing secured transactions.<sup>76</sup> Chapter 927 provides for certain exceptions to the laws of secured transactions when securities are involved.<sup>77</sup> Under Chapter 927, no filing is required to perfect a security interest in securities.<sup>78</sup> In addition, the first party to perfect a security interest in an uncertificated security by registering a transfer, pledge, or release in that party's name, or a name designated by that party, has priority

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69. *Id.* §8321(1)(a).

70. *Id.* §8321(1)(b); *see id.* §8313(1) (requirements for transfer); *supra* notes 42-57 and accompanying text.

71. *Id.* §8321(2). Compare Coogan, *Security Interests in Investment Securities Under Revised Article 8 of the Uniform Commercial Code*, 92 HARV. L. REV. 1013, 1056-58 (1979) (criticism of perfection of certain security interests by revised Article 8 of the Uniform Commercial Code) with Aronstein, *Article 8 Is Ready*, 93 HARV. L. REV. 889, 896-99 (1980) (support for perfection of certain security interests by revised Article 8 of the Uniform Commercial Code). *See generally* CODE, *supra* note 3, at 843 (comments on creation, perfection and termination of security interests in securities); REPORT, *supra* note 2, at 5-8.

72. *See* CAL. COM. CODE §8313(1)(i) (transfer provisions).

73. *See id.* §8321(2) (transfer of the security interest must be under California Commercial Code section 8313(1)(a)-(h), (j)).

74. CAL. COM. CODE §8321(2); *see id.* §8313(1)(i) (transfer of a security interest).

75. *Id.* §8321(2).

76. *Id.* §8321(3). Secured transactions are governed by Division 9 of the California Commercial Code (commencing with §9101). *Id.* §8321(3). *See generally* REPORT, *supra* note 2, at 5-8; CODE, *supra* note 3, at 844.

77. CAL. COM. CODE §8321(3).

78. *Id.* §8321(3)(a).

over any other earlier or subsequent party, except a secured party who has a purchase money security interest in the securities.<sup>79</sup>

Under Chapter 927, when a security is issued by the federal government and a federal statute or regulation provides for the perfection of a security interest differing from those provided under Chapter 927,<sup>80</sup> perfection must be in accordance with the federal statute or regulation.<sup>81</sup> Chapter 927 additionally provides that, when the transferee of a security issued by the federal government takes no action to perfect a security interest under an applicable federal statute or regulation, a transfer for value pursuant to an agreement between the transferor and the transferee is perfected for twenty-one days, but if within that time perfection requirements are not satisfied, the security interest becomes unperfected.<sup>82</sup>

#### D. Termination of Security Interest

Chapter 927 provides that, unless otherwise agreed, a security interest in a security is terminated by transfer of the security from the secured party to the debtor or to a person designated by the debtor.<sup>83</sup> If the security interest is not terminated, the interest becomes unperfected.<sup>84</sup> If the security is certificated, however, the interest will remain perfected for twenty-one days if the transfer to the debtor is for the purpose of sale, exchange, presentation, collection, renewal, or registration of transfer.<sup>85</sup>

### Registration

#### A. Duty to Issuer

Under existing law, the issuer of a *certificated* security is registered

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79. *Id.* §8321(3)(b). The interest must have been perfected at the time of the transfer to the debtor or within 10 days thereafter. *Id.* See CAL. COM. CODE §9312(4) (priority of purchase money security interests). Chapter 927 further provides that secured parties, whether holding certificated or uncertificated securities, and whether or not in possession of a certificated security, must use reasonable care in the custody and possession of the collateral and must take any steps necessary to preserve rights against prior parties unless otherwise agreed. If a certificated security is in the possession of the secured party, the debtor is responsible for reasonable expenses incurred in the custody, preservation, use or operation of the security, including the cost of insurance or taxes. *Id.* §8321(3)(b); see *id.* §9207 (duties of secured party).

80. Specifically, Division 8 of the California Commercial Code regulates security interests in investment securities. *Id.* §8321(5).

81. *Id.* §8321(5).

82. *Id.*

83. *Id.* §8321(4). See *id.* §8313(1) (requirements for transfer of a security).

84. *Id.* §8321(4).

85. *Id.*; see *id.* §8313(1) (requirements for transfer of a security).

form is required<sup>86</sup> to register transfer of the security upon request.<sup>87</sup> Chapter 927 provides that the issuer of an *uncertificated* security is required to register a transfer, pledge or release upon request.<sup>88</sup>

Chapter 927 provides that when the issuer of an uncertificated security, not subject to a registered pledge, is requested by the appropriate person to register a pledge, and the issuer maintains a system for issuing certificated securities to the category of owners which includes the registered owner, the issuer may elect to treat the instruction as a transfer instruction.<sup>89</sup> Under Chapter 927, if the issuer elects to treat the request to register a pledge as a transfer, the issuer must (1) cancel the uncertificated security,<sup>90</sup> (2) issue in the name of the registered owner an equivalent certificated security that notes conspicuously any liens and restrictions of the issuer and any adverse claims to which the uncertificated security was subject,<sup>91</sup> (3) deliver the certificated security to the registered owner,<sup>92</sup> and (4) notify the intended registered pledgee that the issuer has elected to issue a certificated security to the registered owner.<sup>93</sup>

### B. Issuer's Duties as to Adverse Claims

Under existing law, when a certificated security is presented for registration, an issuer is required to inquire into any adverse claims the issuer has received<sup>94</sup> if the adverse claim is in the form of a written notification which provides an address for communication with the claimant and identifies (1) the claimant, (2) the registered owner, and (3) the issue of which the security is a part.<sup>95</sup>

With the enactment of Chapter 927, an issuer of an uncertificated

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86. The requirement that the issuer register the transfer is subject to certain conditions. *Id.* §§8401(1)(a)-(d).

87. *Id.* §8401(1).

88. *Id.*

89. *Id.* §8401(3); *see id.* §8407(c) (requirements for exchange of securities).

90. *Id.* §8401(3)(a).

91. *Id.* §8401(3)(b); *see id.* §8403(7) (issuer's duties as to adverse claims against uncertificated securities); *infra* notes 97-100 and accompanying text.

92. *Id.* §8401(3)(c).

93. *Id.* §8401(3)(d).

94. The claim must be received at a time and in a manner affording the issuer a reasonable opportunity to act on the notification. *Id.* §8403(1). An issuer's duty of inquiry, as to certificated securities, may be discharged by any reasonable means, including notifying an adverse claimant by registered or certified mail that a certificated security has been presented for registration of transfer and that transfer will be registered within 30 days from the mailing date of the notification unless: (1) a restraining order, injunction, or other legal process is issued by a competent court; or (2) an indemnity bond is filed with the issuer sufficient in the issuer's judgment, to protect the issuer, registrar, or other agent of the issuer from any loss that may result from complying with the adverse claim. *Id.* §8403(2).

95. *Id.* §8403(1).

security is under no duty as to adverse claims<sup>96</sup> unless the claim is (1) supported by a restraining order, injunction, or other legal process served upon the issuer,<sup>97</sup> (2) in the form of a written notice from the registered owner or pledgee,<sup>98</sup> or (3) noted on the initial transaction statement sent to the present registered owner.<sup>99</sup> An issuer's duty of inquiry, as to an uncertificated security, is discharged by (1) including a notation of the claim in any statements sent with respect to the security<sup>100</sup> and (2) refusing to register the transfer or pledge of the security unless the nature of the claim does not preclude transfer or pledge.<sup>101</sup>

If, however, a transfer or pledge is registered subject to an adverse claim, Chapter 927 requires a notation of the claim to be made on the initial transaction statement and on all subsequent statements sent to the transferee and pledgee.<sup>102</sup> In addition, if an uncertificated security is subject to a registered pledge prior to a particular adverse claim, the issuer is under no duty as to that claim if transfer of the security is requested by the pledgee unless (1) the claim is embodied in legal process which expressly provides otherwise,<sup>103</sup> (2) the claim is asserted in a written notification from the registered pledgee,<sup>104</sup> or (3) the transfer requested is to the registered owner.<sup>105</sup>

### C. Liability for Registration

Chapter 927 supplements existing law governing the liability of an issuer for registration of certificated securities.<sup>106</sup> Chapter 927 specifies that if an issuer has improperly registered a transfer, pledge, or release of an uncertificated security, the injured party may demand that the issuer restore the records to the condition the records were in prior to the improper registration.<sup>107</sup> The issuer must comply with the demand unless the registration was (1) of a certificated security that

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96. The claim must be received at a time and in a manner affording the issuer a reasonable opportunity to act on the notification. *Id.* §8403(7).

97. *Id.* §8403(7)(a).

98. *Id.* §8403(7)(b).

99. *Id.* §8403(7)(c); *see id.* §8404 (requirements for statements of uncertificated securities); *infra* notes 107-11 and accompanying text.

100. CAL. COM. CODE §8403(8)(a); *see id.* §8404 (requirements for statements of uncertificated securities); *infra* notes 107-11 and accompanying text.

101. *Id.* §8403(8)(b).

102. *Id.* §8403(9).

103. *Id.* §8403(10)(a).

104. *Id.* §8403(10)(b).

105. *Id.* §8403(10)(c).

106. *See id.* §8404 (extent of issuer's liability for registration of securities).

107. *Id.* §8404(3).

had the necessary endorsements,<sup>108</sup> (2) on an instruction received from the appropriate person,<sup>109</sup> or (3) the registration would result in overissue.<sup>110</sup>

#### D. Exchangeability of Securities

Chapter 927 requires an issuer, upon written request, to exchange an uncertificated security for a certificated security, or a certificated security for an uncertificated security, if the issuer maintains a system for issuing both certificated and uncertificated securities, of the class involved, under which both types of securities are regularly issued to a category of owners<sup>111</sup> that includes the person in whose name the new security is to be registered.<sup>112</sup> Chapter 927 provides that when a certificated security is surrendered with all necessary endorsements, the issuer is required to issue an equivalent uncertificated security subject to all liens, restrictions, and claims that were noted on the certificated security.<sup>113</sup> Upon receipt of a transfer instruction requesting the exchange of an uncertificated security, an issuer is required to cancel the uncertificated security and issue an equivalent certificated security on which must be noted conspicuously any liens and restrictions of the issuer and any adverse claims to which the uncertificated security was subject.<sup>114</sup> The certificated security is required to be registered in the name of and delivered to either (1) the registered owner if the uncertificated security were not subject to a registered pledge, or (2) the registered pledgee if the uncertificated security were subject to a registered pledge.<sup>115</sup>

#### E. Statements for Uncertificated Securities

Under Chapter 927, issuers of uncertificated securities must send, at specified intervals or upon the happening of specified transactions,

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108. *Id.* §8404(3)(a); see CAL. COM. CODE §8308 (endorsements).

109. *Id.*

110. *Id.* §8404(3)(b). Section 8104 of the California Commercial Code governs the issuer's liability in situations when registration would result in overissue. *Id.*

111. Division 8 does not prevent an issuer who maintains dual systems of registration from restricting the availability of certificated or uncertificated securities to certain categories of owners, including brokers, bankers, or institutions. CODE, *supra* note 3, at 856.

112. *Id.* §8407(1).

113. *Id.* §8407(2). At the time the uncertificated security is issued, the issuer must have no duty as to an adverse claim or have discharged the duty. *Id.* See CAL. COM. CODE §8403 (issuer's duty as to adverse claims); *supra* notes 95-106 and accompanying text.

114. CAL. COM. CODE §8407(3). See *id.* §8403 (issuer's duty as to adverse claims); *supra* notes 95-106 and accompanying text.

115. CAL. COM. CODE §8407(3).

a written statement to specified parties.<sup>116</sup> Chapter 927 requires that within two business days after the *transfer* of an uncertificated security has been registered, a written statement containing specified information<sup>117</sup> must be sent to the new registered owner and, if the security is transferred subject to a registered pledge, to the registered pledgee.<sup>118</sup> Within two business days after the *pledge* of an uncertificated security has been registered, a written statement containing specified information<sup>119</sup> must be sent to the registered owner and the registered pledgee.<sup>120</sup> Moreover, two business days after the *release from pledge* of an uncertificated security has been registered, a written statement containing specified information<sup>121</sup> must be sent to the registered owner and the pledgee whose interest was released.<sup>122</sup> Furthermore, two business days after the *transfer* of an uncertificated security has been registered, a written statement containing specified information<sup>123</sup> must be sent to the *former* registered owner and the

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116. *Id.* §8408(1).

117. The statement must contain the following: (1) a description of the issue of which the uncertificated security is a part; (2) the number of shares or units transferred; (3) the name, address and taxpayer identification number of the new registered owner and, if the security is transferred subject to a registered pledge, the name, address, and taxpayer identification number of the registered pledgee; (4) a notation of liens and restrictions of the issuer and any adverse claims that the uncertificated security is or may be subject at the time of registration or a statement that there are no liens, restrictions, or adverse claims; (5) the date the transfer was registered; and (6) anything else required by section 416(b) of the Corporations Code. *Id.* §8408(1) *See id.* §8403(7) (issuer's duties as to adverse claims); *supra* notes 97-100 and accompanying text. *See also* CAL. CORP. CODE §416(b) (providing for the issuance of uncertificated securities).

118. CAL. COM. CODE §8408(1).

119. The statement must contain the following: (1) a description of the issue of which the uncertificated security is a part; (2) the number of shares or units pledged; (3) the name, address and taxpayer identification number of the registered owner and the registered pledgee; (4) a notation of liens and restrictions of the issuer and any adverse claims which the uncertificated security is or may be subject at the time of registration or a statement that there are no liens, restrictions, or adverse claims; (5) the date the pledge was registered; and (6) anything else required by section 416(b) of the Corporations Code. *Id.* §8408(2). *See id.* §8403(7) (issuer's duties as to adverse claims); *supra* notes 97-100 and accompanying text. *See* CAL. CORP. CODE §416(b) (providing for the issuance of uncertificated securities).

120. CAL. COM. CODE §8408(2).

121. The statement must contain the following: (1) a description of the issue of which the uncertificated security is a part; (2) the number of shares or units released from pledge; (3) the name, address and taxpayer identification number of the registered owner and the pledgee whose interest was released; (4) a notation of liens and restrictions of the issuer and any adverse claims which the uncertificated security is or may be subject, at the time of registration or a statement that there are no liens, restrictions, or adverse claims; (5) the date the release was registered; and (6) anything else required by section 416(b) of the Corporations Code. *Id.* §8408(3). *Id.* §8403(7) (issuer's duties as to adverse claims); *supra* notes 97-100 and accompanying text. *See* CAL. CORP. CODE §416(b) (providing for the issuance of uncertificated securities).

122. CAL. COM. CODE §8408(3).

123. The statement must contain the following: (1) a description of the issue of which the uncertificated security is a part; (2) the number of shares or units transferred; (3) the name, address and taxpayer identification number of the former registered owner and of any former registered pledgee; and (4) the date the transfer was registered. *Id.* §8408(5).



former registered pledgee, if any.<sup>124</sup>

Chapter 927 requires that at periodic intervals, at least annually, and at any time upon the reasonable written request of the *registered owner*, the issuer must send to the registered owner of each uncertificated security a dated written statement containing specified information.<sup>125</sup> In addition, at periodic intervals, at least annually, and at any time upon the reasonable written request of the *registered pledgee*, the issuer is required to send to the registered pledgee of each uncertificated security a dated written statement containing specified information.<sup>126</sup>

Chapter 927 requires that each statement issued under the provisions of the Commercial Code bear a conspicuous legend specifying that the statement is merely a record of rights, confers no rights on the recipient, and that the statement is neither a negotiable instrument nor a security.<sup>127</sup> Additionally, Chapter 927 requires that a permanent record of the most recent initial transaction statement issued must be maintained for every uncertificated security.<sup>128</sup>

### Transition Provisions

Chapter 927 enacts Division 12 of the California Commercial Code.<sup>129</sup> Division 12 provides for the transition of law governing securities and interests in securities.<sup>130</sup>

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124. *Id.* §8408(5).

125. *Id.* §8408(6). The statement must contain (1) a description of the issue of which the uncertificated security is a part; (2) the name, address and taxpayer identification number of the registered owner; (3) the number of shares or units of the uncertificated security registered in the name of the registered owner on the date of the statement; (4) the name, address and taxpayer identification number of the registered pledgee and the number of shares or units subject to the pledge; (5) a notation of liens and restrictions of the issuer and any adverse claims which the uncertificatd security is or may be subject or a statement that there are no liens, restrictions, or adverse claims; and (6) anything else required by section 416(b) of the Corporations Code. *Id.* See CAL. COM. CODE §8403(7) (issuers duties as to adverse claims); *supra* notes 97-100 and accompanying text. See CAL. CORP. CODE §416(b) (providing for the issuance of uncertificated securities).

126. CAL. COM. CODE §8408(7). The statement must contain (1) a description of the issue of which the uncertificated security is a part; (2) the name, address and taxpayer identification number of the registered owner; (3) the name, address and taxpayer identification number of the registered pledgee; (4) the number of shares or units subject to the pledge; (5) a notation of liens and restrictions of the issuer and any adverse claims that the uncertificated security is or may be subject or a statement that there are no liens, restrictions, or adverse claims; and (6) anything else required by section 416(b) of the Corporations Code. *Id.* See CAL. COM. CODE §8403(7) (issuers duties as to adverse claims); *supra* notes 97-100 and accompanying text. See CAL. CORP. CODE §416(b) (providing for the issuance of uncertificated securities).

127. CAL. COM. CODE §8408(9) (sample form of legend).

128. *Id.* §8408(10).

129. *Id.* §12101.

130. *Id.* §12102.

*A. Continuation of Ownership Interest*

Chapter 927 provides that the owner of an interest in an uncertificated security, other than a security interest acquired (1) prior to January 1, 1985, or (2) after January 1, 1985 as a result of ownership of a security acquired prior to January 1, 1985, is not required to take any action under section 8313 of the California Commercial Code in order to preserve or protect the ownership interest.<sup>131</sup> If a security interest or any other interest attaches after January 1, 1985, however, the rights and obligations of all persons with respect to those interests is governed by Division 8 of the California Commercial Code as revised by the Legislature in the 1983-84 regular session.<sup>132</sup>

*B. Continuation of Security Interest*

Chapter 927 provides that any party who has a security interest in an uncertificated security which attached (1) prior to January 1, 1985 or (2) after January 1, 1985 as a result of a security interest in a security acquired prior to January 1, 1985, is not required to take any action under Division 8 of the California Commercial Code to protect, preserve, or perfect the security interest.<sup>133</sup> Division 9 of the California Commercial Code, as it existed prior to January 1, 1985 will continue to govern the priority and perfection of the security interest. Any action, regarding an uncertificated security, required by Division 9, as it existed prior to January 1, 1985, to continue the security interest will bring the security interest within the scope of Division 8 of the California Commercial Code as revised by the Legislature in the 1983-84 regular session.<sup>134</sup>

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131. *Id.* §12103.

132. *Id.*

133. *Id.* §12104.

134. *Id.*

**Commercial Transactions; secured transactions**

Commercial Code §9102 (amended).  
AB 521 (Young); 1984 STAT. Ch 1197  
(Effective July 1, 1985)

Under prior law, a nonpossessory security interest<sup>1</sup> in the inventory<sup>2</sup> of a retail merchant, other than a purchase money security interest,<sup>3</sup> could not be given or taken unless the merchant was (1) a member of a cooperative association,<sup>4</sup> or (2) a retail merchant with inventory consisting of durable goods<sup>5</sup> having a unit retail value of at least \$500, motor vehicles, house trailers, trailers, semitrailers, farm and construction machinery, or aircraft.<sup>6</sup> Prior law specifically prohibited a purchase money security interest given in the inventory of a retail merchant from extending to after-acquired property.<sup>7</sup> In addition, prior law did not apply to the giving of a security interest in inventory if the merchant had wholesale sales in excess of seventy-five percent, in dollar volume, of total sales of all goods during the twelve months preceeding the giving of the security interest.<sup>8</sup>

With the enactment of Chapter 1197, California law is brought into greater uniformity with the law of other states<sup>9</sup> by allowing retail merchants,<sup>10</sup> except those selling beer, wine, or liquor,<sup>11</sup> to give or take a nonpossessory security interest in their inventory acquired before, on, or after July 1, 1985.<sup>12</sup> Chapter 1197 provides, however, that a nonpossessory security interest in the inventory of a retail merchant whose sales of goods for personal, family, or household purposes exceeded seventy-five percent of total sales of all goods during the twelve months preceding the filing of a security financing statement<sup>13</sup> is invalid unless (1) the security interest is a purchase money security interest, or (2) the security interest secures a debt upon which the secured party has made no restrictions on the use of the funds, other

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1. CAL. COM. CODE §1201(37) (definition of security interest).

2. *Id.* §9109(4) (definition of inventory).

3. CAL. COM. CODE §9107 (definition of purchase money security interest).

4. 1980 Cal. Stat. c. 1156, §2, at 3857 (specified cooperative organizations).

5. CAL. COM. CODE §9105(h) (definition of goods); *id.* §9109 (classification of goods).

6. 1980 Cal. Stat. c. 1156, §2, at 3857 (amending CAL. COM. CODE §9102).

7. *Id.*; CAL. COM. CODE §9204 (definition of after-acquired property).

8. 1980 Cal. Stat. c. 1156, §2, at 3857 (amending CAL. COM. CODE §9102).

9. Article 9 of the Uniform Commercial Code, as adopted in all states other than California, contains no provision prohibiting a security interest in the inventory of a retail merchant. Supplement Report from the UCC Committee of the Business Law Section of the California State Bar Association (April 27, 1983) (copy on file at *Pacific Law Journal*).

10. CAL. COM. CODE §9102(7) (definition of retail merchant).

11. *Id.* §9102(4). Chapter 1197 specifies that retail merchants of beer, wine, or liquor only may give or take a purchase money security interest which does not extend to after-acquired property. *Id.*

12. *Id.* §9102(5).

13. *Id.* §9102(8). A financing statement or a continuation statement filed on or before July 1, 1985, if otherwise sufficient to satisfy the requirements of Division 9 the California Commercial Code (commencing with Section 9101), is effective with respect to a security interest that first becomes permissible under section 9201 on or after July 1, 1985. *Id.*

than those that are commercially reasonable and made in good faith.<sup>14</sup>

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14. *Id.* §9102(5). The restrictions contained in California Commercial Code sections 9102(4), (5), on the giving or taking of a nonpossessory security interest in inventory, do not apply to (1) a cooperative association organized pursuant to Chapter 1 of Division 20 of the Food and Agriculture Code or Part 3 of Division 3 of Title 1 of the Corporations Code, or (2) a retail merchant with inventory consisting of durable goods having a unit retail value of at least \$500, motor vehicles, house trailers, trailers, semitrailers, farm and construction machinery, aircraft, or repair parts of any of the foregoing. *Id.* §9102(6).

## Commercial Transactions; sales

Commercial Code §2326 (amended).  
AB 2304 (Mojonnier); 1984 STAT. Ch 201

Under existing law, when goods delivered primarily for resale may be returned by the buyer even though they conform to the contract, the transaction is a “sale or return.”<sup>1</sup> If the person to whom the goods are delivered is a buyer who deals in goods of the kind involved, title passes upon delivery to the buyer,<sup>2</sup> and the goods are subject to the claims of the buyer’s creditors.<sup>3</sup> Existing law, however, prevents creditors from claiming goods delivered to the buyer and in the buyer’s possession if the deliverer (1) establishes that the buyer is generally known by his creditors to be substantially engaged in selling the goods of others,<sup>4</sup> or (2) complies with secured transaction filing requirements.<sup>5</sup> Chapter 201 stipulates that delivered goods that were used or purchased for personal, family, or household purposes are not subject to claims of the buyer’s creditors.<sup>6</sup>

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1. CAL. COM. CODE §2326(1)(a). Compare *id.* with *id.* §2326(1)(b) (difference between “sale or return” and “sale on approval”).

2. *People v. Baker*, 64 Cal. App. 336, 341, 221 P. 654, 656 (1923). With a sale or return the title passes at once, subject to the right to rescind and return. *Id.* See also Comment, *Sale or Return and Sale on Approval of Goods*, 1962 WIS. L. REV. 93, 93.

3. CAL. COM. CODE §2326(2). *Id.* §1201(12) (definition of creditor).

4. *Id.* §2326(3)(b).

5. *Id.* §2326(3)(c). See *id.* §§9401-9409 (filing provisions for secured transactions). See also Comment, *Proposed Section 9-114 of the Uniform Commercial Code: The Consignor’s Priority In His Goods*, 8 LOY. L.A.L. REV. 139 (1975) (recommending that the consignor file a financing statement even if the consignee’s reputation is well-known). Accord Comment, *Uniform Commercial Code—Consignments and the Consignor’s Duty to Satisfy Public Notice Requirements*, 13 WAKE FOREST L. REV. 522, 541 (1977).

6. CAL. COM. CODE §2326(3)(d). See also News Release, Assemblywoman Sunny Mojonnier, June 14, 1984 (copy on file at the *Pacific Law Journal*). “This new statute protects the personal

Chapter 201 further provides that if a person delivers or consigns for sale goods used or purchased for personal, family, or household purposes, the goods do not become the property of the buyer unless the buyer purchases and pays for the goods in full.<sup>7</sup> Under Chapter 201, any payment received by the buyer from a subsequent purchaser of the goods, less any amount which the deliverer expressly agreed could be deducted from the payment for commissions, fees, or expenses, is the property of the deliverer and is not subject to the claims of the buyer's creditors.<sup>8</sup>

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property (e.g., heirlooms or other valuable items) of individuals who are not ordinarily involved in commerce." *Id.*

7. CAL. COM. CODE §2326(5). This provision does not prevent the retailer from acting as the deliverer's agent to transfer title to a buyer who pays the full purchase price. *Id.*

8. *Id.*