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## Chapter 9: Article Eight: Investment Securities

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## C H A P T E R 9

### Article Eight: Investment Securities

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**§9.1. General.** Article 8 revises the law as to the negotiability and transfer of investment securities. The article has two major effects:

(1) It makes essentially negotiable on the same basis all shares of stock and other investment securities, including various types of bonds, debentures, notes and warrants bought for investment that heretofore were not negotiable. The article does this by in effect re-enacting, with some material additions and with changes of less importance, the substance of the major provisions of the Uniform Stock Transfer Act,<sup>1</sup> and making the provisions apply to all types of investment securities.

(2) The article simplifies and clarifies the requirements as to transfers of investment securities, so as to eliminate or reduce complications, difficulties and delays on transfers of securities, particularly those being sold by estates, trusts and other fiduciaries. This is accomplished in the main by setting out clear, simple rules, and by giving protection for issuers and transfer agents, much along the line of G.L., c. 203, §20, but with more completeness. It also facilitates transfers handled by brokers by making the law that governs these transfers conform to the realities of current commercial practice.

Much of Article 8 restates present Massachusetts law; there are, however, a number of material changes in present law which are commented on below.

**§9.2. "Investment securities."** Section 8-102 defines investment securities so as to include not only stock but also every bond, other obligation or warrant, and certain other instruments issued or dealt in as media for investment. The section also makes Article 8 govern all such securities even though they meet the specifications for commercial paper.

**§9.3. Effect of "overissue."** Section 8-104 continues present law by making invalid an issue of a security beyond the issuer's corporate power. It also, in conjunction with other sections, notably Sections 8-202 and 8-205, gives a bona fide purchaser a right to receive from the issuer, if its agent or apparent agent signed the "overissue" security,

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§9.1. <sup>1</sup> G.L., c. 155, §§24-46.

a similar valid security if available or otherwise the amount paid by the purchaser plus interest.

**§9.4. Issue: Issuer.** Article 8 is designed to protect, when possible, the good faith purchaser of investment securities. Section 8-202 contains a number of provisions, some of which are new law in Massachusetts, that aid the bona fide purchaser. Subsection (1) protects against deceptiveness by making invalid a general reference in a security to the terms of another document, if they conflict with the terms stated in the security itself. Subsection (2)(a) validates a security in the hands of a bona fide purchaser if signed by an appropriate agent or agent with apparent authority and if the issuer is not a governmental unit, even though there was a defect in the issue proceedings other than a violation of a constitutional requirement. In the latter case this subsection validates the security in the hands of a subsequent purchaser for value without notice of the defect.

Subsection (2)(b) is designed to protect the purchaser of an investment security from a governmental unit. If there has been substantial compliance with the legal requirements for issue (which seems to be present Massachusetts law) or if the issuer received substantial consideration for the issue and had the power to borrow for the stated purpose of the issue, purchasers are protected in accordance with the provisions of Subsection (2)(a) discussed immediately above. These provisions are deemed desirable to accomplish an equitable result and to prevent unjust enrichment.

Section 8-202 (4) takes away a technical defense as to nondelivery as against a bona fide purchaser. This merely, of course, puts the burden wholly upon the issuer to make certain it does not let go of signed securities until it means to do so by issuing and delivering them.

The strict provision of the Negotiable Instruments Law that charges notice of any defense to a buyer after maturity<sup>1</sup> has been relaxed to a limited extent by Section 8-203 of the Code. This section protects one who buys in good faith, within a year after maturity or after a call for redemption or exchange, if the money or new securities were promptly made available to the owner, and in other cases if the purchase is within two years.

Section 8-205 makes an issuer responsible to a bona fide purchaser when the security was signed by a person without actual authority but having apparent authority by reason of his being entrusted with similar signings, the preparation of securities for signing, or their responsible handling. This provision may not materially change present law but, even if it does, the burden it imposes upon issuers is one against which, in most cases, they can readily insure.

Although the Negotiable Instruments Law gives some protection to a bona fide purchaser in cases in which blanks in a security are filled in otherwise than as authorized,<sup>2</sup> Section 8-206 (1) (b) of the Code ex-

§9.4. <sup>1</sup> G.L., c. 107, §75, NIL §52.

<sup>2</sup> Id. §§38, 39, NIL §§16, 17.

tends this protection by making the security as completed enforceable by a purchaser for value who took without notice of the incorrectness. Section 8-206 (2) further prevents forfeiture in cases in which a security is improperly altered, by providing that the security remains enforceable according to its original terms.

Section 8-208 of the Code is designed to define the responsibilities of transfer agents and the like to bona fide purchasers, in line with the present general commercial understanding of what such responsibilities are. It will make the law conform to the realities of present commercial practice.

**§9.5. Purchase.** General Laws, c. 203, §20 now protects an issuer or transfer agent, or similar representative, by not requiring that they look to the application of funds, securities, personal property or effects delivered to a trustee. Section 8-304 (2) extends this essential protection to any purchaser of securities from a fiduciary.

Section 8-305 recognizes that securities are frequently dealt with after maturity, call or the like. It provides protection against adverse claims of former owners similar to the protection against issuer's defenses provided in Section 8-203.<sup>1</sup>

An innocent intermediary may under present Massachusetts decisions find himself liable for conversion. Sections 8-306 (4), (5), and 8-318 will protect the holder for security, broker, agent, or bailee from any liability for conversion if he disposes of a security without knowledge that his principal did not himself have the power to dispose of the security.

The Negotiable Instruments Law provides that an endorser assumes responsibility for the issuer's meeting his obligations.<sup>2</sup> Section 8-308 (4) relieves the endorser of a security from this rule.

Whether an owner of a security endorsed without his authority is able to assert his rights against a third party is at present uncertain under Massachusetts law. Section 8-311 protects the owner against the issuer or any purchaser except a bona fide purchaser who receives a new or reissued security on a registration of transfer by the issuer. In this latter situation the owner may recover against the issuer for improper registration under Section 8-404.

Section 8-312 probably extends the legal responsibility of a guarantor of a signature beyond that which he has under present Massachusetts law. The section, however, merely states what his responsibility is commonly considered to be under present commercial practice.

The Statute of Frauds applicable to security transfers is set out in Section 8-319. It modifies present Massachusetts law to make it conform to established and recognized commercial practices in connection with these sales.

**§9.6. Registration.** Simple rules as to the responsibilities of issuers and transfer agents and the like with respect to the transfer of securi-

§9.5. <sup>1</sup> See the text discussion of Section 8-203 in §9.4 *supra*.

<sup>2</sup> G.L., c. 107, §89, NIL §66.

ties are set out in Sections 8-401 through 8-404. These sections generally conform to the present law set out in G.L., c. 203, §20, and are designed to simplify and expedite transfers, particularly by estates and fiduciaries. Under Section 8-404 (1) the issuer and transfer agent are protected in making a transfer when the security bears appropriate endorsements; they are not under a duty to inquire into adverse claims.

The Code provides that the owner of a lost security must notify the issuer of his loss within a reasonable time. Section 8-405 (1) provides that the owner who fails thus to notify the issuer loses his right to damages for a wrongful transfer and his right to have a replacement security issued to him.