

12A' 8 - 101

LEGISLATIVE HISTORY CHECKLIST

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974.901 New Jersey. Law Revision Commission.
L446 Annual report...1994. February 1, 1995. Trenton, 1995.
[see p. 10 & Appendix G]

974.901 New Jersey. Law Revision Commission.
L446 Annual report...1995. February 1, 1996.
[see pp. 5-6, Appendix C]

KBP:pp

§1 - Title 12A.
Chapter 8
Investment Securities
N.J.S.12A:8-101
et seq.
§§5,6
N.J.S. 12A:9-115 &
12A:9-116
§21 - Repealer

P.L. 1997, CHAPTER 252, *approved September 12, 1997*
Assembly, No. 2019
CORRECTED COPY

1 AN ACT concerning commercial transactions, replacing chapter 8 of
2 Title 12A of the New Jersey Statutes, enacting additional sections
3 of chapter 9 of Title 12A of the New Jersey Statutes and revising
4 various parts of the statutory law.

5
6 **BE IT ENACTED** by the Senate and General Assembly of the State
7 of New Jersey:

8
9 1. Chapter 8 of Title 12A of the New Jersey Statutes
10 (N.J.S.12A:8-101 through 12A:8-805, including any amendments or
11 supplements thereto) is repealed and replaced as follows:

12
13 CHAPTER 8. INVESTMENT SECURITIES

14
15 PART 1

16 SHORT TITLE AND GENERAL MATTERS

17 12A:8-101. Short Title

18 This chapter may be cited as Uniform Commercial
19 Code--Investment Securities.

20 12A:8-102. Definitions.

21 a. In this chapter:

22 (1) "Adverse claim" means a claim that a claimant has a property
23 interest in a financial asset and that it is a violation of the rights of the
24 claimant for another person to hold, transfer, or deal with the financial
25 asset.

26 (2) "Bearer form," as applied to a certificated security, means a
27 form in which the security is payable to the bearer of the security
28 certificate according to its terms but not by reason of an indorsement.

29 (3) "Broker" means a person defined as a broker or dealer under
30 the federal securities laws, but without excluding a bank acting in that
31 capacity.

32 (4) "Certificated security" means a security that is represented by

EXPLANATION - Matter enclosed in bold-faced brackets [thus] in the above bill is not enacted and intended to be omitted in the law.

Matter underlined thus is new matter.

1 a certificate.

2 (5) "Clearing corporation" means:

3 (a) a person that is registered as a "clearing agency" under the
4 federal securities laws;

5 (b) a federal reserve bank; or

6 (c) any other person that provides clearance or settlement services
7 with respect to financial assets that would require it to register as a
8 clearing agency under the federal securities laws but for an exclusion
9 or exemption from the registration requirement, if its activities as a
10 clearing corporation, including promulgation of rules, are subject to
11 regulation by a federal or state governmental authority.

12 (6) "Communicate" means to:

13 (a) send a signed writing; or

14 (b) transmit information by any mechanism agreed upon by the
15 persons transmitting and receiving the information.

16 (7) "Entitlement holder" means a person identified in the records
17 of a securities intermediary as the person having a security entitlement
18 against the securities intermediary. If a person acquires a security
19 entitlement by virtue of paragraphs (2) or (3) of subsection b. of
20 12A:8-501, that person is the entitlement holder.

21 (8) "Entitlement order" means a notification communicated to a
22 securities intermediary directing transfer or redemption of a financial
23 asset to which the entitlement holder has a security entitlement.

24 (9) "Financial asset," except as otherwise provided in 12A:8-103,
25 means:

26 (a) a security;

27 (b) an obligation of a person or a share, participation, or other
28 interest in a person or in property or an enterprise of a person, which
29 is, or is of a type, dealt in or traded on financial markets, or which is
30 recognized in any area in which it is issued or dealt in as a medium for
31 investment; or

32 (c) any property that is held by a securities intermediary for another
33 person in a securities account if the securities intermediary has
34 expressly agreed with the other person that the property is to be
35 treated as a financial asset under this chapter.

36 As context requires, the term means either the interest itself or the
37 means by which a person's claim to it is evidenced, including a
38 certificated or uncertificated security, a security certificate, or a
39 security entitlement.

40 (10) "Good faith," for purposes of the obligation of good faith in
41 the performance or enforcement of contracts or duties within this
42 chapter, means honesty in fact and the observance of reasonable
43 commercial standards of fair dealing.

44 (11) "Indorsement" means a signature that alone or accompanied
45 by other words is made on a security certificate in registered form or
46 on a separate document for the purpose of assigning, transferring, or

1 redeeming the security or granting a power to assign, transfer, or
2 redeem it.

3 (12) "Instruction" means a notification communicated to the issuer
4 of an uncertificated security which directs that the transfer of the
5 security be registered or that the security be redeemed.

6 (13) "Registered form," as applied to a certificated security, means
7 a form in which:

8 (a) the security certificate specifies a person entitled to the security;
9 and

10 (b) a transfer of the security may be registered upon books
11 maintained for that purpose by or on behalf of the issuer, or the
12 security certificate so states.

13 (14) "Securities intermediary" means:

14 (a) a clearing corporation; or

15 (b) a person, including a bank or broker, that in the ordinary course
16 of its business maintains securities accounts for others and is acting in
17 that capacity.

18 (15) "Security," except as otherwise provided in 12A:8-103, means
19 an obligation of an issuer or a share, participation, or other interest in
20 an issuer or in property or an enterprise of an issuer:

21 (a) which is represented by a security certificate in bearer or
22 registered form, or the transfer of which may be registered upon books
23 maintained for that purpose by or on behalf of the issuer;

24 (b) which is one of a class or series or by its terms is divisible into
25 a class or series of shares, participations, interests, or obligations; and

26 (c) which:

27 (A) is, or is of a type, dealt in or traded on securities exchanges or
28 securities markets; or

29 (B) is a medium for investment and by its terms expressly provides
30 that it is a security governed by this chapter.

31 (16) "Security certificate" means a certificate representing a
32 security.

33 (17) "Security entitlement" means the rights and property interest
34 of an entitlement holder with respect to a financial asset specified in
35 12A:8-501 through 12A:8-511.

36 (18) "Uncertificated security" means a security that is not
37 represented by a certificate.

38 b. Other definitions applying to this chapter and the sections in
39 which they appear are:

40	Appropriate person	12A:8-107
41	Control	12A:8-106
42	Delivery	12A:8-301
43	Investment company security	12A:8-103
44	Issuer	12A:8-201
45	Overissue	12A:8-210
46	Protected purchaser	12A:8-303

1 Securities account

12A:8-501

2 c. In addition, chapter 1 contains general definitions and principles
3 of construction and interpretation applicable throughout this chapter.

4 d. The characterization of a person, business, or transaction for
5 purposes of this chapter does not determine the characterization of the
6 person, business, or transaction for purposes of any other law,
7 regulation, or rule.

8 12A:8-103. Rule for Determining whether Certain Obligations and
9 Interests are Securities or Financial Assets.

10 a. A share or similar equity interest issued by a corporation,
11 business trust, joint stock company, or similar entity is a security.

12 b. An "investment company security" is a security. "Investment
13 company security" means a share or similar equity interest issued by
14 an entity that is registered as an investment company under the federal
15 investment company laws, an interest in a unit investment trust that is
16 so registered, or a face-amount certificate issued by a face-amount
17 certificate company that is so registered. Investment company security
18 does not include an insurance policy or endowment policy or annuity
19 contract issued by an insurance company.

20 c. An interest in a partnership or limited liability company is not a
21 security unless it is dealt in or traded on securities exchanges or in
22 securities markets, its terms expressly provide that it is a security
23 governed by this chapter, or it is an investment company security.
24 However, an interest in a partnership or limited liability company is a
25 financial asset if it is held in a securities account.

26 d. A writing that is a security certificate is governed by this chapter
27 and not by chapter 3, even though it also meets the requirements of
28 that chapter. However, a negotiable instrument governed by chapter
29 3 is a financial asset if it is held in a securities account.

30 e. An option or similar obligation issued by a clearing corporation
31 to its participants is not a security, but is a financial asset.

32 f. A commodity contract, as defined in 12A:9-115, is not a security
33 or a financial asset.

34 12A:8-104. Acquisition of Security or Financial Asset or Interest
35 Therein.

36 a. A person acquires a security or an interest therein, under this
37 chapter, if:

38 (1) the person is a purchaser to whom a security is delivered
39 pursuant to 12A:8-301; or

40 (2) the person acquires a security entitlement to the security
41 pursuant to 12A:8-501.

42 b. A person acquires a financial asset, other than a security, or an
43 interest therein, under this chapter, if the person acquires a security
44 entitlement to the financial asset.

45 c. A person who acquires a security entitlement to a security or
46 other financial asset has the rights specified in 12A:8-501 through

1 12A:8-511, but is a purchaser of any security, security entitlement, or
2 other financial asset held by the securities intermediary only to the
3 extent provided in 12A:8-503.

4 d. Unless the context shows that a different meaning is intended,
5 a person who is required by other law, regulation, rule, or agreement
6 to transfer, deliver, present, surrender, exchange, or otherwise put in
7 the possession of another person a security or financial asset satisfies
8 that requirement by causing the other person to acquire an interest in
9 the security or financial asset pursuant to subsection a. or b. of this
10 section.

11 12A:8-105. Notice of Adverse Claim.

12 a. A person has notice of an adverse claim if:

13 (1) the person knows of the adverse claim;

14 (2) the person is aware of facts sufficient to indicate that there is a
15 significant probability that the adverse claim exists and deliberately
16 avoids information that would establish the existence of the adverse
17 claim; or

18 (3) the person has a duty, imposed by statute or regulation, to
19 investigate whether an adverse claim exists, and the investigation so
20 required would establish the existence of the adverse claim.

21 b. Having knowledge that a financial asset or interest therein is or
22 has been transferred by a representative imposes no duty of inquiry
23 into the rightfulness of a transaction and is not notice of an adverse
24 claim. However, a person who knows that a representative has
25 transferred a financial asset or interest therein in a transaction that is,
26 or whose proceeds are being used, for the individual benefit of the
27 representative or otherwise in breach of duty has notice of an adverse
28 claim.

29 c. An act or event that creates a right to immediate performance of
30 the principal obligation represented by a security certificate or sets a
31 date on or after which the certificate is to be presented or surrendered
32 for redemption or exchange does not itself constitute notice of an
33 adverse claim except in the case of a transfer more than:

34 (1) one year after a date set for presentment or surrender for
35 redemption or exchange; or

36 (2) six months after a date set for payment of money against
37 presentation or surrender of the certificate, if money was available for
38 payment on that date.

39 d. A purchaser of a certificated security has notice of an adverse
40 claim if the security certificate:

41 (1) whether in bearer or registered form, has been indorsed "for
42 collection" or "for surrender" or for some other purpose not involving
43 transfer; or

44 (2) is in bearer form and has on it an unambiguous statement that
45 it is the property of a person other than the transferor, but the mere
46 writing of a name on the certificate is not such a statement.

- 1 e. Filing of a financing statement under chapter 9 is not notice of
2 an adverse claim to a financial asset.
- 3 12A:8-106. Control.
- 4 a. A purchaser has "control" of a certificated security in bearer
5 form if the certificated security is delivered to the purchaser.
- 6 b. A purchaser has "control" of a certificated security in registered
7 form if the certificated security is delivered to the purchaser, and:
- 8 (1) the certificate is indorsed to the purchaser or in blank by an
9 effective indorsement; or
- 10 (2) the certificate is registered in the name of the purchaser, upon
11 original issue or registration of transfer by the issuer.
- 12 c. A purchaser has "control" of an uncertificated security if:
- 13 (1) the uncertificated security is delivered to the purchaser; or
14 (2) the issuer has agreed that it will comply with instructions
15 originated by the purchaser without further consent by the registered
16 owner.
- 17 d. A purchaser has "control" of a security entitlement if:
- 18 (1) the purchaser becomes the entitlement holder; or
19 (2) the securities intermediary has agreed that it will comply with
20 entitlement orders originated by the purchaser without further consent
21 by the entitlement holder.
- 22 e. If an interest in a security entitlement is granted by the
23 entitlement holder to the entitlement holder's own securities
24 intermediary, the securities intermediary has control.
- 25 f. A purchaser who has satisfied the requirements of paragraph (2)
26 of subsection c. or paragraph (2) of subsection d. of this section has
27 control even if the registered owner in the case of paragraph (2) of
28 subsection c. or the entitlement holder in the case of paragraph (2) of
29 subsection d. of this section retains the right to make substitutions for
30 the uncertificated security or security entitlement, to originate
31 instructions or entitlement orders to the issuer or securities
32 intermediary, or otherwise to deal with the uncertificated security or
33 security entitlement.
- 34 g. An issuer or a securities intermediary may not enter into an
35 agreement of the kind described in of paragraph (2) subsection c. or
36 paragraph (2) of subsection d. of this section without the consent of
37 the registered owner or entitlement holder, but an issuer or a securities
38 intermediary is not required to enter into such an agreement even
39 though the registered owner or entitlement holder so directs. An
40 issuer or securities intermediary that has entered into such an
41 agreement is not required to confirm the existence of the agreement to
42 another party unless requested to do so by the registered owner or
43 entitlement holder.
- 44 12A:8-107. Whether Indorsement, Instruction, or Entitlement
45 Order is Effective.
- 46 a. "Appropriate person" means:

- 1 (1) with respect to an indorsement, the person specified by a
2 security certificate or by an effective special indorsement to be entitled
3 to the security;
- 4 (2) with respect to an instruction, the registered owner of an
5 uncertificated security;
- 6 (3) with respect to an entitlement order, the entitlement holder;
- 7 (4) if the person designated in paragraph (1), (2), or (3) of this
8 subsection a. is deceased, the designated person's successor taking
9 under other law or the designated person's personal representative
10 acting for the estate of the decedent; or
- 11 (5) if the person designated in paragraph (1), (2), or (3) of this
12 subsection a. lacks capacity, the designated person's guardian,
13 conservator, or other similar representative who has power under
14 other law to transfer the security or financial asset.
- 15 b. An indorsement, instruction, or entitlement order is effective if:
- 16 (1) it is made by the appropriate person;
- 17 (2) it is made by a person who has power under the law of agency
18 to transfer the security or financial asset on behalf of the appropriate
19 person, including, in the case of an instruction or entitlement order, a
20 person who has control under paragraph (2) of subsection c. or
21 paragraph (2) of subsection d. of 12A:8-106; or
- 22 (3) the appropriate person has ratified it or is otherwise precluded
23 from asserting its ineffectiveness.
- 24 c. An indorsement, instruction, or entitlement order made by a
25 representative is effective even if:
- 26 (1) the representative has failed to comply with a controlling
27 instrument or with the law of the State having jurisdiction of the
28 representative relationship, including any law requiring the
29 representative to obtain court approval of the transaction; or
- 30 (2) the representative's action in making the indorsement,
31 instruction, or entitlement order or using the proceeds of the
32 transaction is otherwise a breach of duty.
- 33 d. If a security is registered in the name of or specially indorsed to
34 a person described as a representative, or if a securities account is
35 maintained in the name of a person described as a representative, an
36 indorsement, instruction, or entitlement order made by the person is
37 effective even though the person is no longer serving in the described
38 capacity.
- 39 e. Effectiveness of an indorsement, instruction, or entitlement
40 order is determined as of the date the indorsement, instruction, or
41 entitlement order is made, and an indorsement, instruction, or
42 entitlement order does not become ineffective by reason of any later
43 change of circumstances.
- 44 12A:8-108. Warranties in Direct Holding.
- 45 a. A person who transfers a certificated security to a purchaser for
46 value warrants to the purchaser, and an indorser, if the transfer is by

- 1 indorsement, warrants to any subsequent purchaser, that:
- 2 (1) the certificate is genuine and has not been materially altered;
- 3 (2) the transferor or indorser does not know of any fact that might
- 4 impair the validity of the security;
- 5 (3) there is no adverse claim to the security;
- 6 (4) the transfer does not violate any restriction on transfer;
- 7 (5) if the transfer is by indorsement, the indorsement is made by an
- 8 appropriate person, or if the indorsement is by an agent, the agent has
- 9 actual authority to act on behalf of the appropriate person; and
- 10 (6) the transfer is otherwise effective and rightful.
- 11 b. A person who originates an instruction for registration of
- 12 transfer of an uncertificated security to a purchaser for value warrants
- 13 to the purchaser that:
- 14 (1) the instruction is made by an appropriate person, or if the
- 15 instruction is by an agent, the agent has actual authority to act on
- 16 behalf of the appropriate person;
- 17 (2) the security is valid;
- 18 (3) there is no adverse claim to the security; and
- 19 (4) at the time the instruction is presented to the issuer:
- 20 (a) the purchaser will be entitled to the registration of transfer;
- 21 (b) the transfer will be registered by the issuer free from all liens,
- 22 security interests, restrictions, and claims other than those specified in
- 23 the instruction;
- 24 (c) the transfer will not violate any restriction on transfer; and
- 25 (d) the requested transfer will otherwise be effective and rightful.
- 26 c. A person who transfers an uncertificated security to a purchaser
- 27 for value and does not originate an instruction in connection with the
- 28 transfer warrants that:
- 29 (1) the uncertificated security is valid;
- 30 (2) there is no adverse claim to the security;
- 31 (3) the transfer does not violate any restriction on transfer; and
- 32 (4) the transfer is otherwise effective and rightful.
- 33 d. A person who indorses a security certificate warrants to the
- 34 issuer that:
- 35 (1) there is no adverse claim to the security; and
- 36 (2) the indorsement is effective.
- 37 e. A person who originates an instruction for registration of
- 38 transfer of an uncertificated security warrants to the issuer that:
- 39 (1) the instruction is effective; and
- 40 (2) at the time the instruction is presented to the issuer the
- 41 purchaser will be entitled to the registration of transfer.
- 42 f. A person who presents a certificated security for registration of
- 43 transfer or for payment or exchange warrants to the issuer that the
- 44 person is entitled to the registration, payment, or exchange, but a
- 45 purchaser for value and without notice of adverse claims to whom
- 46 transfer is registered warrants only that the person has no knowledge

1 of any unauthorized signature in a necessary indorsement.

2 g. If a person acts as agent of another in delivering a certificated
3 security to a purchaser, the identity of the principal was known to the
4 person to whom the certificate was delivered, and the certificate
5 delivered by the agent was received by the agent from the principal or
6 received by the agent from another person at the direction of the
7 principal, the person delivering the security certificate warrants only
8 that the delivering person has authority to act for the principal and
9 does not know of any adverse claim to the certificated security.

10 h. A secured party who redelivers a security certificate received,
11 or after payment and on order of the debtor delivers the security
12 certificate to another person, makes only the warranties of an agent
13 under subsection g. of this section.

14 i. Except as otherwise provided in subsection g. of this section, a
15 broker acting for a customer makes to the issuer and a purchaser the
16 warranties provided in subsections a. through f. of this section. A
17 broker that delivers a security certificate to its customer, or causes its
18 customer to be registered as the owner of an uncertificated security,
19 makes to the customer the warranties provided in subsection a. or b.
20 of this section, and has the rights and privileges of a purchaser under
21 this section. The warranties of and in favor of the broker acting as an
22 agent are in addition to applicable warranties given by and in favor of
23 the customer.

24 12A:8-109. Warranties in Indirect Holding.

25 a. A person who originates an entitlement order to a securities
26 intermediary warrants to the securities intermediary that:

27 (1) the entitlement order is made by an appropriate person, or if the
28 entitlement order is by an agent, the agent has actual authority to act
29 on behalf of the appropriate person; and

30 (2) there is no adverse claim to the security entitlement.

31 b. A person who delivers a security certificate to a securities
32 intermediary for credit to a securities account or originates an
33 instruction with respect to an uncertificated security directing that the
34 uncertificated security be credited to a securities account makes to the
35 securities intermediary the warranties specified in subsection a. or b.
36 of 12A:8-108.

37 c. If a securities intermediary delivers a security certificate to its
38 entitlement holder or causes its entitlement holder to be registered as
39 the owner of an uncertificated security, the securities intermediary
40 makes to the entitlement holder the warranties specified in subsection
41 a. or b. of 12A:8-108.

42 12A:8-110. Applicability; Choice of Law.

43 a. The local law of the issuer's jurisdiction, as specified in
44 subsection d. of this section, governs:

45 (1) the validity of a security;

46 (2) the rights and duties of the issuer with respect to registration of

1 transfer;

2 (3) the effectiveness of registration of transfer by the issuer;

3 (4) whether the issuer owes any duties to an adverse claimant to a
4 security; and

5 (5) whether an adverse claim can be asserted against a person to
6 whom transfer of a certificated or uncertificated security is registered
7 or a person who obtains control of an uncertificated security.

8 b. The local law of the securities intermediary's jurisdiction, as
9 specified in subsection e. of this section, governs:

10 (1) acquisition of a security entitlement from the securities
11 intermediary;

12 (2) the rights and duties of the securities intermediary and
13 entitlement holder arising out of a security entitlement;

14 (3) whether the securities intermediary owes any duties to an
15 adverse claimant to a security entitlement; and

16 (4) whether an adverse claim can be asserted against a person who
17 acquires a security entitlement from the securities intermediary or a
18 person who purchases a security entitlement or interest therein from
19 an entitlement holder.

20 c. The local law of the jurisdiction in which a security certificate is
21 located at the time of delivery governs whether an adverse claim can
22 be asserted against a person to whom the security certificate is
23 delivered.

24 d. "Issuer's jurisdiction" means the jurisdiction under which the
25 issuer of the security is organized or, if permitted by the law of that
26 jurisdiction, the law of another jurisdiction specified by the issuer. An
27 issuer organized under the law of this State may specify the law of
28 another jurisdiction as the law governing the matters specified in
29 paragraphs (2) through (5) of subsection a. of this section.

30 e. The following rules determine a "securities intermediary's
31 jurisdiction" for purposes of this section:

32 (1) If an agreement between the securities intermediary and its
33 entitlement holder specifies that it is governed by the law of a
34 particular jurisdiction, that jurisdiction is the securities intermediary's
35 jurisdiction.

36 (2) If an agreement between the securities intermediary and its
37 entitlement holder does not specify the governing law as provided in
38 paragraph (1) of this subsection e., but expressly specifies that the
39 securities account is maintained at an office in a particular jurisdiction,
40 that jurisdiction is the securities intermediary's jurisdiction.

41 (3) If an agreement between the securities intermediary and its
42 entitlement holder does not specify a jurisdiction as provided in
43 paragraph (1) or (2) of this subsection e., the securities intermediary's
44 jurisdiction is the jurisdiction in which is located the office identified
45 in an account statement as the office serving the entitlement holder's
46 account.

1 (4) If an agreement between the securities intermediary and its
2 entitlement holder does not specify a jurisdiction as provided in
3 paragraph (1) or (2) of this subsection e. and an account statement
4 does not identify an office serving the entitlement holder's account as
5 provided in paragraph (3) of this subsection e., the securities
6 intermediary's jurisdiction is the jurisdiction in which is located the
7 chief executive office of the securities intermediary.

8 f. A securities intermediary's jurisdiction is not determined by the
9 physical location of certificates representing financial assets, or by the
10 jurisdiction in which is organized the issuer of the financial asset with
11 respect to which an entitlement holder has a security entitlement, or by
12 the location of facilities for data processing or other record keeping
13 concerning the account.

14 12A:8-111. Clearing Corporation Rules.

15 A rule adopted by a clearing corporation governing rights and
16 obligations among the clearing corporation and its participants in the
17 clearing corporation is effective even if the rule conflicts with this
18 chapter and affects another party who does not consent to the rule.

19 12A:8-112. Creditor's Legal Process.

20 a. The interest of a debtor in a certificated security may be reached
21 by a creditor only by actual seizure of the security certificate by the
22 officer making the attachment or levy, except as otherwise provided
23 in subsection d. of this section. However, a certificated security for
24 which the certificate has been surrendered to the issuer may be reached
25 by a creditor by legal process upon the issuer.

26 b. The interest of a debtor in an uncertificated security may be
27 reached by a creditor only by legal process upon the issuer at its chief
28 executive office in the United States, except as otherwise provided in
29 subsection d. of this section.

30 c. The interest of a debtor in a security entitlement may be reached
31 by a creditor only by legal process upon the securities intermediary
32 with whom the debtor's securities account is maintained, except as
33 otherwise provided in subsection d. of this section.

34 d. The interest of a debtor in a certificated security for which the
35 certificate is in the possession of a secured party, or in an
36 uncertificated security registered in the name of a secured party, or a
37 security entitlement maintained in the name of a secured party, may be
38 reached by a creditor by legal process upon the secured party.

39 e. A creditor whose debtor is the owner of a certificated security,
40 uncertificated security, or security entitlement is entitled to aid from
41 a court of competent jurisdiction, by injunction or otherwise, in
42 reaching the certificated security, uncertificated security, or security
43 entitlement or in satisfying the claim by means allowed at law or in
44 equity in regard to property that cannot readily be reached by other
45 legal process.

46 12A:8-113. Statute of Frauds Inapplicable.

1 A contract or modification of a contract for the sale or purchase of
2 a security is enforceable whether or not there is a writing signed or
3 record authenticated by a party against whom enforcement is sought,
4 even if the contract or modification is not capable of performance
5 within one year of its making.

6 12A:8-114. Evidentiary Rules concerning Certificated Securities.

7 The following rules apply in an action on a certificated security
8 against the issuer:

9 (1) Unless specifically denied in the pleadings, each signature on
10 a security certificate or in a necessary indorsement is admitted.

11 (2) If the effectiveness of a signature is put in issue, the burden of
12 establishing effectiveness is on the party claiming under the signature,
13 but the signature is presumed to be genuine or authorized.

14 (3) If signatures on a security certificate are admitted or
15 established, production of the certificate entitles a holder to recover
16 on it unless the defendant establishes a defense or a defect going to the
17 validity of the security.

18 (4) If it is shown that a defense or defect exists, the plaintiff has
19 the burden of establishing that the plaintiff or some person under
20 whom the plaintiff claims is a person against whom the defense or
21 defect cannot be asserted.

22 12A:8-115. Securities Intermediary and Others not Liable to
23 Adverse Claimant.

24 A securities intermediary that has transferred a financial asset
25 pursuant to an effective entitlement order, or a broker or other agent
26 or bailee that has dealt with a financial asset at the direction of its
27 customer or principal, is not liable to a person having an adverse claim
28 to the financial asset, unless the securities intermediary, or broker or
29 other agent or bailee:

30 (1) took the action after it had been served with an injunction,
31 restraining order, or other legal process enjoining it from doing so,
32 issued by a court of competent jurisdiction, and had a reasonable
33 opportunity to act on the injunction, restraining order, or other legal
34 process; or

35 (2) acted in collusion with the wrongdoer in violating the rights of
36 the adverse claimant; or

37 (3) in the case of a security certificate that has been stolen, acted
38 with notice of the adverse claim.

39 12A:8-116. Securities Intermediary as Purchaser for Value.

40 A securities intermediary that receives a financial asset and
41 establishes a security entitlement to the financial asset in favor of an
42 entitlement holder is a purchaser for value of the financial asset. A
43 securities intermediary that acquires a security entitlement to a
44 financial asset from another securities intermediary acquires the
45 security entitlement for value if the securities intermediary acquiring
46 the security entitlement establishes a security entitlement to the

1 financial asset in favor of an entitlement holder.

2

3

PART 2
ISSUE AND ISSUER

4

5

6 12A:8-201. Issuer.

7

a. With respect to an obligation on or a defense to a security, an
8 "issuer" includes a person that:

9

(1) places or authorizes the placing of its name on a security
10 certificate, other than as authenticating trustee, registrar, transfer
11 agent, or the like, to evidence a share, participation, or other interest
12 in its property or in an enterprise, or to evidence its duty to perform
13 an obligation represented by the certificate;

14 (2) creates a share, participation, or other interest in its property or
15 in an enterprise, or undertakes an obligation, that is an uncertificated
16 security;

17 (3) directly or indirectly creates a fractional interest in its rights or
18 property, if the fractional interest is represented by a security
19 certificate; or

20 (4) becomes responsible for, or in place of, another person
21 described as an issuer in this section.

22 b. With respect to an obligation on or defense to a security, a
23 guarantor is an issuer to the extent of its guaranty, whether or not its
24 obligation is noted on a security certificate.

25 c. With respect to a registration of a transfer, issuer means a
26 person on whose behalf transfer books are maintained.

27 12A:8-202. Issuer's Responsibility and Defenses; Notice of Defect
28 or Defense.

29 a. Even against a purchaser for value and without notice, the terms
30 of a certificated security include terms stated on the certificate and
31 terms made part of the security by reference on the certificate to
32 another instrument, indenture, or document or to a constitution,
33 statute, ordinance, rule, regulation, order, or the like, to the extent the
34 terms referred to do not conflict with terms stated on the certificate.
35 A reference under this subsection does not of itself charge a purchaser
36 for value with notice of a defect going to the validity of the security,
37 even if the certificate expressly states that a person accepting it admits
38 notice. The terms of an uncertificated security include those stated in
39 any instrument, indenture, or document or in a constitution, statute,
40 ordinance, rule, regulation, order, or the like, pursuant to which the
41 security is issued.

42 b. The following rules apply if an issuer asserts that a security is
43 not valid:

44 (1) A security other than one issued by a government or
45 governmental subdivision, agency, or instrumentality, even though
46 issued with a defect going to its validity, is valid in the hands of a

1 purchaser for value and without notice of the particular defect unless
2 the defect involves a violation of a constitutional provision. In that
3 case, the security is valid in the hands of a purchaser for value and
4 without notice of the defect, other than one who takes by original
5 issue.

6 (2) Paragraph (1) of this subsection b. applies to an issuer that is
7 a government or governmental subdivision, agency, or instrumentality
8 only if there has been substantial compliance with the legal
9 requirements governing the issue or the issuer has received a
10 substantial consideration for the issue as a whole or for the particular
11 security and a stated purpose of the issue is one for which the issuer
12 has power to borrow money or issue the security.

13 c. Except as otherwise provided in 12A:8-205, lack of genuineness
14 of a certificated security is a complete defense, even against a
15 purchaser for value and without notice.

16 d. All other defenses of the issuer of a security, including
17 nondelivery and conditional delivery of a certificated security, are
18 ineffective against a purchaser for value who has taken the certificated
19 security without notice of the particular defense.

20 e. This section does not affect the right of a party to cancel a
21 contract for a security "when, as and if issued" or "when distributed"
22 in the event of a material change in the character of the security that
23 is the subject of the contract or in the plan or arrangement pursuant to
24 which the security is to be issued or distributed.

25 f. If a security is held by a securities intermediary against whom an
26 entitlement holder has a security entitlement with respect to the
27 security, the issuer may not assert any defense that the issuer could not
28 assert if the entitlement holder held the security directly.

29 12A:8-203. Staleness as Notice of Defect or Defense.

30 After an act or event, other than a call that has been revoked,
31 creating a right to immediate performance of the principal obligation
32 represented by a certificated security or setting a date on or after
33 which the security is to be presented or surrendered for redemption or
34 exchange, a purchaser is charged with notice of any defect in its issue
35 or defense of the issuer, if the act or event:

36 a. requires the payment of money, the delivery of a certificated
37 security, the registration of transfer of an uncertificated security, or
38 any of them on presentation or surrender of the security certificate, the
39 money or security is available on the date set for payment or exchange,
40 and the purchaser takes the security more than one year after that date;
41 or

42 b. is not covered by subsection a. of this section and the purchaser
43 takes the security more than two years after the date set for surrender
44 or presentation or the date on which performance became due.

45 12A:8-204. Effect of Issuer's Restriction on Transfer.

46 A restriction on transfer of a security imposed by the issuer, even

1 if otherwise lawful, is ineffective against a person without knowledge
2 of the restriction unless:

3 a. the security is certificated and the restriction is noted
4 conspicuously on the security certificate; or

5 b. the security is uncertificated and the registered owner has been
6 notified of the restriction.

7 12A:8-205. Effect of Unauthorized Signature on Security
8 Certificate.

9 An unauthorized signature placed on a security certificate before or
10 in the course of issue is ineffective, but the signature is effective in
11 favor of a purchaser for value of the certificated security if the
12 purchaser is without notice of the lack of authority and the signing has
13 been done by:

14 a. an authenticating trustee, registrar, transfer agent, or other
15 person entrusted by the issuer with the signing of the security
16 certificate or of similar security certificates, or the immediate
17 preparation for signing of any of them; or

18 b. an employee of the issuer, or of any of the persons listed in
19 subsection a. of this section, entrusted with responsible handling of the
20 security certificate.

21 12A:8-206. Completion or Alteration of Security Certificate.

22 a. If a security certificate contains the signatures necessary to its
23 issue or transfer but is incomplete in any other respect:

24 (1) any person may complete it by filling in the blanks as
25 authorized; and

26 (2) even if the blanks are incorrectly filled in, the security
27 certificate as completed is enforceable by a purchaser who took it for
28 value and without notice of the incorrectness.

29 b. A complete security certificate that has been improperly altered,
30 even if fraudulently, remains enforceable, but only according to its
31 original terms.

32 12A:8-207. Rights and Duties of Issuer with Respect to Registered
33 Owners.

34 a. Before due presentment for registration of transfer of a
35 certificated security in registered form or of an instruction requesting
36 registration of transfer of an uncertificated security, the issuer or
37 indenture trustee may treat the registered owner as the person
38 exclusively entitled to vote, receive notifications, and otherwise
39 exercise all the rights and powers of an owner.

40 b. This chapter does not affect the liability of the registered owner
41 of a security for a call, assessment, or the like.

42 12A:8-208. Effect of Signature of Authenticating Trustee,
43 Registrar, or Transfer Agent.

44 a. A person signing a security certificate as authenticating trustee,
45 registrar, transfer agent, or the like, warrants to a purchaser for value
46 of the certificated security, if the purchaser is without notice of a

1 particular defect, that:

2 (1) the certificate is genuine;

3 (2) the person's own participation in the issue of the security is
4 within the person's capacity and within the scope of the authority
5 received by the person from the issuer; and

6 (3) the person has reasonable grounds to believe that the
7 certificated security is in the form and within the amount the issuer is
8 authorized to issue.

9 b. Unless otherwise agreed, a person signing under subsection a.
10 of this section does not assume responsibility for the validity of the
11 security in other respects.

12 12A:8-209. Issuer's Lien.

13 A lien in favor of an issuer upon a certificated security is valid
14 against a purchaser only if the right of the issuer to the lien is noted
15 conspicuously on the security certificate.

16 12A:8-210. Overissue.

17 a. In this section, "overissue" means the issue of securities in
18 excess of the amount the issuer has corporate power to issue, but an
19 overissue does not occur if appropriate action has cured the overissue.

20 b. Except as otherwise provided in subsections c. and d. of this
21 section, the provisions of this chapter which validate a security or
22 compel its issue or reissue do not apply to the extent that validation,
23 issue, or reissue would result in overissue.

24 c. If an identical security not constituting an overissue is
25 reasonably available for purchase, a person entitled to issue or
26 validation may compel the issuer to purchase the security and deliver
27 it if certificated or register its transfer if uncertificated, against
28 surrender of any security certificate the person holds.

29 d. If a security is not reasonably available for purchase, a person
30 entitled to issue or validation may recover from the issuer the price the
31 person or the last purchaser for value paid for it with interest from the
32 date of the person's demand.

33

34

PART 3

35

TRANSFER OF CERTIFICATED AND UNCERTIFICATED SECURITIES

36

37

38 12A:8-301. Delivery.

39 a. Delivery of a certificated security to a purchaser occurs when:

40 (1) the purchaser acquires possession of the security certificate;

41 (2) another person, other than a securities intermediary, either
42 acquires possession of the security certificate on behalf of the
43 purchaser or, having previously acquired possession of the certificate,
44 acknowledges that it holds for the purchaser; or

45 (3) a securities intermediary acting on behalf of the purchaser
46 acquires possession of the security certificate, only if the certificate is

1 in registered form and has been specially indorsed to the purchaser by
2 an effective indorsement.

3 b. Delivery of an uncertificated security to a purchaser occurs
4 when:

5 (1) the issuer registers the purchaser as the registered owner, upon
6 original issue or registration of transfer; or

7 (2) another person, other than a securities intermediary, either
8 becomes the registered owner of the uncertificated security on behalf
9 of the purchaser or, having previously become the registered owner,
10 acknowledges that it holds for the purchaser.

11 12A:8-302. Rights of Purchaser.

12 a. Except as otherwise provided in subsections b. and c. of this
13 section, upon delivery of a certificated or uncertificated security to a
14 purchaser, the purchaser acquires all rights in the security that the
15 transferor had or had power to transfer.

16 b. A purchaser of a limited interest acquires rights only to the
17 extent of the interest purchased.

18 c. A purchaser of a certificated security who as a previous holder
19 had notice of an adverse claim does not improve its position by taking
20 from a protected purchaser.

21 12A:8-303. Protected Purchaser.

22 a. "Protected purchaser" means a purchaser of a certificated or
23 uncertificated security, or of an interest therein, who:

24 (1) gives value;

25 (2) does not have notice of any adverse claim to the security; and

26 (3) obtains control of the certificated or uncertificated security.

27 b. In addition to acquiring the rights of a purchaser, a protected
28 purchaser also acquires its interest in the security free of any adverse
29 claim.

30 12A:8-304. Indorsement.

31 a. An indorsement may be in blank or special. An indorsement in
32 blank includes an indorsement to bearer. A special indorsement
33 specifies to whom a security is to be transferred or who has power to
34 transfer it. A holder may convert a blank indorsement to a special
35 indorsement.

36 b. An indorsement purporting to be only of part of a security
37 certificate representing units intended by the issuer to be separately
38 transferable is effective to the extent of the indorsement.

39 c. An indorsement, whether special or in blank, does not constitute
40 a transfer until delivery of the certificate on which it appears or, if the
41 indorsement is on a separate document, until delivery of both the
42 document and the certificate.

43 d. If a security certificate in registered form has been delivered to
44 a purchaser without a necessary indorsement, the purchaser may
45 become a protected purchaser only when the indorsement is supplied.
46 However, against a transferor, a transfer is complete upon delivery and

1 the purchaser has a specifically enforceable right to have any necessary
2 indorsement supplied.

3 e. An indorsement of a security certificate in bearer form may give
4 notice of an adverse claim to the certificate, but it does not otherwise
5 affect a right to registration that the holder possesses.

6 f. Unless otherwise agreed, a person making an indorsement
7 assumes only the obligations provided in 12A:8-108 and not an
8 obligation that the security will be honored by the issuer.

9 12A:8-305. Instruction.

10 a. If an instruction has been originated by an appropriate person
11 but is incomplete in any other respect, any person may complete it as
12 authorized and the issuer may rely on it as completed, even though it
13 has been completed incorrectly.

14 b. Unless otherwise agreed, a person initiating an instruction
15 assumes only the obligations imposed by 12A:8-108 and not an
16 obligation that the security will be honored by the issuer.

17 12A:8-306. Effect of Guaranteeing Signature, Indorsement, or
18 Instruction.

19 a. A person who guarantees a signature of an indorser of a security
20 certificate warrants that at the time of signing:

21 (1) the signature was genuine;

22 (2) the signer was an appropriate person to indorse, or if the
23 signature is by an agent, the agent had actual authority to act on behalf
24 of the appropriate person; and

25 (3) the signer had legal capacity to sign.

26 b. A person who guarantees a signature of the originator of an
27 instruction warrants that at the time of signing:

28 (1) the signature was genuine;

29 (2) the signer was an appropriate person to originate the
30 instruction, or if the signature is by an agent, the agent had actual
31 authority to act on behalf of the appropriate person, if the person
32 specified in the instruction as the registered owner was, in fact, the
33 registered owner, as to which fact the signature guarantor does not
34 make a warranty; and

35 (3) the signer had legal capacity to sign.

36 c. A person who specially guarantees the signature of an originator
37 of an instruction makes the warranties of a signature guarantor under
38 subsection b. of this section and also warrants that at the time the
39 instruction is presented to the issuer:

40 (1) the person specified in the instruction as the registered owner
41 of the uncertificated security will be the registered owner; and

42 (2) the transfer of the uncertificated security requested in the
43 instruction will be registered by the issuer free from all liens, security
44 interests, restrictions, and claims other than those specified in the
45 instruction.

46 d. A guarantor under subsections a. and b. of this section or a

1 special guarantor under subsection c. of this section does not
2 otherwise warrant the rightfulness of the transfer.

3 e. A person who guarantees an indorsement of a security certificate
4 makes the warranties of a signature guarantor under subsection a. of
5 this section and also warrants the rightfulness of the transfer in all
6 respects.

7 f. A person who guarantees an instruction requesting the transfer
8 of an uncertificated security makes the warranties of a special
9 signature guarantor under subsection c. of this section and also
10 warrants the rightfulness of the transfer in all respects.

11 g. An issuer may not require a special guaranty of signature, a
12 guaranty of indorsement, or a guaranty of instruction as a condition to
13 registration of transfer.

14 h. The warranties under this section are made to a person taking or
15 dealing with the security in reliance on the guaranty, and the
16 guarantor is liable to the person for loss resulting from their breach.
17 An indorser or originator of an instruction whose signature,
18 indorsement, or instruction has been guaranteed is liable to a guarantor
19 for any loss suffered by the guarantor as a result of breach of the
20 warranties of the guarantor.

21 12A:8-307. Purchaser's Right to Requisites for Registration of
22 Transfer.

23 Unless otherwise agreed, the transferor of a security on due demand
24 shall supply the purchaser with proof of authority to transfer or with
25 any other requisite necessary to obtain registration of the transfer of
26 the security, but if the transfer is not for value, a transferor need not
27 comply unless the purchaser pays the necessary expenses. If the
28 transferor fails within a reasonable time to comply with the demand,
29 the purchaser may reject or rescind the transfer.

30

31

PART 4

32

REGISTRATION

33

34 12A:8-401. Duty of Issuer to Register Transfer.

35 a. If a certificated security in registered form is presented to an
36 issuer with a request to register transfer or an instruction is presented
37 to an issuer with a request to register transfer of an uncertificated
38 security, the issuer shall register the transfer as requested if:

39 (1) under the terms of the security the person seeking registration
40 of transfer is eligible to have the security registered in its name;

41 (2) the indorsement or instruction is made by the appropriate
42 person or by an agent who has actual authority to act on behalf of the
43 appropriate person;

44 (3) reasonable assurance is given that the indorsement or instruction
45 is genuine and authorized (12A:8-402);

46 (4) any applicable law relating to the collection of taxes has been

1 complied with;

2 (5) the transfer does not violate any restriction on transfer imposed
3 by the issuer in accordance with 12A:8-204;

4 (6) a demand that the issuer not register transfer has not become
5 effective under 12A:8-403, or the issuer has complied with subsection
6 b. of 12A:8-403 but no legal process or indemnity bond is obtained as
7 provided in subsection d. of 12A:8-403; and

8 (7) the transfer is in fact rightful or is to a protected purchaser.

9 b. If an issuer is under a duty to register a transfer of a security, the
10 issuer is liable to a person presenting a certificated security or an
11 instruction for registration or to the person's principal for loss
12 resulting from unreasonable delay in registration or failure or refusal
13 to register the transfer.

14 12A:8-402. Assurance that Indorsement or Instruction is Effective.

15 a. An issuer may require the following assurance that each
16 necessary indorsement or each instruction is genuine and authorized:

17 (1) in all cases, a guaranty of the signature of the person making an
18 indorsement or originating an instruction including, in the case of an
19 instruction, reasonable assurance of identity;

20 (2) if the indorsement is made or the instruction is originated by an
21 agent, appropriate assurance of actual authority to sign;

22 (3) if the indorsement is made or the instruction is originated by a
23 fiduciary pursuant to paragraph (4) or (5) of subsection a. of
24 12A:8-107, appropriate evidence of appointment or incumbency;

25 (4) if there is more than one fiduciary, reasonable assurance that all
26 who are required to sign have done so; and

27 (5) if the indorsement is made or the instruction is originated by a
28 person not covered by another provision of this subsection, assurance
29 appropriate to the case corresponding as nearly as may be to the
30 provisions of this subsection.

31 b. An issuer may elect to require reasonable assurance beyond that
32 specified in this section.

33 c. In this section:

34 (1) "Guaranty of the signature" means a guaranty signed by or on
35 behalf of a person reasonably believed by the issuer to be responsible.
36 An issuer may adopt standards with respect to responsibility if they are
37 not manifestly unreasonable.

38 (2) "Appropriate evidence of appointment or incumbency" means:

39 (a) in the case of a fiduciary appointed or qualified by a court, a
40 certificate issued by or under the direction or supervision of the court
41 or an officer thereof and dated within 60 days before the date of
42 presentation for transfer; or

43 (b) in any other case, a copy of a document showing the
44 appointment or a certificate issued by or on behalf of a person
45 reasonably believed by an issuer to be responsible or, in the absence of
46 that document or certificate, other evidence the issuer reasonably

1 considers appropriate.

2 12A:8-403. Demand that Issuer not Register Transfer.

3 a. A person who is an appropriate person to make an indorsement
4 or originate an instruction may demand that the issuer not register
5 transfer of a security by communicating to the issuer a notification that
6 identifies the registered owner and the issue of which the security is a
7 part and provides an address for communications directed to the
8 person making the demand. The demand is effective only if it is
9 received by the issuer at a time and in a manner affording the issuer
10 reasonable opportunity to act on it.

11 b. If a certificated security in registered form is presented to an
12 issuer with a request to register transfer or an instruction is presented
13 to an issuer with a request to register transfer of an uncertificated
14 security after a demand that the issuer not register transfer has become
15 effective, the issuer shall promptly communicate to the person who
16 initiated the demand at the address provided in the demand and the
17 person who presented the security for registration of transfer or
18 initiated the instruction requesting registration of transfer a
19 notification stating that:

20 (1) the certificated security has been presented for registration of
21 transfer or the instruction for registration of transfer of the
22 uncertificated security has been received;

23 (2) a demand that the issuer not register transfer had previously
24 been received; and

25 (3) the issuer will withhold registration of transfer for a period of
26 time stated in the notification in order to provide the person who
27 initiated the demand an opportunity to obtain legal process or an
28 indemnity bond.

29 c. The period described in paragraph (3) of subsection b. of this
30 section may not exceed 30 days after the date of communication of the
31 notification. A shorter period may be specified by the issuer if it is not
32 manifestly unreasonable.

33 d. An issuer is not liable to a person who initiated a demand that
34 the issuer not register transfer for any loss the person suffers as a
35 result of registration of a transfer pursuant to an effective indorsement
36 or instruction if the person who initiated the demand does not, within
37 the time stated in the issuer's communication, either:

38 (1) obtain an appropriate restraining order, injunction, or other
39 process from a court of competent jurisdiction enjoining the issuer
40 from registering the transfer; or

41 (2) file with the issuer an indemnity bond, sufficient in the issuer's
42 judgment to protect the issuer and any transfer agent, registrar, or
43 other agent of the issuer involved from any loss it or they may suffer
44 by refusing to register the transfer.

45 e. This section does not relieve an issuer from liability for
46 registering transfer pursuant to an indorsement or instruction that was

1 not effective.

2 12A:8-404. Wrongful Registration.

3 a. Except as otherwise provided in 12A:8-406, an issuer is liable
4 for wrongful registration of transfer if the issuer has registered a
5 transfer of a security to a person not entitled to it, and the transfer was
6 registered:

7 (1) pursuant to an ineffective indorsement or instruction;

8 (2) after a demand that the issuer not register transfer became
9 effective under subsection a. of 12A:8-403 and the issuer did not
10 comply with subsection b. of 12A:8-403;

11 (3) after the issuer had been served with an injunction, restraining
12 order, or other legal process enjoining it from registering the transfer,
13 issued by a court of competent jurisdiction, and the issuer had a
14 reasonable opportunity to act on the injunction, restraining order, or
15 other legal process; or

16 (4) by an issuer acting in collusion with the wrongdoer.

17 b. An issuer that is liable for wrongful registration of transfer under
18 subsection a. of this section on demand shall provide the person
19 entitled to the security with a like certificated or uncertificated
20 security, and any payments or distributions that the person did not
21 receive as a result of the wrongful registration. If an overissue would
22 result, the issuer's liability to provide the person with a like security is
23 governed by 12A:8-210.

24 c. Except as otherwise provided in subsection a. of this section or
25 in a law relating to the collection of taxes, an issuer is not liable to an
26 owner or other person suffering loss as a result of the registration of
27 a transfer of a security if registration was made pursuant to an
28 effective indorsement or instruction.

29 12A:8-405. Replacement of Lost, Destroyed, or Wrongfully Taken
30 Security.

31 a. If an owner of a certificated security, whether in registered or
32 bearer form, claims that the certificate has been lost, destroyed, or
33 wrongfully taken, the issuer shall issue a new certificate if the owner:

34 (1) so requests before the issuer has notice that the certificate has
35 been acquired by a protected purchaser;

36 (2) files with the issuer a sufficient indemnity bond; and

37 (3) satisfies other reasonable requirements imposed by the issuer.

38 b. If, after the issue of a new security certificate, a protected
39 purchaser of the original certificate presents it for registration of
40 transfer, the issuer shall register the transfer unless an overissue would
41 result. In that case, the issuer's liability is governed by 12A:8-210. In
42 addition to any rights on the indemnity bond, an issuer may recover the
43 new certificate from a person to whom it was issued or any person
44 taking under that person, except a protected purchaser.

45 12A:8-406. Obligation to Notify Issuer of Lost, Destroyed, or
46 Wrongfully Taken Security Certificate.

1 If a security certificate has been lost, apparently destroyed, or
2 wrongfully taken, and the owner fails to notify the issuer of that fact
3 within a reasonable time after the owner has notice of it and the issuer
4 registers a transfer of the security before receiving notification, the
5 owner may not assert against the issuer a claim for registering the
6 transfer under 12A:8-404 or a claim to a new security certificate under
7 12A:8-405.

8 12A:8-407. Authenticating Trustee, Transfer Agent, and Registrar.

9 A person acting as authenticating trustee, transfer agent, registrar,
10 or other agent for an issuer in the registration of a transfer of its
11 securities, in the issue of new security certificates or uncertificated
12 securities, or in the cancellation of surrendered security certificates,
13 has the same obligation to the holder or owner of a certificated or
14 uncertificated security with regard to the particular functions
15 performed as the issuer has in regard to those functions.

16
17 PART 5
18 SECURITY ENTITLEMENTS
19

20 12A:8-501. Securities Account; Acquisition of Security
21 Entitlement from Securities Intermediary.

22 a. "Securities account" means an account to which a financial asset
23 is or may be credited in accordance with an agreement under which the
24 person maintaining the account undertakes to treat the person for
25 whom the account is maintained as entitled to exercise the rights that
26 comprise the financial asset.

27 b. Except as otherwise provided in subsections d. and e. of this
28 section, a person acquires a security entitlement if a securities
29 intermediary:

30 (1) indicates by book entry that a financial asset has been credited
31 to the person's securities account;

32 (2) receives a financial asset from the person or acquires a financial
33 asset for the person and, in either case, accepts it for credit to the
34 person's securities account; or

35 (3) becomes obligated under other law, regulation, or rule to credit
36 a financial asset to the person's securities account.

37 c. If a condition of subsection b. of this section has been met, a
38 person has a security entitlement even though the securities
39 intermediary does not itself hold the financial asset.

40 d. If a securities intermediary holds a financial asset for another
41 person, and the financial asset is registered in the name of, payable to
42 the order of, or specially indorsed to the other person, and has not
43 been indorsed to the securities intermediary or in blank, the other
44 person is treated as holding the financial asset directly rather than as
45 having a security entitlement with respect to the financial asset.

46 e. Issuance of a security is not establishment of a security

1 entitlement.

2 12A:8-502. Assertion of Adverse Claim Against Entitlement
3 Holder.

4 An action based on an adverse claim to a financial asset, whether
5 framed in conversion, replevin, constructive trust, equitable lien, or
6 other theory, may not be asserted against a person who acquires a
7 security entitlement under 12A:8-501 for value and without notice of
8 the adverse claim.

9 12A:8-503. Property Interest of Entitlement Holder in Financial
10 Asset held by Securities Intermediary.

11 a. To the extent necessary for a securities intermediary to satisfy
12 all security entitlements with respect to a particular financial asset, all
13 interests in that financial asset held by the securities intermediary are
14 held by the securities intermediary for the entitlement holders, are not
15 property of the securities intermediary, and are not subject to claims
16 of creditors of the securities intermediary, except as otherwise
17 provided in 12A:8-511.

18 b. An entitlement holder's property interest with respect to a
19 particular financial asset under subsection a. of this section is a pro
20 rata property interest in all interests in that financial asset held by the
21 securities intermediary, without regard to the time the entitlement
22 holder acquired the security entitlement or the time the securities
23 intermediary acquired the interest in that financial asset.

24 c. An entitlement holder's property interest with respect to a
25 particular financial asset under subsection a. may be enforced against
26 the securities intermediary only by exercise of the entitlement holder's
27 rights under 12A:8-505 through 12A:8-508.

28 d. An entitlement holder's property interest with respect to a
29 particular financial asset under subsection a. of this section may be
30 enforced against a purchaser of the financial asset or interest therein
31 only if:

32 (1) insolvency proceedings have been initiated by or against the
33 securities intermediary;

34 (2) the securities intermediary does not have sufficient interests in
35 the financial asset to satisfy the security entitlements of all of its
36 entitlement holders to that financial asset;

37 (3) the securities intermediary violated its obligations under
38 12A:8-504 by transferring the financial asset or interest therein to the
39 purchaser; and

40 (4) the purchaser is not protected under subsection e. of this
41 section.

42 The trustee or other liquidator, acting on behalf of all entitlement
43 holders having security entitlements with respect to a particular
44 financial asset, may recover the financial asset, or interest therein,
45 from the purchaser. If the trustee or other liquidator elects not to
46 pursue that right, an entitlement holder whose security entitlement

1 remains unsatisfied has the right to recover its interest in the financial
2 asset from the purchaser.

3 e. An action based on the entitlement holder's property interest
4 with respect to a particular financial asset under subsection a. of this
5 section, whether framed in conversion, replevin, constructive trust,
6 equitable lien, or other theory, may not be asserted against any
7 purchaser of a financial asset or interest therein who gives value,
8 obtains control, and does not act in collusion with the securities
9 intermediary in violating the securities intermediary's obligations under
10 12A:8-504.

11 12A:8-504. Duty of Securities Intermediary to Maintain Financial
12 Asset.

13 a. A securities intermediary shall promptly obtain and thereafter
14 maintain a financial asset in a quantity corresponding to the aggregate
15 of all security entitlements it has established in favor of its entitlement
16 holders with respect to that financial asset. The securities intermediary
17 may maintain those financial assets directly or through one or more
18 other securities intermediaries.

19 b. Except to the extent otherwise agreed by its entitlement holder,
20 a securities intermediary may not grant any security interests in a
21 financial asset it is obligated to maintain pursuant to subsection a. of
22 this section.

23 c. A securities intermediary satisfies the duty in subsection a. of
24 this section if:

25 (1) the securities intermediary acts with respect to the duty as
26 agreed upon by the entitlement holder and the securities intermediary;
27 or

28 (2) in the absence of agreement, the securities intermediary
29 exercises due care in accordance with reasonable commercial
30 standards to obtain and maintain the financial asset.

31 d. This section does not apply to a clearing corporation that is
32 itself the obligor of an option or similar obligation to which its
33 entitlement holders have security entitlements.

34 12A:8-505. Duty of Securities Intermediary with Respect to
35 Payments and Distributions.

36 a. A securities intermediary shall take action to obtain a payment
37 or distribution made by the issuer of a financial asset. A securities
38 intermediary satisfies the duty if:

39 (1) the securities intermediary acts with respect to the duty as
40 agreed upon by the entitlement holder and the securities intermediary;
41 or

42 (2) in the absence of agreement, the securities intermediary
43 exercises due care in accordance with reasonable commercial
44 standards to attempt to obtain the payment or distribution.

45 b. A securities intermediary is obligated to its entitlement holder
46 for a payment or distribution made by the issuer of a financial asset if

1 the payment or distribution is received by the securities intermediary.

2 12A:8-506. Duty of Securities Intermediary to Exercise Rights as
3 Directed by Entitlement Holder.

4 A securities intermediary shall exercise rights with respect to a
5 financial asset if directed to do so by an entitlement holder. A
6 securities intermediary satisfies the duty if:

7 a. the securities intermediary acts with respect to the duty as
8 agreed upon by the entitlement holder and the securities intermediary;
9 or

10 b. in the absence of agreement, the securities intermediary either
11 places the entitlement holder in a position to exercise the rights
12 directly or exercises due care in accordance with reasonable
13 commercial standards to follow the direction of the entitlement holder.

14 12A:8-507. Duty of Securities Intermediary to Comply with
15 Entitlement Order.

16 a. A securities intermediary shall comply with an entitlement order
17 if the entitlement order is originated by the appropriate person, the
18 securities intermediary has had reasonable opportunity to assure itself
19 that the entitlement order is genuine and authorized, and the securities
20 intermediary has had reasonable opportunity to comply with the
21 entitlement order. A securities intermediary satisfies the duty if:

22 (1) the securities intermediary acts with respect to the duty as
23 agreed upon by the entitlement holder and the securities intermediary;
24 or

25 (2) in the absence of agreement, the securities intermediary
26 exercises due care in accordance with reasonable commercial
27 standards to comply with the entitlement order.

28 b. If a securities intermediary transfers a financial asset pursuant to
29 an ineffective entitlement order, the securities intermediary shall
30 reestablish a security entitlement in favor of the person entitled to it,
31 and pay or credit any payments or distributions that the person did not
32 receive as a result of the wrongful transfer. If the securities
33 intermediary does not reestablish a security entitlement, the securities
34 intermediary is liable to the entitlement holder for damages.

35 12A:8-508. Duty of Securities Intermediary to Change Entitlement
36 Holder's Position to Other Form of Security Holding.

37 A securities intermediary shall act at the direction of an entitlement
38 holder to change a security entitlement into another available form of
39 holding for which the entitlement holder is eligible, or to cause the
40 financial asset to be transferred to a securities account of the
41 entitlement holder with another securities intermediary. A securities
42 intermediary satisfies the duty if:

43 a. the securities intermediary acts as agreed upon by the
44 entitlement holder and the securities intermediary; or

45 b. in the absence of agreement, the securities intermediary
46 exercises due care in accordance with reasonable commercial

1 standards to follow the direction of the entitlement holder.

2 12A:8-509. Specification of Duties of Securities Intermediary by
3 Other Statute or Regulation; Manner of Performance of Duties of
4 Securities Intermediary and Exercise of Rights of Entitlement Holder.

5 a. If the substance of a duty imposed upon a securities intermediary
6 by 12A:8-504 through 12A:8-508 is the subject of other statute,
7 regulation, or rule, compliance with that statute, regulation, or rule
8 satisfies the duty.

9 b. To the extent that specific standards for the performance of the
10 duties of a securities intermediary or the exercise of the rights of an
11 entitlement holder are not specified by other statute, regulation, or rule
12 or by agreement between the securities intermediary and entitlement
13 holder, the securities intermediary shall perform its duties and the
14 entitlement holder shall exercise its rights in a commercially reasonable
15 manner.

16 c. The obligation of a securities intermediary to perform the duties
17 imposed by 12A:8-504 through 12A:8-508 is subject to:

18 (1) rights of the securities intermediary arising out of a security
19 interest under a security agreement with the entitlement holder or
20 otherwise; and

21 (2) rights of the securities intermediary under other law, regulation,
22 rule, or agreement to withhold performance of its duties as a result of
23 unfulfilled obligations of the entitlement holder to the securities
24 intermediary.

25 d. The provisions of 12A:8-504 through 12A:8-508 do not require
26 a securities intermediary to take any action that is prohibited by other
27 statute, regulation, or rule.

28 12A:8-510. Rights of Purchaser of Security Entitlement from
29 Entitlement Holder.

30 a. An action based on an adverse claim to a financial asset or
31 security entitlement, whether framed in conversion, replevin,
32 constructive trust, equitable lien, or other theory, may not be asserted
33 against a person who purchases a security entitlement, or an interest
34 therein, from an entitlement holder if the purchaser gives value, does
35 not have notice of the adverse claim, and obtains control.

36 b. If an adverse claim could not have been asserted against an
37 entitlement holder under 12A:8-502, the adverse claim cannot be
38 asserted against a person who purchases a security entitlement, or an
39 interest therein, from the entitlement holder.

40 c. In a case not covered by the priority rules in chapter 9, a
41 purchaser for value of a security entitlement, or an interest therein,
42 who obtains control has priority over a purchaser of a security
43 entitlement, or an interest therein, who does not obtain control.
44 Purchasers who have control rank equally, except that a securities
45 intermediary as purchaser has priority over a conflicting purchaser
46 who has control unless otherwise agreed by the securities

1 intermediary.

2 12A:8-511. Priority among Security Interests and Entitlement
3 Holders.

4 a. Except as otherwise provided in subsections b. and c. of this
5 section, if a securities intermediary does not have sufficient interests
6 in a particular financial asset to satisfy both its obligations to
7 entitlement holders who have security entitlements to that financial
8 asset and its obligation to a creditor of the securities intermediary who
9 has a security interest in that financial asset, the claims of entitlement
10 holders, other than the creditor, have priority over the claim of the
11 creditor.

12 b. A claim of a creditor of a securities intermediary who has a
13 security interest in a financial asset held by a securities intermediary
14 has priority over claims of the securities intermediary's entitlement
15 holders who have security entitlements with respect to that financial
16 asset if the creditor has control over the financial asset.

17 c. If a clearing corporation does not have sufficient financial assets
18 to satisfy both its obligations to entitlement holders who have security
19 entitlements with respect to a financial asset and its obligation to a
20 creditor of the clearing corporation who has a security interest in that
21 financial asset, the claim of the creditor has priority over the claims of
22 entitlement holders.

23

24

PART 6

25

TRANSITION PROVISION

26

27 12A:8-603. Savings Clause.

28 a. This act does not affect an action or proceeding commenced
29 before this act takes effect.

30 b. If a security interest in a security is perfected at the date this act
31 takes effect, and the action by which the security interest was
32 perfected would suffice to perfect a security interest under this act, no
33 further action is required to continue perfection. If a security interest
34 in a security is perfected at the date this act takes effect but the action
35 by which the security interest was perfected would not suffice to
36 perfect a security interest under this act, the security interest remains
37 perfected for a period of four months after the effective date and
38 continues perfected thereafter if appropriate action to perfect under
39 this act is taken within that period. If a security interest is perfected
40 at the date this act takes effect and the security interest can be
41 perfected by filing under this act, a financing statement signed by the
42 secured party instead of the debtor may be filed within that period to
43 continue perfection or thereafter to perfect.

44

45 2. 12A:9-103 is amended to read as follows:

46 12A:9-103. Perfection of Security Interests in Multiple State

1 Transactions.

2 (1) Documents, instruments and ordinary goods.

3 (a) This subsection applies to documents and instruments and to
4 goods other than those covered by a certificate of title described in
5 subsection (2), mobile goods described in subsection (3), and minerals
6 described in subsection (5).

7 (b) Except as otherwise provided in this subsection, perfection and
8 the effect of perfection or nonperfection of a security interest in
9 collateral are governed by the law of the jurisdiction where the
10 collateral is when the last event occurs on which is based the assertion
11 that the security interest is perfected or unperfected.

12 (c) If the parties to a transaction creating a purchase money
13 security interest in goods in one jurisdiction understand at the time
14 that the security interest attaches that the goods will be kept in another
15 jurisdiction, then the law of the other jurisdiction governs the
16 perfection and the effect of perfection or nonperfection of the security
17 interest from the time it attaches until 30 days after the debtor receives
18 possession of the goods and thereafter if the goods are taken to the
19 other jurisdiction before the end of the 30-day period.

20 (d) When collateral is brought into and kept in this State while
21 subject to a security interest perfected under the law of the jurisdiction
22 from which the collateral was removed, the security interest remains
23 perfected, but if action is required by subchapter 3 of this chapter to
24 perfect the security interest,

25 (i) if the action is not taken before the expiration of the period of
26 perfection in the other jurisdiction or the end of four months after the
27 collateral is brought into this State, whichever period first expires, the
28 security interest becomes unperfected at the end of that period and is
29 thereafter deemed to have been unperfected as against a person who
30 became a purchaser after removal;

31 (ii) if the action is taken before the expiration of the period
32 specified in subparagraph (i), the security interest continues perfected
33 thereafter;

34 (iii) for the purpose of priority over a buyer of consumer goods
35 (subsection (2) of 12A:9-307), the period of the effectiveness of a
36 filing in the jurisdiction from which the collateral is removed is
37 governed by the rules with respect to perfection in subparagraphs (i)
38 and (ii).

39 (2) Certificate of title.

40 (a) This subsection applies to goods covered by a certificate of title
41 issued under a statute of this State or of another jurisdiction under the
42 law of which indication of a security interest on the certificate is
43 required as a condition of perfection.

44 (b) Except as otherwise provided in this subsection, perfection and
45 the effect of perfection or nonperfection of the security interest are
46 governed by the law (including the conflict of laws rules) of the

1 jurisdiction issuing the certificate until four months after the goods are
2 removed from that jurisdiction and thereafter until the goods are
3 registered in another jurisdiction, but in any event not beyond
4 surrender of the certificate. After the expiration of that period, the
5 goods are not covered by the certificate of title within the meaning of
6 this section.

7 (c) Except with respect to the rights of a buyer described in the
8 next paragraph, a security interest, perfected in another jurisdiction
9 otherwise than by notation on a certificate of title, in goods brought
10 into this State and thereafter covered by a certificate of title issued by
11 this State is subject to the rules stated in paragraph (d) of subsection
12 (1).

13 (d) If goods are brought into this State while a security interest
14 therein is perfected in any manner under the law of the jurisdiction
15 from which the goods are removed and a certificate of title is issued
16 by this State and the certificate does not show that the goods are
17 subject to the security interest or that they may be subject to security
18 interests not shown on the certificate, the security interest is
19 subordinate to the rights of a buyer of the goods who is not in the
20 business of selling goods of that kind to the extent that he gives value
21 and receives delivery of the goods after issuance of the certificate and
22 without the knowledge of the security interest.

23 (3) Accounts, general intangibles and mobile goods.

24 (a) This subsection applies to accounts (other than an account
25 described in subsection (5) on minerals) and general intangibles (other
26 than uncertificated securities) and to goods which are mobile and
27 which are of a type normally used in more than one jurisdiction, such
28 as motor vehicles, trailers, rolling stock, airplanes, shipping containers,
29 road building and construction machinery and commercial harvesting
30 machinery and the like, if the goods are equipment or are inventory
31 leased or held for lease by the debtor to others, and are not covered by
32 a certificate of title described in subsection (2).

33 (b) The law (including the conflict of laws rules) of the jurisdiction
34 in which the debtor is located governs the perfection and the effect of
35 perfection or nonperfection of the security interest.

36 (c) If, however, the debtor is located in a jurisdiction which is not
37 a part of the United States, and which does not provide for perfection
38 of the security interest by filing or recording in that jurisdiction, the
39 law of the jurisdiction in the United States in which the debtor has its
40 major executive office in the United States governs the perfection and
41 the effect of perfection or nonperfection of the security interest
42 through filing. In the alternative, if the debtor is located in a
43 jurisdiction which is not a part of the United States or Canada and the
44 collateral is accounts or general intangibles for money due or to
45 become due, the security interest may be perfected by notification to
46 the account debtor. As used in this paragraph, "United States" includes

1 its territories and possessions and the Commonwealth of Puerto Rico.

2 (d) A debtor shall be deemed located at his place of business if he
3 has one, at his chief executive office if he has more than one place of
4 business, otherwise at his residence. If, however, the debtor is a
5 foreign air carrier under the Federal Aviation Act of 1958, 49U.S.C.
6 §1301 et seq., as amended, it shall be deemed located at the designated
7 office of the agent upon whom service of process may be made on
8 behalf of the foreign air carrier.

9 (e) A security interest perfected under the law of the jurisdiction
10 of the location of the debtor is perfected until the expiration of four
11 months after a change of the debtor's location to another jurisdiction,
12 or until perfection would have ceased by the law of the first
13 jurisdiction, whichever period first expires. Unless perfected in the
14 new jurisdiction before the end of that period, it becomes unperfected
15 thereafter and is deemed to have been unperfected as against a person
16 who became a purchaser after the change.

17 (4) Chattel paper.

18 The rules stated for goods in subsection (1) apply to a possessory
19 security interest in chattel paper. The rules stated for accounts in
20 subsection (3) apply to a nonpossessory security interest in chattel
21 paper, but the security interest may not be perfected by notification to
22 the account debtor.

23 (5) Minerals.

24 Perfection and the effect of perfection or nonperfection of a
25 security interest which is created by a debtor who has an interest in
26 minerals or the like (including oil and gas) before extraction and which
27 attaches thereto as extracted, or which attaches to an account resulting
28 from the sale thereof at the wellhead or minehead are governed by the
29 law (including the conflict of laws rules) of the jurisdiction wherein the
30 wellhead or minehead is located.

31 (6) **[Uncertificated securities.**

32 The law (including the conflict of laws rules) of the jurisdiction of
33 organization of the issuer governs the perfection and the effect of
34 perfection or non-perfection of a security interest in uncertificated
35 securities.] Investment property.

36 (a) This subsection applies to investment property.

37 (b) Except as otherwise provided in paragraph (f), during the time
38 that a security certificate is located in a jurisdiction, perfection of a
39 security interest, the effect of perfection or non-perfection, and the
40 priority of a security interest in the certificated security represented
41 thereby are governed by the local law of that jurisdiction.

42 (c) Except as otherwise provided in paragraph (f), perfection of a
43 security interest, the effect of perfection or non-perfection, and the
44 priority of a security interest in an uncertificated security are governed
45 by the local law of the issuer's jurisdiction as specified in subsection d.
46 of 12A:8-110.

1 (d) Except as otherwise provided in paragraph (f), perfection of a
2 security interest, the effect of perfection or non-perfection, and the
3 priority of a security interest in a security entitlement or securities
4 account are governed by the local law of the securities intermediary's
5 jurisdiction as specified in subsection e. of 12A:8-110.

6 (e) Except as otherwise provided in paragraph (f), perfection of a
7 security interest, the effect of perfection or non-perfection, and the
8 priority of a security interest in a commodity contract or commodity
9 account are governed by the local law of the commodity intermediary's
10 jurisdiction. The following rules determine a "commodity
11 intermediary's jurisdiction" for purposes of this paragraph:

12 (i) If an agreement between the commodity intermediary and
13 commodity customer specifies that it is governed by the law of a
14 particular jurisdiction, that jurisdiction is the commodity intermediary's
15 jurisdiction.

16 (ii) If an agreement between the commodity intermediary and
17 commodity customer does not specify the governing law as provided
18 in subparagraph (i) of this paragraph, but expressly specifies that the
19 commodity account is maintained at an office in a particular
20 jurisdiction, that jurisdiction is the commodity intermediary's
21 jurisdiction.

22 (iii) If an agreement between the commodity intermediary and
23 commodity customer does not specify a jurisdiction as provided in
24 subparagraphs (i) or (ii) of this paragraph, the commodity
25 intermediary's jurisdiction is the jurisdiction in which is located the
26 office identified in an account statement as the office serving the
27 commodity customer's account.

28 (iv) If an agreement between the commodity intermediary and
29 commodity customer does not specify a jurisdiction as provided in
30 subparagraphs (i) or (ii) of this paragraph and an account statement
31 does not identify an office serving the commodity customer's account
32 as provided in subparagraph (iii) of this paragraph, the commodity
33 intermediary's jurisdiction is the jurisdiction in which is located the
34 chief executive office of the commodity intermediary.

35 (f) Perfection of a security interest by filing, automatic perfection
36 of a security interest in investment property granted by a broker or
37 securities intermediary, and automatic perfection of a security interest
38 in a commodity contract or commodity account granted by a
39 commodity intermediary are governed by the local law of the
40 jurisdiction in which the debtor is located.

41 (cf: P.L.1989, c.348, s.48)

42

43 3. N.J.S.12A:9-105 is amended to read as follows:

44 12A:9-105. Definitions and index of definitions.

45 (1) In this chapter unless the context otherwise requires:

46 (a) "Account debtor" means the person who is obligated on an

1 account, chattel paper or general intangible;

2 (b) "Chattel paper" means a writing or writings which evidence
3 both a monetary obligation and a security interest in or a lease of
4 specific goods, but a charter or other contract involving the use or hire
5 of a vessel is not chattel paper. When a transaction is evidenced both
6 by such a security agreement or a lease and by an instrument or a
7 series of instruments, the group of writings taken together constitutes
8 chattel paper;

9 (c) "Collateral" means the property subject to a security interest,
10 and includes accounts and chattel paper which have been sold;

11 (d) "Debtor" means the person who owes payment or other
12 performance of the obligation secured, whether or not he owns or has
13 rights in the collateral, and includes the seller of accounts or chattel
14 paper. Where the debtor and the owner of the collateral are not the
15 same person, the term "debtor" means the owner of the collateral in
16 any provision of the chapter dealing with the collateral, the obligor in
17 any provision dealing with the obligation, and may include both where
18 the context so requires;

19 (e) "Deposit account" means a demand, time, savings, passbook or
20 like account maintained with a bank, savings and loan association,
21 credit union or like organization, other than an account evidenced by
22 a certificate of deposit;

23 (f) "Document" means document of title as defined in the general
24 definitions of chapter 1 (12A:1-201) , and a receipt of the kind
25 described in subsection (2) of 12A:7-201;

26 (g) "Encumbrance" includes real estate mortgages and other liens
27 on real estate and all other rights in real estate that are not ownership
28 interests;

29 (h) "Goods" includes all things which are movable at the time the
30 security interest attaches or which are fixtures (12A:9-313), but does
31 not include money, documents, instruments, investment property,
32 accounts, chattel paper, general intangibles, or minerals or the like
33 (including oil and gas) before extraction. "Goods" also includes
34 standing timber which is to be cut and removed under a conveyance or
35 contract for sale, the unborn young of animals, and growing crops;

36 (i) "Instrument" means a negotiable instrument (defined in
37 12A:3-104), or [a certificated security (defined in 12A:8-102) or] any
38 other writing which evidences a right to the payment of money and is
39 not itself a security agreement or lease and is of a type which is in
40 ordinary course of business transferred by delivery with any necessary
41 indorsement or assignment. The term does not include investment
42 property;

43 (2) Other definitions applying to this chapter and the sections in
44 which they appear are:

45 "Account." 12A:9-106.

46 "Attach." 12A:9-203.

1	<u>"Commodity contract."</u>	<u>12A:9-115.</u>
2	<u>"Commodity customer."</u>	<u>12A:9-115.</u>
3	<u>"Commodity intermediary."</u>	<u>12A:9-115.</u>
4	"Construction mortgage."	12A:9-313(1).
5	"Consumer goods."	12A:9-109(1).
6	<u>"Control."</u>	<u>12A:9-115.</u>
7	"Equipment."	12A:9-109(2).
8	"Farm products."	12A:9-109(3).
9	"Fixture."	12A:9-313(1).
10	"Fixture filing."	12A:9-313(1).
11	"General intangibles."	12A:9-106.
12	"Inventory."	12A:9-109(4)
13	<u>"Investment property."</u>	<u>12A:9-115.</u>
14	"Lien creditor."	12A:9-301(3).
15	"Proceeds."	12A:9-306(1).
16	"Purchase money security interest."	12A:9-107.
17	"United States."	12A:9-103 (3).
18	(3) The following definitions in other chapters apply to this	
19	chapter:	
20	<u>"Broker."</u>	<u>12A:8-102.</u>
21	<u>"Certificated security."</u>	<u>12A:8-102.</u>
22	"Check."	12A:3-104.
23	<u>"Clearing corporation."</u>	<u>12A:8-102.</u>
24	"Contract for sale."	12A:2-106.
25	<u>"Control."</u>	<u>12A:8-106.</u>
26	<u>"Delivery."</u>	<u>12A:8-301.</u>
27	<u>"Entitlement holder."</u>	<u>12A:8-102.</u>
28	<u>"Financial asset."</u>	<u>12A:8-102.</u>
29	"Holder in due course."	12A:3-302.
30	"Note."	12A:3-104.
31	"Sale."	12A:2-106.
32	<u>"Securities intermediary."</u>	<u>12A:8-102.</u>
33	<u>"Security."</u>	<u>12A:8-102.</u>
34	<u>"Security certificate."</u>	<u>12A:8-102.</u>
35	<u>"Security entitlement."</u>	<u>12A:8-102.</u>
36	<u>"Uncertificated security."</u>	<u>12A:8-102.</u>

37 (4) In addition chapter 1 contains general definitions and principles
38 of construction and interpretation applicable throughout this chapter.
39 (cf: P.L.1989, c.348, s.49)

40

41 4. N.J.S.12A:9-106 is amended to read as follows:

42 12A:9-106. Definitions: "Account"; "General Intangibles."

43 "Account" means any right to payment for goods sold or leased or
44 for services rendered which is not evidenced by an instrument or
45 chattel paper, whether or not it has been earned by performance. All
46 rights to payment earned or unearned under a charter or other contract

1 involving the use or hire of a vessel and all rights incident to the
2 charter or contract are accounts. "General intangibles" means any
3 personal property (including things in action) other than goods,
4 accounts, chattel paper, documents, instruments, investment property
5 and money.

6 (cf: P.L.1981, c.138, s.10)

7

8 5. (New section) N.J.S.12A:9-115. Investment Property.

9 (1) In this chapter 9 of Title 12A of the New Jersey Statutes:

10 (a) "Commodity account" means an account maintained by a
11 commodity intermediary in which a commodity contract is carried for
12 a commodity customer.

13 (b) "Commodity contract" means a commodity futures contract, an
14 option on a commodity futures contract, a commodity option, or other
15 contract that, in each case, is:

16 (i) traded on or subject to the rules of a board of trade that has been
17 designated as a contract market for such a contract pursuant to the
18 federal commodities laws; or

19 (ii) traded on a foreign commodity board of trade, exchange, or
20 market, and is carried on the books of a commodity intermediary for
21 a commodity customer.

22 (c) "Commodity customer" means a person for whom a commodity
23 intermediary carries a commodity contract on its books.

24 (d) "Commodity intermediary" means:

25 (i) a person who is registered as a futures commission merchant
26 under the federal commodities laws; or

27 (ii) a person who in the ordinary course of its business provides
28 clearance or settlement services for a board of trade that has been
29 designated as a contract market pursuant to the federal commodities
30 laws.

31 (e) "Control" with respect to a certificated security, uncertificated
32 security, or security entitlement has the meaning specified in
33 12A:8-106. A secured party has control over a commodity contract
34 if by agreement among the commodity customer, the commodity
35 intermediary, and the secured party, the commodity intermediary has
36 agreed that it will apply any value distributed on account of the
37 commodity contract as directed by the secured party without further
38 consent by the commodity customer. If a commodity customer grants
39 a security interest in a commodity contract to its own commodity
40 intermediary, the commodity intermediary as secured party has
41 control. A secured party has control over a securities account or
42 commodity account if the secured party has control over all security
43 entitlements or commodity contracts carried in the securities account
44 or commodity account.

45 (f) "Investment property" means:

46 (i) a security, whether certificated or uncertificated;

- 1 (ii) a security entitlement;
- 2 (iii) a securities account;
- 3 (iv) a commodity contract; or
- 4 (v) a commodity account.

5 (2) Attachment or perfection of a security interest in a securities
6 account is also attachment or perfection of a security interest in all
7 security entitlements carried in the securities account. Attachment or
8 perfection of a security interest in a commodity account is also
9 attachment or perfection of a security interest in all commodity
10 contracts carried in the commodity account.

11 (3) A description of collateral in a security agreement or financing
12 statement is sufficient to create or perfect a security interest in a
13 certificated security, uncertificated security, security entitlement,
14 securities account, commodity contract, or commodity account
15 whether it describes the collateral by those terms, or as investment
16 property, or by description of the underlying security, financial asset,
17 or commodity contract. A description of investment property
18 collateral in a security agreement or financing statement is sufficient
19 if it identifies the collateral by specific listing, by category, by quantity,
20 by a computational or allocational formula or procedure, or by any
21 other method, if the identity of the collateral is objectively
22 determinable.

23 (4) Perfection of a security interest in investment property is
24 governed by the following rules:

25 (a) A security interest in investment property may be perfected by
26 control.

27 (b) Except as otherwise provided in paragraphs (c) and (d), a
28 security interest in investment property may be perfected by filing.

29 (c) If the debtor is a broker or securities intermediary, a security
30 interest in investment property is perfected when it attaches. The
31 filing of a financing statement with respect to a security interest in
32 investment property granted by a broker or securities intermediary has
33 no effect for purposes of perfection or priority with respect to that
34 security interest.

35 (d) If a debtor is a commodity intermediary, a security interest in a
36 commodity contract or a commodity account is perfected when it
37 attaches. The filing of a financing statement with respect to a security
38 interest in a commodity contract or a commodity account granted by
39 a commodity intermediary has no effect for purposes of perfection or
40 priority with respect to that security interest.

41 (5) Priority between conflicting security interests in the same
42 investment property is governed by the following rules:

43 (a) A security interest of a secured party who has control over
44 investment property has priority over a security interest of a secured
45 party who does not have control over the investment property.

46 (b) Except as otherwise provided in paragraphs (c) and (d) of this

1 subsection, conflicting security interests of secured parties each of
2 whom has control rank equally.

3 (c) Except as otherwise agreed by the securities intermediary, a
4 security interest in a security entitlement or a securities account
5 granted to the debtor's own securities intermediary has priority over
6 any security interest granted by the debtor to another secured party.

7 (d) Except as otherwise agreed by the commodity intermediary, a
8 security interest in a commodity contract or a commodity account
9 granted to the debtor's own commodity intermediary has priority over
10 any security interest granted by the debtor to another secured party.

11 (e) Conflicting security interests granted by a broker, a securities
12 intermediary, or a commodity intermediary which are perfected
13 without control rank equally.

14 (f) In all other cases, priority between conflicting security interests
15 in investment property is governed by subsections (5), (6) and (7) of
16 12A:9-312. The provisions of subsection (4) of 12A:9-312 do not
17 apply to investment property.

18 (6) If a security certificate in registered form is delivered to a
19 secured party pursuant to agreement, a written security agreement is
20 not required for attachment or enforceability of the security interest,
21 delivery suffices for perfection of the security interest, and the security
22 interest has priority over a conflicting security interest perfected by
23 means other than control, even if a necessary indorsement is lacking.

24

25 6. (New section) N.J.S.12A:9-116. Security Interest Arising in
26 Purchase or Delivery of Financial Asset.

27 (1) If a person buys a financial asset through a securities
28 intermediary in a transaction in which the buyer is obligated to pay the
29 purchase price to the securities intermediary at the time of the
30 purchase, and the securities intermediary credits the financial asset to
31 the buyer's securities account before the buyer pays the securities
32 intermediary, the securities intermediary has a security interest in the
33 buyer's security entitlement securing the buyer's obligation to pay. A
34 security agreement is not required for attachment or enforceability of
35 the security interest, and the security interest is automatically
36 perfected.

37 (2) If a certificated security, or other financial asset represented by
38 a writing which in the ordinary course of business is transferred by
39 delivery with any necessary indorsement or assignment, is delivered
40 pursuant to an agreement between persons in the business of dealing
41 with such securities or financial assets and the agreement calls for
42 delivery versus payment, the person delivering the certificate or other
43 financial asset has a security interest in the certificated security or
44 other financial asset securing the seller's right to receive payment. A
45 security agreement is not required for attachment or enforceability of
46 the security interest, and the security interest is automatically

1 perfected.

2

3 7. N.J.S.12A:9-203 is amended to read as follows:

4 12A:9-203. Attachment and Enforceability of Security Interest;
5 Proceeds; Formal Requisites.

6 (1) Subject to the provisions of 12A:4-210 on the security interest
7 of a collecting bank, [12A:8-321 on security interests in securities
8 and] 12A:9-113 on a security interest arising under the chapter on
9 sales and 12A:9-115 and 12A:9-116 on security interests in investment
10 property , a security interest is not enforceable against the debtor or
11 third parties with respect to the collateral and does not attach unless:

12 (a) the collateral is in the possession of the secured party
13 pursuant to agreement, the collateral is investment property and the
14 secured party has control pursuant to agreement, or the debtor has
15 signed a security agreement which contains a description of the
16 collateral and in addition, when the security interest covers crops
17 growing or to be grown or timber to be cut, a description of the land
18 concerned;

19 (b) value has been given; and

20 (c) the debtor has rights in the collateral.

21 (2) A security interest attaches when it becomes enforceable
22 against the debtor with respect to the collateral. Attachment occurs
23 as soon as all of the events specified in subsection (1) have taken place
24 unless explicit agreement postpones the time of attaching.

25 (3) Unless otherwise agreed a security agreement gives the secured
26 party the rights to proceeds provided by 12A:9-306.

27 (4) A transaction, although subject to this chapter, is also subject
28 to the provisions of those statutes set forth as saved from repeal by
29 this subtitle in section 12A:10-104, and in case of conflict between the
30 provisions of this chapter and any such statute so saved from repeal,
31 the provisions of such statute control. Failure to comply with any
32 such applicable statute has only the effect which is specified therein.

33 (5) In case of conflict between this chapter and the provisions of
34 "The Credit Union Act of 1984," P.L.1984, c.171, [ss.] §2 to 46
35 (C.17:13-79 to C.17:13-124), concerning a transaction subject to this
36 chapter and also subject to the provisions of "The Credit Union Act of
37 1984," the provisions of "The Credit Union Act of 1984" shall control.
38 (cf: P.L.1995, c.28, s.7)

39

40 8. N.J.S.12A:9-301 is amended to read as follows:

41 12A:9-301. Persons who take priority over unperfected security
42 interests; right of "lien creditor."

43 (1) Except as otherwise provided in subsection (2), an unperfected
44 security interest is subordinate to the rights of

45 (a) Persons entitled to priority under 12A:9-312;

46 (b) A person who becomes a lien creditor before the security

1 interest is perfected;

2 (c) In the case of goods, instruments, documents, and chattel paper,
3 a person who is not a secured party and who is a transferee in bulk or
4 other buyer not in ordinary course of business, or is a buyer of farm
5 products in ordinary course of business, to the extent that he gives
6 value and receives delivery of the collateral without knowledge of the
7 security interest and before it is perfected;

8 (d) in the case of accounts [and] , general intangibles, and
9 investment property, a person who is not a secured party and who is
10 a transferee to the extent that he gives value without knowledge of the
11 security interest and before it is perfected.

12 (2) If the secured party files with respect to a purchase money
13 security interest before or within 10 days after the debtor receives
14 possession of the collateral, he takes priority over the rights of a
15 transferee in bulk or of a lien creditor which arise between the time the
16 security interest attaches and the time of filing.

17 (3) A "lien creditor" means a creditor who has acquired a lien on
18 the property involved by attachment, levy or the like and includes an
19 assignee for benefit of creditors from the time of assignment, and a
20 trustee in bankruptcy from the date of the filing of the petition or a
21 receiver in equity from the time of appointment.

22 (4) A person who becomes a lien creditor while a security interest
23 is perfected takes subject to the security interest only to the extent that
24 it secures advances made before he becomes a lien creditor or within
25 45 days thereafter or made without knowledge of the lien or pursuant
26 to a commitment entered into without knowledge of the lien.

27 (cf: P.L.1981, c.138, s.15)

28

29 9. N.J.S.12A:9-302 is amended to read as follows:

30 12A:9-302. When Filing Is Required to Perfect Security Interests;
31 Security Interests to Which Filing Provisions of This Chapter Do Not
32 Apply.

33 (1) A financing statement shall be filed to perfect all security
34 interests except the following:

35 (a) A security interest in collateral in possession of the secured
36 party under 12A:9-305;

37 (b) a security interest temporarily perfected in instruments ,
38 certificated securities or documents without delivery under 12A:9-304
39 or in proceeds for a 10 day period under 12A: 9-306;

40 (c) A security interest created by an assignment of a beneficial
41 interest in a trust or a decedent's estate;

42 (d) A purchase money security interest in consumer goods; but
43 filing is required for a motor vehicle required to be registered; and
44 fixture filing is required for priority over conflicting interests in
45 fixtures to the extent provided in 12A:9-313;

46 (e) An assignment of accounts which does not alone or in

1 conjunction with other assignments to the same assignee transfer a
2 significant part of the outstanding accounts of the assignor;

3 (f) a security interest of a collecting bank (12A:4-210) [or in
4 securities (12A: 8-321)] or arising under the chapter on sales (see
5 12A:9-113) or covered in subsection (3) of this section;

6 (g) an assignment for the benefit of all the creditors of the
7 transferor, and subsequent transfers by the assignee thereunder ;

8 (h) a security interest in investment property which is perfected
9 without filing under 12A:9-115 or 12A: 9-116.

10 (2) If a secured party assigns a perfected security interest, no filing
11 under this chapter is required in order to continue the perfected status
12 of the security interest against creditors of and transferees from the
13 original debtor.

14 (3) The filing of a financing statement otherwise required by this
15 chapter is not necessary or effective to perfect a security interest in
16 property subject to:

17 (a) A statute or treaty of the United States which provides for a
18 national or international registration or a national or international
19 certificate of title or which specifies a place of filing different from that
20 specified in this chapter for filing of the security interest; or

21 (b) The following statutes of this State:

22 R.S.39:10-1 to R.S.39:10-9 both inclusive;

23 P.L.1971, c.311 (C.39:10-9.1 and C.39:10-9.2);

24 R.S.39:10-10 to R.S.39:10-16 both inclusive;

25 R.S.39:10-18 to R.S.39:10-25 both inclusive;

26 P.L.1984, c.152 (C.12:7A-1 to C.12:7A-29 both inclusive);

27 but during any period in which collateral is inventory held for sale by
28 a person who is in the business of selling goods of that kind, the filing
29 provisions of this chapter (subchapter 4) apply to a security interest in
30 that collateral created by him as debtor; or

31 (c) A certificate of title statute of another jurisdiction under the
32 law of which indication of a security interest on the certificate is
33 required as a condition of perfection (subsection (2) of 12A:9-103).

34 (4) Compliance with a statute or treaty described in subsection (3)
35 is equivalent to the filing of a financing statement under this chapter,
36 and a security interest in property subject to the statute or treaty can
37 be perfected only by compliance therewith except as provided in
38 12A:9-103 on multiple state transactions. Duration and renewal of
39 perfection of a security interest perfected by compliance with the
40 statute or treaty are governed by the provisions of the statute or
41 treaty; in other respects the security interest is subject to this chapter.
42 (cf: P.L.1995, c.28, s.9)

43

44 10. N.J.S.12A:9-303 is amended to read as follows:

45 12A:9-303. When security interest is perfected; Continuity of
46 perfection.

1 (1) A security interest is perfected when it has attached and when
2 all of the applicable steps required for perfection have been taken.
3 Such steps are specified in 12A:9-115, 12A:9-302, 9-304, 9-305, and
4 9-306. If such steps are taken before the security interest attaches, it
5 is perfected at the time when it attaches.

6 (2) If a security interest is originally perfected in any way permitted
7 under this chapter and is subsequently perfected in some other way
8 under this chapter, without an intermediate period when it was
9 unperfected, the security interest shall be deemed to be perfected
10 continuously for the purposes of this chapter.

11 (cf: N.J.S.12A:9-303)

12

13 11. N.J.S.12A:9-304 is amended to read as follows:

14 12A:9-304. Perfection of Security Interest In Instruments,
15 Documents, and Goods Covered by Documents; Perfection by
16 Permissive Filing; Temporary Perfection Without Filing or Transfer of
17 Possession.

18 (1) A security interest in chattel paper or negotiable documents
19 may be perfected by filing. A security interest in money or instruments
20 (other than [certificated securities or] instruments which constitute
21 part of chattel paper) can be perfected only by the secured party's
22 taking possession, except as provided in subsections (4) and (5) of this
23 section and subsections (2) and (3) of 12A:9-306 on proceeds.

24 (2) During the period that goods are in the possession of the issuer
25 of a negotiable document therefor, a security interest in the goods is
26 perfected by perfecting a security interest in the document, and any
27 security interest in the goods otherwise perfected during such period
28 is subject thereto.

29 (3) A security interest in goods in the possession of a bailee other
30 than one who has issued a negotiable document therefor is perfected
31 by issuance of a document in the name of the secured party or by the
32 bailee's receipt of notification of the secured party's interest or by
33 filing as to the goods.

34 (4) A security interest in instruments [(other than certificated
35 securities)], certificated securities, or negotiable documents is
36 perfected without filing or the taking of possession for a period of 21
37 days from the time it attaches to the extent that it arises for new value
38 given under a written security agreement.

39 (5) A security interest remains perfected for a period of 21 days
40 without filing where a secured party having a perfected security
41 interest in an instrument [(other than a certificated security)], a
42 certificated security, a negotiable document, or goods in possession of
43 a bailee other than one who has issued a negotiable document therefor:

44 (a) Makes available to the debtor the goods or documents
45 representing the goods for the purpose of ultimate sale or exchange or
46 for the purpose of loading, unloading, storing, shipping, transshipping,

1 manufacturing, processing or otherwise dealing with them in a manner
2 preliminary to their sale or exchange, but priority between conflicting
3 security interests in the goods is subject to subsection (3) of
4 12A:9-312; or

5 (b) delivers the instrument or certificated security to the debtor for
6 the purpose of ultimate sale or exchange or of presentation, collection,
7 renewal, or registration of transfer.

8 (6) After the 21-day period in subsections (4) and (5) perfection
9 depends upon compliance with applicable provisions of this chapter.
10 (cf: P.L.1989, c.348, s.52)

11

12 12. N.J.S.12A:9-305 is amended to read as follows:

13 12A:9-305. When Possession by Secured Party Perfects Security
14 Interest Without Filing.

15 A security interest in letters of credit and advices of credit
16 (subsection (2)(a) of 12A: 5-116), goods, instruments [(other than
17 certificated securities)], money, negotiable documents, or chattel
18 paper may be perfected by the secured party's taking possession of the
19 collateral. If such collateral other than goods covered by a negotiable
20 document is held by a bailee, the secured party is deemed to have
21 possession from the time the bailee receives notification of the secured
22 party's interest. A security interest is perfected by possession from the
23 time possession is taken without a relation back and continues only so
24 long as possession is retained, unless otherwise specified in this
25 chapter. The security interest may be otherwise perfected as provided
26 in this chapter before or after the period of possession by the secured
27 party.

28 (cf: P.L.1989, c.348, s.53)

29

30 13. N.J.S.12A:9-306 is amended to read as follows:

31 12A:9-306. "Proceeds"; Secured party's rights on disposition of
32 collateral.

33 (1) "Proceeds" includes whatever is received upon the sale, lease,
34 exchange, collection, or other disposition of collateral or proceeds.
35 Insurance payable by reason of loss or damage to the collateral is
36 proceeds, except to the extent that it is payable to a person other than
37 a party to the security agreement. Any payments or distributions made
38 with respect to investment property collateral are proceeds. Money,
39 checks, deposit accounts, and the like, are "cash proceeds". All other
40 proceeds are "non-cash proceeds".

41 (2) Except where this chapter or the chapter on leases (2A)
42 otherwise provides, a security interest continues in collateral
43 notwithstanding sale, lease, exchange or other disposition thereof
44 unless the disposition was authorized by the secured party in the
45 security agreement or otherwise, and also continues in any identifiable
46 proceeds including collections received by the debtor.

1 (3) The security interest in proceeds is a continuously perfected
2 security interest if the interest in the original collateral was perfected
3 but it ceases to be a perfected security interest and becomes
4 unperfected 10 days after receipt of the proceeds by the debtor unless

5 (a) A filed financing statement covers the original collateral and the
6 proceeds are collateral in which a security interest may be perfected by
7 filing in the office or offices where the financing statement has been
8 filed and, if the proceeds are acquired with cash proceeds, the
9 description of collateral in the financing statement indicates the types
10 of property constituting the proceeds; or

11 (b) A filed financing statement covers the original collateral and the
12 proceeds are identifiable cash proceeds; [or]

13 (c) The original collateral was investment property and the
14 proceeds are identifiable cash proceeds; or

15 (d) The security interest in the proceeds is perfected before the
16 expiration of the 10-day period.

17 Except as provided in this section, a security interest in proceeds
18 can be perfected only by the methods or under the circumstances
19 permitted in this chapter for original collateral of the same type.

20 (4) In the event of insolvency proceedings instituted by or against
21 a debtor, a secured party with a perfected security interest in proceeds
22 has a perfected security interest only in the following proceeds:

23 (a) In identifiable noncash proceeds and in separate deposit
24 accounts containing only proceeds;

25 (b) In identifiable cash proceeds in the form of money which is
26 neither commingled with other money nor deposited in a deposit
27 account prior to the insolvency proceedings;

28 (c) In identifiable cash proceeds in the form of checks and the like
29 which are not deposited in a deposit account prior to the insolvency
30 proceedings; and

31 (d) In all cash and deposit accounts of the debtor in which proceeds
32 have been commingled with other funds, but the perfected security
33 interest under this paragraph (d) is

34 (i) Subject to any right of set-off; and

35 (ii) Limited to an amount not greater than the amount of any cash
36 proceeds received by the debtor within 10 days before the institution
37 of the insolvency proceedings less the sum of (I) the payments to the
38 secured party on account of cash proceeds received by the debtor
39 during that period and (II) the cash proceeds received by the debtor
40 during that period to which the secured party is entitled under
41 paragraphs (a) through (c) of this subsection (4).

42 (5) If a sale or lease of goods results in an account or chattel paper
43 which is transferred by the seller or lessor to a secured party, and if the
44 goods are returned to or are repossessed by the seller or lessor or the
45 secured party, the following rules determine priorities:

46 (a) If the goods were collateral at the time of sale or lease, for an

1 indebtedness of the seller or lessor which is still unpaid, the original
2 security interest attaches again to the goods covered by the sale or
3 lease and continues as a perfected security interest if it was perfected
4 at the time when the goods were sold or leased. If the security interest
5 was originally perfected by a filing which is still effective, nothing
6 further is required to continue the perfected status; in any other case,
7 the secured party shall take possession of the returned or repossessed
8 goods or shall file.

9 (b) An unpaid transferee of the chattel paper has a security interest
10 in the goods against the transferor. This security interest is prior to a
11 security interest asserted under paragraph (a) to the extent that the
12 transferee of the chattel paper was entitled to priority under
13 12A:9-308.

14 (c) An unpaid transferee of the account has a security interest in the
15 goods against the transferor. This security interest is subordinate to
16 a security interest asserted under paragraph (a).

17 (d) A security interest of an unpaid transferee asserted under
18 paragraph (b) or (c) shall be perfected for protection against creditors
19 of the transferor and purchasers of the returned or repossessed goods.
20 (cf: P.L.1994, c.114, s.8)

21

22 14. N.J.S.12A:9-309 is amended to read as follows:

23 12A:9-309. Protection of Purchasers of Instruments, Documents,
24 and Securities.

25 Nothing in this chapter limits the rights of a holder in due course of
26 a negotiable instrument (12A:3-302) or a holder to whom a negotiable
27 document of title has been duly negotiated (12A:7-501) or a [bona
28 fide] protected purchaser of a security (~~[12A:8-302]~~ 12A:8-303) and
29 such holders or purchasers take priority over an earlier security
30 interest even though perfected. Filing under this chapter does not
31 constitute notice of the security interest to such holders or purchasers.
32 (cf: P.L.1989, c.348, s.54)

33

34 15. N.J.S.12A:9-312 is amended to read as follows:

35 12A:9-312. Priorities Among Conflicting Security Interests in the
36 Same Collateral.

37 (1) The rules of priority stated in other sections of this subchapter,
38 and in the following sections shall govern when applicable: 12A:4-210
39 with respect to the security interests of collecting banks in items being
40 collected, accompanying documents and proceeds; 12A:9-103 on
41 security interests related to other jurisdictions; 12A:9-114 on
42 consignments; 12A:9-115 on security interests in investment property.

43 (2) (Deleted by amendment, P.L.1962, c.203, s.4.)

44 (3) A perfected purchase money security interest in inventory has
45 priority over a conflicting security interest in the same inventory and
46 also has priority in identifiable cash proceeds received on or before the

1 delivery of the inventory to a buyer if:

2 (a) The purchase money security interest is perfected at the time
3 the debtor receives possession of the inventory; and

4 (b) The purchase money secured party gives notification in writing
5 to the holder of the conflicting security interest if the holder had filed
6 a financing statement covering the same types of inventory (i) before
7 the date of the filing made by the purchase money secured party, or (ii)
8 before the beginning of the 21-day period where the purchase money
9 security interest is temporarily perfected without filing or possession
10 (subsection (5) of 12A:9-304); and

11 (c) The holder of the conflicting security interest receives the
12 notification within five years before the debtor receives possession of
13 the inventory; and

14 d) The notification states that the person giving the notice has or
15 expects to acquire a purchase money security interest in inventory of
16 the debtor, describing such inventory by item or type.

17 (4) A purchase money security interest in collateral other than
18 inventory has priority over a conflicting security interest in the same
19 collateral or its proceeds if the purchase money security interest is
20 perfected at the time the debtor receives possession of the collateral
21 or within 10 days thereafter.

22 (5) In all cases not governed by other rules stated in this section
23 (including cases of purchase money security interests which do not
24 qualify for the special priorities set forth in subsections (3) and (4) of
25 this section), priority between conflicting security interests in the same
26 collateral shall be determined according to the following rules:

27 (a) Conflicting security interests rank according to priority in time
28 of filing or perfection. Priority dates from the time a filing is first
29 made covering the collateral or the time the security interest is first
30 perfected, whichever is earlier, provided that there is no period
31 thereafter when there is neither filing nor perfection.

32 (b) So long as conflicting security interests are unperfected, the
33 first to attach has priority.

34 (6) For the purposes of subsection (5) a date of filing or perfection
35 as to collateral is also a date of filing or perfection as to proceeds.

36 (7) If future advances are made while a security interest is
37 perfected by filing, the taking of possession, or under [12A:8-321 on
38 securities] 12A:9-115 or 12A: 9-116 on investment property, the
39 security interest has the same priority for the purposes of subsection
40 (5) of this section or subsection (5) of 12A: 9-115 with respect to the
41 future advances as it does with respect to the first advance. If a
42 commitment is made before or while the security interest is so
43 perfected, the security interest has the same priority with respect to
44 advances made pursuant thereto. In other cases a perfected security
45 interest has priority from the date the advance is made.

46 (cf: P.L.1995, c.28, s.10)

1 16. N.J.S.12A:1-105 is amended to read as follows:

2 12A:1-105. Territorial application of the act; Parties' power to
3 choose applicable law.

4 (1) Except as provided hereafter in this section, when a transaction
5 bears a reasonable relation to this State and also to another state or
6 nation the parties may agree that the law either of this State or of such
7 other state or nation shall govern their rights and duties. Failure such
8 agreement this act applies to transactions bearing an appropriate
9 relation to this State.

10 (2) Where one of the following provisions of this act specifies the
11 applicable law, that provision governs and a contrary agreement is
12 effective only to the extent permitted by the law (including the conflict
13 of laws rules) so specified:

14 Rights of creditors against sold goods. 12A:2-402.

15 Applicability of the Chapter on Leases. 12A:2A-105 and 12A:2A-
16 106.

17 Applicability of the Chapter on Bank Deposits and Collections.
18 12A:4-102.

19 Governing law in the Chapter on Funds Transfers. 12A:4A-507.

20 Applicability of the Chapter on Investment Securities. [12A:8-106]
21 12A:8-110.

22 Perfection provisions of the Chapter on Secured Transactions.
23 12A:9-103.

24 (cf: P.L.1994, c.114, s.3)

25

26 17. N.J.S.12A:1-206 is amended to read as follows:

27 12A:1-206. Statute of frauds for kinds of personal property not
28 otherwise covered.

29 (1) Except in the cases described in subsection (2) of this section a
30 contract for the sale of personal property is not enforceable by way of
31 action or defense beyond five thousand dollars in amount or value of
32 remedy unless there is some writing which indicates that a contract for
33 sale has been made between the parties at a defined or stated price,
34 reasonably identifies the subject matter, and is signed by the party
35 against whom enforcement is sought or by his authorized agent.

36 (2) Subsection (1) of this section does not apply to contracts for the
37 sale of goods (12A:2-201) nor of securities ([12A:8-319] 12A:8-113)
38 nor to security agreements (12A:9-203).

39 (cf: P.L.1961, c.120, s.1-206)

40

41 18. N.J.S.12A:4-104 is amended to read as follows:

42 12A:4-104. Definitions and Index of Definitions.

43 a. In this chapter, unless the context otherwise requires:

44 (1) "Account" means any deposit or credit account with a bank,
45 including a demand, time, savings, passbook, share draft, or like
46 account, other than an account evidenced by a certificate of deposit;

1 (2) "Afternoon" means the period of a day between noon and
2 midnight;

3 (3) "Banking day" means the part of a day on which a bank is open
4 to the public for carrying on substantially all of its banking functions;

5 (4) "Clearing house" means an association of banks or other payors
6 regularly clearing items;

7 (5) "Customer" means a person having an account with a bank or
8 for whom a bank has agreed to collect items, including a bank that
9 maintains an account at another bank

10 (6) "Documentary draft" means a draft to be presented for
11 acceptance or payment if specified documents, certificated securities
12 (12A:8-102) or instructions for uncertificated securities (~~12A:8-308~~
13 12A:8-102), or other certificates, statements, or the like are to be
14 received by the drawee or other payor before acceptance or payment
15 of the draft;

16 (7) "Draft" means a draft as defined in 12A:3-104 or an item, other
17 than an instrument, that is an order.

18 (8) "Drawee" means a person ordered in a draft to make payment.

19 (9) "Item" means an instrument or a promise or order to pay
20 money handled by a bank for collection or payment. The term does
21 not include a payment order governed by chapter 4A or a credit or
22 debit card slip;

23 (10) "Midnight deadline" with respect to a bank is midnight on its
24 next banking day following the banking day on which it receives the
25 relevant item or notice or from which the time for taking action
26 commences to run, whichever is later;

27 (11) "Settle" means to pay in cash, by clearing-house settlement,
28 in a charge or credit or by remittance, or otherwise as agreed. A
29 settlement may be either provisional or final;

30 (12) "Suspends payments" with respect to a bank means that it has
31 been closed by order of the supervisory authorities, that a public
32 officer has been appointed to take it over or that it ceases or refuses
33 to make payments in the ordinary course of business.

34 b. Other definitions applying to this chapter and the sections in
35 which they appear are:

36	"Agreement for electronic presentment"	12A:4-110.
37	"Bank"	12A:4-105.
38	"Collecting bank"	12A:4-105.
39	"Depository bank"	12A:4-105.
40	"Intermediary bank"	12A:4-105.
41	"Payor bank"	12A:4-105.
42	"Presenting bank"	12A:4-105.
43	"Presentment notice"	12A:4-110.

44 c. The following definitions in other chapters apply to this chapter:

45	"Acceptance"	12A:3-409.
46	"Alteration"	12A:3-407.

1	"Cashier's check"	12A:3-104.
2	"Certificate of deposit"	12A:3-104.
3	"Certified check"	12A:3-409.
4	"Check"	12A:3-104.
5	"Good faith"	12A:3-103.
6	"Holder in due course"	12A:3-302.
7	"Instrument"	12A:3-104.
8	"Notice of dishonor"	12A:3-503.
9	"Order"	12A:3-103.
10	"Ordinary care"	12A:3-103.
11	"Person entitled to enforce"	12A:3-301.
12	"Presentment"	12A:3-501.
13	"Promise"	12A:3-103.
14	"Prove"	12A:3-103.
15	"Teller's check"	12A:3-104.
16	"Unauthorized signature"	12A:3-403.

17 d. In addition chapter 1 contains general definitions and principles
 18 of construction and interpretation applicable throughout this chapter.
 19 (cf: N.J.S.12:4A-104)

20

21 19. N.J.S.12A:5-114 is amended to read as follows:

22 12A:5-114. Issuer's Duty and Privilege to Honor; Right to
 23 Reimbursement.

24 (1) An issuer shall honor a draft or demand for payment which
 25 complies with the terms of the relevant credit regardless of whether
 26 the goods or documents conform to the underlying contract for sale or
 27 other contract between the customer and the beneficiary. The issuer
 28 is not excused from honor of such a draft or demand by reason of an
 29 additional general term that all documents shall be satisfactory to the
 30 issuer, but an issuer may require that specified documents shall be
 31 satisfactory to it.

32 (2) Unless otherwise agreed when documents appear on their face
 33 to comply with the terms of a credit but a required document does not
 34 in fact conform to the warranties made on negotiation or transfer of a
 35 document of title (12A:7-507) or of a certificated security
 36 (~~12A:8-306~~ 12A:8-108) or is forged or fraudulent or there is fraud
 37 in the transaction:

38 (a) The issuer shall honor the draft on demand for payment if honor
 39 is demanded by a negotiating bank or other holder of the draft or
 40 demand which has taken the draft or demand under the credit and
 41 under circumstances which would make it a holder in due course
 42 (12A:3-302) and in an appropriate case would make it a person to
 43 whom a document of title has been duly negotiated (12A:7-502) or a
 44 ~~bona fide~~ protected purchaser of a certificated security
 45 (~~12A:8-302~~ 12A:8-302); and

46 (b) In all other cases as against its customer, an issuer acting in

1 good faith may honor the draft or demand for payment despite
2 notification from the customer of fraud, forgery or other defect not
3 apparent on the face of the documents but a court of appropriate
4 jurisdiction may enjoin such honor.

5 (3) Unless otherwise agreed an issuer which has duly honored a
6 draft or demand for payment is entitled to immediate reimbursement
7 of any payment made under the credit and to be put in effectively
8 available funds not later than the day before maturity of any
9 acceptance made under the credit.

10 (cf: P.L.1989, c.348, s.2)

11

12 20. N.J.S.14A:7-3 is amended to read as follows:

13 14A:7-3. Subscription for shares.

14 (1) Unless otherwise provided by the subscription agreement or
15 unless all of the subscribers consent to the revocation of such
16 subscription, a subscription for shares of a corporation to be formed
17 shall be irrevocable for a period of six months if no certificate of
18 incorporation shall be filed within such period. If the certificate of
19 incorporation is filed within such period, or if it is filed at any later
20 time before revocation, such subscription shall also be irrevocable until
21 60 days after the filing of the certificate of incorporation.
22 Subscriptions for shares, whether made before or after the
23 organization of a corporation, shall be accepted or rejected by the
24 board, unless the certificate of incorporation or the by-laws require
25 action by the shareholders.

26 (2) [A subscription agreement, whether made before or after the
27 formation of a corporation, shall not be enforceable unless it satisfies
28 the requirements provided in N.J.S. 12A:8-319 with respect to a
29 contract for the sale of securities.] (~~Deleted by amendment, P.L. . . c.~~
30 ~~_____.~~)

31 (3) A subscriber shall not become a holder of any shares for which
32 the full consideration has not been paid. Unless otherwise provided by
33 the subscription agreement

34 (a) Any payment made by the subscriber, in accordance with the
35 subscription agreement or as called for by the board, shall be applied
36 to pay the full consideration for as many whole shares as possible and
37 any remaining balance of such payment shall be applied as part
38 payment of a share;

39 (b) A share certificate shall be registered in the name of the
40 subscriber for the number of shares so paid for in full; and

41 (c) The corporation shall be entitled to retain such share certificate
42 as security for the performance by the subscriber of his obligations
43 under the subscription agreement and subject to the power of sale or
44 rescission upon default provided in paragraphs 14A:7-3(5)(b) and
45 14A:7-3(5)(c).

46 (4) Unless otherwise provided by the subscription agreement

1 (a) Subscriptions for shares, whether made before or after the
2 organization of a corporation, shall be paid in full at such time, or in
3 such installments and at such times, as shall be determined by the
4 board;

5 (b) Any call made by the board for payment on subscriptions shall
6 be uniform as to all shares of the same class or as to all shares of the
7 same series, as the case may be;

8 (c) All such calls for payments on subscriptions shall be upon 30
9 days' notice thereof and of the time and place of payment, which notice
10 shall be given personally or by registered or certified mail.

11 (5) In the event of default in the payment of any installment or call
12 or other amount due under the terms of the subscription agreement,
13 including any amount which may become due as a result of a default
14 in the performance of any provision thereof, the corporation shall have
15 the following rights and duties:

16 (a) It may proceed to collect the amount due in the same manner
17 as any other debt owing to it. At any time before full satisfaction of
18 the claim or any judgment therefor, it may proceed as provided in
19 paragraph 14A:7-3(5)(b).

20 (b) It may sell the shares in any reasonable manner. Notice of the
21 time and place of any public sale or of the time after which any private
22 sale may be had, together with a statement of the amount due upon
23 each share, shall be given in writing to the subscriber personally or by
24 registered or certified mail at least 20 days before any such time stated
25 in the notice. Unless otherwise provided in the subscription
26 agreement, the corporation may not be the purchaser at any sale. Any
27 excess of net proceeds realized over the amount due plus interest shall
28 be paid over to the subscriber. If the sale is made in good faith, in a
29 reasonable manner and upon the notice required by this paragraph, the
30 corporation may recover the difference between the amount due plus
31 interest and the net proceeds of the sale. A good faith purchaser for
32 value shall acquire title to the sold shares free of any rights of the
33 subscriber even though the corporation fails to comply with one or
34 more of the requirements of this subsection.

35 (c) It may rescind the subscription, with the effect provided in
36 subsection 14A:7-3(6), and may recover damages for breach of
37 contract. Unless special circumstances show proximate damages of a
38 different amount, the measure of damages shall be the difference
39 between the market price at the time and place for tender of the shares
40 and the unpaid contract price. Liquidated damages may be provided
41 for in the subscription agreement in an amount which is reasonable
42 under the circumstances, including the difficulties of proof of loss.
43 The subscriber shall be entitled to restitution of any amount by which
44 the sum of his payments exceeds the corporation's damages for breach
45 of contract, whether fixed by agreement or judgment.

46 The rights and duties set forth in subsection 14A:7-3(5) shall be

1 interpreted as cumulative so far as is consistent with the purpose of
2 entitling the corporation to a full and single recovery of the amount
3 due or its damages. The subscription agreement may limit the rights
4 and remedies of the corporation set forth in subsection 14A:7-3(5),
5 and may add to them so far as is consistent with the preceding
6 sentence.

7 (6) The rescission by the corporation of a subscription under which
8 a portion of the shares subscribed for have been issued and in which
9 the corporation retains a security interest, as provided in subsection
10 14A:7-3(3), shall effect the cancellation of such shares.

11 (7) A contract made with a corporation to purchase its shares is a
12 subscription agreement and not an executory contract to purchase
13 shares, unless otherwise provided in the agreement.

14 (cf: P.L.1988, c.94, s.35)

15

16 21. Sections 1 through 12 of P.L.1959, c.200 (C.14:18-1 through
17 14:18-12) are repealed.

18

19 22. This act shall take effect immediately.

20

21

22

STATEMENT

23

24 This bill enacts Uniform Commercial Code Revised Article 8
25 "Investment Securities." The revision was approved by the National
26 Conference of Commissioners on Uniform State Laws (NCCUSL) at
27 its 1994 Annual Meeting. The New Jersey Law Revision Commission
28 has examined Revised Article 8 pursuant to its statutory obligation to
29 consider uniform state laws for adoption in New Jersey. The Law
30 Revision Commission recommends its enactment. Revised Article 8
31 has already been adopted in many states. The Chairman of the Federal
32 Reserve Board and the Chairman of the Securities and Exchange
33 Commission support Revised Article 8 and have urged states to adopt
34 it because the legal uncertainties that arise when existing Article 8 is
35 applied to the indirect holding system prevent banks from making
36 loans to securities firms in times of financial crisis.

37 Revised Article 8 deals with the transfer of investment securities
38 such as stocks and bonds. The revision was necessitated by the
39 development of the indirect holding system for securities. Under this
40 system, securities are mainly held through a chain of securities
41 intermediaries starting with a central depository holding an
42 immobilized certificate representing a large number of shares of the
43 issuer. Existing Article 8 is based on the assumption that securities are
44 held directly from the issuer. Since this assumption is completely at
45 odds with how securities actually are held, existing Article 8 impedes
46 the transfer of securities and affects the ability of securities firms to

1 obtain bank financing.

2 The bill establishes legal rules for the settlement of securities trades.
3 "It sets the ground rules for implementing transfers and resolves
4 disputes that may arise when different people claim conflicting
5 interests." While federal securities law establishes disclosure
6 requirements of financial information for the sale of securities and
7 regulates brokers, dealers and other market place participants, Article
8 8 supplements this scheme of regulation by setting rules about the
9 transfer of securities.

10 The revision was necessitated by major changes in the way
11 securities are held. Article 8 assumes that a person who owns
12 securities has a direct relationship with the company that issued the
13 security. It assumes that if the securities are evidenced by physical
14 certificates, the owner holds them. If the securities are uncertificated,
15 the company transfers ownership on its own books. While both of
16 these situations occur, a third possibility is far more common. Almost
17 all forms of publicly traded securities are issued in certificated form.
18 However, these certificates are held, not by individual investors, but
19 by clearing corporations in what is called an "immobilized" form,
20 designating that the physical document remains in the possession of
21 the clearing corporation and does not change hands to indicate
22 transfers in ownership. This type of securities holding system is called
23 the indirect holding system. "Settlement of securities trading occurs
24 not by delivery of certificates or by registration of transfer on the
25 records of the issuers or their transfer agents, but by computer entries
26 in the records of clearing corporations and securities intermediaries."
27 Current Article 8 does not deal effectively with the indirect holding
28 system.

29 Revised Article 8 accommodates the indirect holding system. It
30 takes a neutral position on the evolution of securities holding
31 practices. The revision assumes that "the path of development will be
32 determined by market and regulatory forces and that the Article 8 rules
33 should not seek to influence the development in any specific
34 direction." As a result, the rules of existing Article 8 have been
35 retained for the direct holding system and a new Part 5 added to set
36 forth the commercial law rules for the indirect holding system. In
37 addition, the rules for obtaining a security interest in securities have
38 been moved to Article 9.

39 Equally important are the rules addressing the question of systemic
40 risk, "that is, the risk that a failure of one securities firm might cause
41 others to fail." If securities transactions are not final, and if a
42 securities firm fails, persons injured by the failure may seek to unwind
43 the transaction and thus threaten the solvency of other firms. Revised
44 Article 8 reduces systemic risk by establishing rules to finalize
45 securities transactions. As a further precaution, Revised Article 8
46 "establishes simple rules on the use of securities as collateral for loans

1 in order to ensure that financial institutions can be assured of their
2 legal rights in providing financing to securities firms that may be
3 necessary to maintain liquidity in times of stress."

4 Sections 1 through 12 of P.L.1959, c.200 (C.14:18-1 through
5 14:18-12), concerning fiduciary security transfers are repealed.

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10 Concerns transfer of investment securities and establishes rules for
11 settlement of securities trades.

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43 issuer. Existing Article 8 is based on the assumption that securities are
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14 certificates, the owner holds them. If the securities are uncertificated,
15 the company transfers ownership on its own books. While both of
16 these situations occur, a third possibility is far more common. Almost
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44 Article 8 reduces systemic risk by establishing rules to finalize
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10 Concerns transfer of investment securities and establishes rules for
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ASSEMBLY FINANCIAL INSTITUTIONS COMMITTEE

STATEMENT TO

ASSEMBLY, No. 2019

STATE OF NEW JERSEY

DATED: OCTOBER 7, 1996

The Assembly Financial Institutions Committee reports favorably Assembly Bill No. 2019.

This bill enacts Uniform Commercial Code Revised Article 8 "Investment Securities." The revision was approved by the National Conference of Commissioners on Uniform State Laws (NCCUSL) at its 1994 Annual Meeting. The New Jersey Law Revision Commission has examined Revised Article 8 pursuant to its statutory obligation to consider uniform state laws for adoption in New Jersey. The Law Revision Commission recommends its enactment. Revised Article 8 has already been adopted in many states. The Chairman of the Federal Reserve Board and the Chairman of the Securities and Exchange Commission support Revised Article 8 and have urged states to adopt it because the legal uncertainties that arise when existing Article 8 is applied to the indirect holding system prevent banks from making loans to securities firms in times of financial crisis.

Revised Article 8 deals with the transfer of investment securities such as stocks and bonds. The revision was necessitated by the development of the indirect holding system for securities. Under this system, securities are mainly held through a chain of securities intermediaries starting with a central depository holding an immobilized certificate representing a large number of shares of the issuer. Existing Article 8 is based on the assumption that securities are held directly from the issuer. Since this assumption is completely at odds with how securities actually are held, existing Article 8 impedes the transfer of securities and affects the ability of securities firms to obtain bank financing.

The bill establishes legal rules for the settlement of securities trades. "It sets the ground rules for implementing transfers and resolves disputes that may arise when different people claim conflicting interests." While federal securities law establishes disclosure requirements of financial information for the sale of securities and regulates brokers, dealers and other market place participants, Article 8 supplements this scheme of regulation by setting rules about the transfer of securities.

The revision was necessitated by major changes in the way securities are held. Article 8 assumes that a person who owns securities has a direct relationship with the company that issued the

security. It assumes that if the securities are evidenced by physical certificates, the owner holds them. If the securities are uncertificated, the company transfers ownership on its own books. While both of these situations occur, a third possibility is far more common. Almost all forms of publicly traded securities are issued in certificated form. However, these certificates are held, not by individual investors, but by clearing corporations in what is called an "immobilized" form, designating that the physical document remains in the possession of the clearing corporation and does not change hands to indicate transfers in ownership. This type of securities holding system is called the indirect holding system. "Settlement of securities trading occurs not by delivery of certificates or by registration of transfer on the records of the issuers or their transfer agents, but by computer entries in the records of clearing corporations and securities intermediaries." Current Article 8 does not deal effectively with the indirect holding system.

Revised Article 8 accommodates the indirect holding system. It takes a neutral position on the evolution of securities holding practices. The revision assumes that "the path of development will be determined by market and regulatory forces and that the Article 8 rules should not seek to influence the development in any specific direction." As a result, the rules of existing Article 8 have been retained for the direct holding system and a new Part 5 added to set forth the commercial law rules for the indirect holding system. In addition, the rules for obtaining a security interest in securities have been moved to Article 9.

Equally important are the rules addressing the question of systemic risk, "that is, the risk that a failure of one securities firm might cause others to fail." If securities transactions are not final, and if a securities firm fails, persons injured by the failure may seek to unwind the transaction and thus threaten the solvency of other firms. Revised Article 8 reduces systemic risk by establishing rules to finalize securities transactions. As a further precaution, Revised Article 8 "establishes simple rules on the use of securities as collateral for loans in order to ensure that financial institutions can be assured of their legal rights in providing financing to securities firms that may be necessary to maintain liquidity in times of stress."

Sections 1 through 12 of P.L.1959, c.200 (C.14:18-1 through 14:18-12), concerning fiduciary security transfers are repealed.

Legislature incorporate into the Criminal Code those Title 2A and Title 24 provisions with continuing validity. Provisions that are obsolete or superseded by other law are recommended for repeal. Provisions that are regulatory in nature are recommended for compilation in other titles of the statutes. The Commission revised the language for some provisions but mainly followed the substantive meaning of the existing statutes. The recommendations contained in this report, if adopted, would help to complete the codification of New Jersey criminal law.

D. Uniform Commercial Code Revised Article 8 – Investment Securities

In 1994, the National Conference of Commissioners on Uniform State Laws and the American Law Institute –the sponsors of the Uniform Commercial Code – approved a revision of Article 8 – Investment Securities, along with related amendments to Article 9 and conforming amendments to other articles. Revised Article 8 has been enacted in 13 states.⁴ In 1995, the Commission filed a Report and Recommendations on Article 8 - Investment Securities (see Appendix C).

Revised Article 8 deals with arcane subjects related to the securities holding and transfer system. Existing Article 8, adopted in New Jersey in 1961, is based on a holding and transfer system which assumes that securities are transferred by the physical delivery of certificates. The set of rules contained in existing Article 8 are premised on this practice. Because the majority of securities owners no longer hold physical certificates, existing law does not address the legal consequences of the acquisition, transfer and settlement of securities. In most cases, securities are held and transferred through an "indirect holding" system, that is, the ownership of securities is represented by a book-entry in the records of a depository, clearing house or brokerage firm.⁵

Revised Article 8 delineates the ownership right a person acquires in a financial asset held in the indirect holding system. This ownership right, called a "security entitlement," consists of a package of rights representing a pro-rata share in securities held by a financial institution for beneficial owners. Revised Article 8 provides legal rules for the acquisition and transfer of these investment securities. Therefore, the revision reflects the commercial practices of the marketplace.

⁴ The 13 states are: Arizona, Arkansas, Idaho, Illinois, Indiana, Louisiana, Minnesota, Nebraska, Oklahoma, Oregon, Texas, Washington, and West Virginia.

⁵ For example, a large proportion of publicly traded securities are held in the name of the Depository Trust Corporation (DTC). The clearing and settlement of trades with these securities is made through the National Securities Clearing Corporation. The DTC is the first tier shareholder of record for most IBM shares traded on the New York Stock Exchange. The members of the DTC are the second tier owners. These large banks and brokerage firms hold respective positions in IBM shares by notations on their DTC account records. Similarly, banks and brokerage firms that have accounts with DTC members comprise the third tier of this ownership system. The chain of ownership flows downward to the ultimate owner, for example, a consumer holding through a small brokerage firm.

Revised Article 8 significantly clarifies the rights of third party creditors. Since Article 8 sets the legal foundation for clearance and settlement of trades on a book-entry system, it reduces the systemic risk posed by the insolvency of a financial institution in the indirect holding system. Banks, knowing their secured claims are protected, have incentives to make capital available to financial institutions in times of crisis. Federal Reserve Board Chairman Alan Greenspan has supported the revision..

The Commission's Report recommends that the Legislature enact Revised Article 8.

V. TENTATIVE REPORTS

In 1995, the Commission published two Tentative Reports. A tentative report represents the first settled attempt of the Commission to revise an area of law. It is the product of lengthy deliberations, but it is not final. A tentative report is distributed to the general public for comment. The Commission considers these comments and amends its report.

A. Evidence

In 1995, the Commission released its Tentative Report Relating to Evidence (see Appendix D). That report follows the 1993 enactment of the New Jersey Rules of Evidence. The procedure used for adopting the rules was the one established by the Evidence Act, 2A:84A-33 through 39. That procedure represents a compromise settlement of the difficult issue of whether the Supreme Court or the Legislature has the power to enact valid rules of evidence. See Busik v. Levine 63 N.J. 351, 367-368 (1973). The procedure involves acquiescence by both the Legislature and the Court; by using this procedure any question of which branch has the power to make rules becomes moot. As a result, it is desirable that the New Jersey Rules of Evidence be what was intended, a comprehensive statement of the law of evidence.

However, a number of statutory sections that deal with the admissibility of evidence overlap with or duplicate the rules. In some instances, differences in terminology create the potential for confusion. In all cases, the overlap obscures the statutory intention of stating evidence rules comprehensively in one place. Some of these sections were identified as superseded both in the current Rules of Evidence and in its predecessor. These sections serve no purpose but to confuse.

STATE OF NEW JERSEY
NEW JERSEY LAW REVISION COMMISSION

FINAL REPORT

REVISED UNIFORM COMMERCIAL CODE
ARTICLE 8 - INVESTMENT SECURITIES

NEW JERSEY LAW REVISION COMMISSION
15 Washington Street, Room 1302
Newark, New Jersey 07102
201-648-4575
(Fax) 648-3123

May 1995

Final Recommendation

The Law Revision Commission recommends that the Legislature adopt Uniform Commercial Code Revised Article 8 with conforming and miscellaneous amendments to Articles 1, 4, 5, 9 and 10. Revised Article 8 improves existing law by reflecting contemporary practices of the securities industry and provides useful rules for the resolution of commercial disputes. Since securities transactions have national implications there is no justification for difference in local law.

Short Statement

The National Conference of Commissioners on Uniform State Laws (NCCUSL) approved Uniform Commercial Code Revised Article 8 "Investment Securities" at its 1994 Annual Meeting.¹ Revised Article 8 deals with the transfer of investment securities such as stocks and bonds. The revision was necessitated by the development of the indirect holding system for securities. Under this system, securities are mainly held through a chain of securities intermediaries starting with a central depository holding an immobilized certificate representing a large number of shares of the issuer. Existing Article 8 is based on the assumption that securities are held directly from the issuer. Since this assumption is completely at odds with how securities actually are held, existing Article 8 impedes the transfer of securities and affects the ability of securities firms to obtain bank financing.

The New Jersey Law Revision Commission has examined Revised Article 8 pursuant to its statutory obligation to consider uniform state laws for adoption in New Jersey. Five states: Arkansas, Idaho, Indiana, Nebraska and West Virginia, have already enacted the revision.² Seventeen other states are considering its adoption.³ The Chairman of the Federal Reserve Board and the Chairman of the Securities

¹ Cited as RUCC; for an overview see Mooney, Rocks and Schwartz, An Introduction to the Revised U.C.C. Article 8 and Review of Other Recent Developments with Investment Securities, 49 Bus. Law. 1891 (1994).

² NCCUSL, A Few Facts About Revised UCC Article 8 (1994). This fact sheet is available from the Chicago headquarters of the National Conference of Commissioners on Uniform State Laws, 676 north St. Clair Street, Suite 1700, Chicago, Illinois 60611. The fact sheet cited here is current to 10 May 1995.

³ Id.

Exchange Commission support Revised Article 8 and have urged states to adopt it because the legal uncertainties that arise when existing Article 8 is applied to the indirect holding system prevent banks from making loans to securities firms in times of financial crisis.⁴ This reluctance to finance securities transactions can lead to systemic risk, that is the failure of one financial institution may cause other institutions to fail. "Studies of the October 1987 stock market break indicated that uncertainty concerning the application of the old Article 8 rules to modern securities transactions adversely affected liquidity and placed significant stress on the securities clearance and settlement system."⁵

Discussion

Existing Article 8 entitled "Investment Securities," enacted in New Jersey in 1961, covers the settlement of securities trades. "It sets the ground rules for implementing transfers and resolves disputes that may arise when different people claim conflicting interests."⁶ Article 8 is "one part of the mosaic of laws under which securities are bought, sold and pledged."⁷ Federal securities law establishes disclosure requirements of financial information for the sale of securities and regulates brokers, dealers and other market place participants. "State corporate and contract law establish the rights that owners of equity and debt securities have against issuers."⁸ Article 8 supplements this scheme of regulation by setting rules about the transfer of securities.

When Article 8 was drafted in the 1940's and 1950's, the securities industry used a "direct holding system" to define the relationship between the issuer of the security and its owner. In the direct holding system, the issuer records the name of the owner on its books, thus giving rise to the "direct relation" between issuer and owner, and issues a certificate representing ownership or a debt relation. The rules of Article 8 covering delivery of securities and the rights and obligations of parties to

⁴ UCC 8 and Financial Markets 5 Spring 1995 containing remarks of Alan Greenspan about Article 8 revisions.

⁵ Rogers, Revised UCC Article 8 Why It's Needed What It Does 1 (1994).

⁶ Id.

⁷ Id.

⁸ Id.

securities transactions were predicated on the assumption that possession and delivery of physical certificates were the key elements of transfer of ownership in the securities holding system.

In the 1960's, the business practices of the securities industry changed. In response to increased trading volume, the securities industry adopted the practice of issuing non-paper securities called in the terminology of Article 8 "uncertificated securities." This is because the "mechanical problems of processing the paperwork for securities transfers reached crisis proportions in the late 1960's, leading to calls for the elimination of the physical certificates and development of modern electronic systems for recording ownership of securities and transfers of ownership."⁹ As a result, NCCUSL promulgated the 1978 amendments to Article 8 which added parallel provisions dealing with uncertificated securities to the existing rules of Article 8 on certificated securities. The system of securities holding contemplated by the 1978 amendments differed from the traditional system only in that ownership of securities would not be evidenced by physical certificates. Instead of surrendering an indorsed certificate for registration of transfer, an instruction would be sent to the issuer directing it to register the transfer on its books. The State of New Jersey enacted the 1978 amendments to Article 8 in 1990.

However, contrary to the assumption of the 1978 amendments that uncertificated securities would replace paper certificates, securities continued to be issued in certificated form. Virtually all forms of publicly traded securities are still issued in certificated form. However, these certificates are held, not by individual investors, but by clearing corporations in what is called an "immobilized" form, designating that the physical document remains in the possession of the clearing corporation and does not change hands to indicate transfers in ownership. This type of securities holding system is called the indirect holding system. "Settlement of securities trading occurs not by delivery of certificates or by registration of transfer on the records of the issuers or their transfer agents, but by computer entries in the

⁹ Prefatory Note, Revised UCC 8, 1 (1994).

records of clearing corporations and securities intermediaries."¹⁰ Thus, even after the 1978 amendments, the rules of Article 8 did not deal effectively with the indirect holding system.¹¹

A large proportion of publicly traded securities are held in the name of the Depository Trust Company (DTC), and the clearing and settling of trades made with these securities is carried out by the National Securities Clearing Corporation.¹² For example, the shareholder of record for most shares of IBM traded on the New York Stock Exchange is the DTC. The members of the DTC -- about 600 banks and brokers -- have accounts at the DTC that show their respective positions in IBM stock. In turn, the members of DTC hold these IBM shares on behalf of their customers, say smaller securities firms. These securities firms then hold IBM shares on behalf of their retail customers -- individual investors. No person in the chain delivers physical stock certificates of IBM to execute a trade. Rather, DTC holds an IBM "jumbo certificate" and transfers of the ownership of IBM shares are recorded by adjustments to the participants' DTC accounts. The DTC members provide analogous clearance and settlement functions to their own customers thereby completing transfers in ownership at each level of the indirect holding system.

As is the case with DTC, most securities are represented by immobilized certificates. Just as nothing happens to these certificates as a result of daily trading, nothing happens to the official registry of stockholders maintained by the issuers or

¹⁰ *Id.* at 2.

¹¹ *Id.*

¹² The 1994 Annual Report of DTC states that it has in custody approximately 78% of shares of companies represented in the Dow Jones Industrial Average, 70% of all NYSE listed U.S. companies, 57% of shares included in the NASDAQ and 50% of American Stock Exchange-listed companies, 85% of the principal amount of outstanding corporate debt listed on the NYSE, and 95% of the principal amount of outstanding municipal bonds. See DTC AR 5 (1993). While the DTC is a major securities depository it is not the only depository in the US. Other depositories, such as those in Philadelphia and Chicago, exist and the Federal Reserve Banks maintain an indirect holding system for the great bulk of Treasury securities.

In a conversation with Carl H. Urist, Deputy General Counsel and vice president of DTC, Mr. Urist stated that the split between DTC and NSCC is of historical origin since banks did not want to become members of NSCC because of NSCC's policy of guaranteeing all trades. The banks did not want to accept the risk of failing brokerage firms. There is no reason why one institution cannot perform both the depository and clearance and settlement tasks. Mr Urist believes that NSCC now has banks as members.

their transfer agents. "The principal mechanism through which securities trades are settled today is not delivery of certificates or registration of transfers on the issuer's books, but netted settlement arrangements and accounting entries on the books of a multi-tiered pyramid of securities intermediaries."¹³ Since the 1978 amendment of Article 8 is geared to concepts of transfer of physical certificates and registration of transfers on issuer's books, the existing Article 8 rules are out of touch with the reality of the securities market.

To accommodate the indirect holding system, NCCUSL decided to revise Article 8 and appointed Professor James Rogers of Boston College Law School as the Reporter. The drafting approach remained neutral as to the future development of the securities industry. "Revised Article 8 takes a neutral position on the evolution of securities holding practices."¹⁴ The revision assumes that "the path of development will be determined by market and regulatory forces and that the Article 8 rules should not seek to influence the development in any specific direction."¹⁵ As a result, the rules of existing Article 8 have been retained for the direct holding system and a new Part 5 added to set forth the commercial law rules for the indirect holding system. In addition, the rules for obtaining a security interest in securities have been moved to Article 9.

Equally important are the rules addressing the question of systemic risk, "that is, the risk that a failure of one securities firm might cause others to fail."¹⁶ If securities transactions are not final, and if a securities firm fails, persons injured by the failure may seek to unwind the transaction and thus threaten the solvency of other firms. Revised Article 8 reduces systemic risk by establishing rules to finalize securities transactions. As a further precaution, Revised Article 8 "establishes simple rules on the use of securities as collateral for loans in order to ensure that financial

¹³ Prefatory Note supra note 9 at 5.

¹⁴ Id. at 6.

¹⁵ Id.

¹⁶ Rogers supra note 5 at 1.

institutions can be assured of their legal rights in providing financing to securities firms that may be necessary to maintain liquidity in times of stress."¹⁷

Differences from Current Law

a. Indirect Holding System Rules

An "entitlement holder" is a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary."¹⁸ The term "security entitlement", defined in Section 8-102(a)(17), describes the bundle of rights a person acquires when that person owns a financial asset within an indirect securities holding system.¹⁹ It is the set of rights by the holder against the securities intermediary that holds the security on behalf of the holder. The rules that govern a security entitlement are set forth in Part 5 entitled "Security Entitlements" consisting of eleven sections. Revised Article 8 organizes the concept of security entitlement around three basic definitions: (1) "securities account," (2) "security entitlement" and (3) "security holder."

Securities entitlements are claims to securities accounts, somewhat analogous to claims depositors have on bank accounts, though the analogy is imperfect. A "securities account" is "an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset."²⁰ A "security entitlement" "means the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5."²¹ A person acquires a security entitlement when a securities intermediary credits a financial asset, or accepts the financial asset for

¹⁷ Id.

¹⁸ RUCC 8-102(a)(7).

¹⁹ The Part 5 rules apply not only to securities, RUCC 8-102(17), but to financial assets RUCC 8-102(9). The term financial asset includes other interests, obligations or property that is held through securities accounts, such as money market instruments. While the latter are not Article 8 securities, since they are governed by Article 3, they are financial assets for purposes of the Part 5 rules of Revised Article 8.

²⁰ RUCC 8-501(a).

²¹ RUCC 8-102(17).

credit, to the person's securities account.²² The securities intermediary need not hold the asset itself, since the securities intermediary may hold the asset through another securities intermediary. The security entitlement right in a financial asset is a property right of the security entitlement holder. It does not belong to the securities intermediary and is not subject to the claims of creditors of the securities intermediary. An entitlement holder's property interest with respect to a particular financial asset is a pro rata property interest in all interests in that financial asset held by the securities intermediary. The rights of entitlement holders are not determined by the time of acquisition. The right is not to a specific physical object, but a claim to property held by the securities intermediary.²³

While a security entitlement holder does not have a right to specific financial assets, the securities intermediary has a duty to provide the entitlement holder with all corporate and economic rights of security ownership. Thus, the securities intermediary must "maintain a quantity of financial assets corresponding to the aggregate of all security entitlements it has established."²⁴ A securities intermediary also has an obligation to pass the payment of dividends and other distributions to the entitlement holder.²⁵ In addition, the securities intermediary has an obligation to obey the instructions of the entitlement holder with respect to the financial asset including an order to sell or transfer the asset.²⁶ However, this duty does not preclude the owner of the security entitlement from conferring discretionary authority on the securities intermediary to manage the financial asset.

Since a security entitlement is a claim against a securities intermediary and not a claim to a specific physical object, an entitlement holder generally cannot assert claims against third parties even when the securities intermediary wrongfully has transferred the interest of the entitlement holder to the third party. A transferee who

²² RUCC 8-501(b).

²³ Revised Article 8 does not determine how property is to be distributed on failure of the securities intermediary. "The Bankruptcy Code and Securities Investor Protection Act ("SIPA") provides that all customer property is distributed pro rata among all customers in proportion to the dollar value of their total positions." RUCC Official Comment 1 to RUCC 8-503.

²⁴ Official Comment 1 to RUCC 8-504; RUCC 8-504(a).

²⁵ RUCC 8-505(a).

²⁶ RUCC 8-506 and 507.

gave value and obtained control of the financial asset is protected against the claims of the broker's customers unless the transferee acted in collusion with the broker. This rule is justified on grounds of "the fundamental policies of investor protection that underlie [Article 8] and other bodies of law governing the securities business."²⁷

The Official Comment states:

"The commercial law rules for the securities holding and transfer system must be assessed from the forward-looking perspective of their impact on the vast number of transactions in which no wrongful conduct occurred or will occur, rather than from the post hoc perspective of what rule might be most advantageous to a particular class of persons in litigation that might arise out of the occasional case in which someone has acted wrongfully. ... There is no reason to think that rules permitting customers of an intermediary to trace and recover securities that their intermediary wrongfully transferred work to the advantage of investors in general. To the contrary, application of such rules would often merely shift losses from one set of investors to another. The uncertainties that would result from rules permitting such recoveries would work to the disadvantage of all participants in the securities markets."²⁸

As a general rule, if a securities firm fails and there is not enough securities to satisfy the claims of its creditors and customers, the claims of the customers prevail. However, if the creditors have taken "control" of the investment property, the claims of the secured creditors prime those of the customers. As a practical matter, a secured lender, such as a bank, takes control of securities within an indirect holding system when the secured lender requires the securities intermediary to transfer its holdings at the clearing company to the secured lender. In that case, the secured lender wins in a priority contest with the broker's customers, even though both the customer and the bank have control over the asset. The rationale for this rule is that it is needed to protect bank financing of securities firms and thus give securities firms access to capital in times of financial stress.

However, the rule should not lead to customer losses. First, a securities intermediary is forbidden from granting security interests in its customers' property. Second, Revised Article 8 and SEC regulations require brokers to maintain adequate

²⁷ Official Comment 3 to RUCC 8-503.

²⁸ Id.

quantities of financial assets to satisfy customers' claims. Third, SEC and self-regulatory organization inspections enforce these requirements. Even if a customer does sustain a loss due to the failure of his securities firm, the customer is protected against loss from a shortfall by the Securities Investor Protection Act (SIPA). Customers are insured under SIPA up to \$500,000 in shortfalls after distribution of the property of the insolvent securities intermediary. "This means that a customer with a claim for \$5 million of stock who received \$4.5 million from the pro rata distribution would then receive an additional \$500,000 worth of securities from SIPA."²⁹

b. Creation and Perfection of Security Interests

The creation and perfection of security interests in investment property "have been taken out of Article 8 and placed in Article 9, thus returning to the structure used prior to the 1978 amendments."³⁰ A security interest in investment property may be perfected by taking control of investment property or by filing a financing statement. The term "control" means roughly "that the secured party has taken whatever steps are necessary, given the way the investment property is held to ensure that the collateral can be liquidated without further action by the debtor."³¹ A secured party who has control of investment property has priority over a secured party who has filed but does not have control.

With regard to a security entitlement, the term "control," defined in Section 8-106, means (1) a purchaser has become the entitlement holder, or (2) the securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder.³² Assume a customer (A) borrows money from his bank (B) using his investment property held by his securities intermediary (SI). A instructs SI to transfer the shares from his account to B's account at SI. The bank has control because it is an entitlement holder of the

²⁹ Rogers, supra note 5 at 3.

³⁰ Rogers supra note 5 at 4; see Mooney, Rocks and Schwartz supra note 1 at 1896-1902.

³¹ Rogers, supra note 5 at 4.

³² UCC 1-201(33) defines "purchaser" as "a person who takes by purchase. The term "purchase" means a "taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property." UCC 1-201(32).

investment property. Now assume A, B and SI enter into an agreement by which SI will act on instructions from B about the stock but that A will continue to receive dividends and other payments. The bank has control because the securities intermediary will act on its instructions. A written and signed security agreement are not needed to perfect a security interest based on control pursuant to agreement among the customer bank and his securities firm.

Alternatively, a security interest in investment property may be perfected by filing. The secured creditor must obtain a written and signed security agreement and file a financing statement containing an adequate description of the collateral. A secured creditor who perfects by filing runs the risk of losing its protection to a creditor who perfects by control, regardless of the time of filing and of whether the control creditor knows of the filing. The rationale for rejecting the "first in time" rule of Article 9 is that the "control" rule recognizes that the securities industry is not in the habit of perfecting its security interests by filing and rewards the creditor who takes all steps necessary to gain control and thus be in a position to foreclose the collateral on default. The filing requirement does not apply to non-control creditors making financing arrangements for securities and commodities firms. These financing arrangements are automatically perfected when they attach.

As noted already, the general priority rule is that a creditor with control has priority over all other secured creditors. In cases of "dual control," such as where a securities firm and a bank have control because a customer grants a security interest in his accounts first to the firm holding the accounts and then to an outside bank, the security interest of the securities firm primes that of the bank. Where two banks have control over the investment property of a securities firm, such as when the securities firm, a clearing corporation and the banks enter into agreements, the banks share pro rata in the investment property if it is discovered that they hold the same securities.

D. Uniform Commercial Code Revised Article 8

The Commission completed a Tentative Report Relating to Uniform Commercial Code Revised Article 8 -- Investment Securities, and distributed it for public comment (see Appendix G).

The National Conference of Commissioners on Uniform State Laws approved Uniform Commercial Code Revised Article 8 -- Investment Securities at its 1994 Annual Meeting. Revised Article 8 covers issues related to the settlement of securities trades for securities held directly by legal owners and for securities held indirectly by securities professionals on behalf of beneficial owners. Most publicly traded equity securities in the United States are held indirectly by members of the Depository Trust Company. Existing Article 8 is predicated on the assumption that securities are held directly in the name of legal owners, and therefore does not reflect the way most securities are actually held. Revised Article 8 cures this problem by providing rules for the indirect holding system. Rules for the direct holding system are retained, since the revision assumes that Article 8 should not seek to influence the development of the securities holding system.

E. Judgments

The Commission completed a Tentative Report Relating to Judgments and distributed it for public comment (see Appendix H).

The Commission's review of statutes concerning judgments continues the effort begun in 1989 to revise Title 2A provisions concerning the courts and the administration of civil justice. The current 32 sections include many which are outdated, unclear and superseded in practice by newer, more detailed rules. Moreover, even taken together the statutes and rules do not reflect the totality of current practice.

The Commission proposal states the processes by which a judgment or order is recorded and the process by which information concerning subsequent events that affect

Introduction

The National Conference of Commissioners on Uniform State Laws (NCCUSL) approved Uniform Commercial Code Revised Article 8, "Investment Securities" at its 1994 Annual Meeting. Revised Article 8 is recommended for adoption in all states. The staff of the New Jersey Law Revision Commission has reviewed Revised Article 8 and sets forth its findings in this report. Article 8 improves existing Article 8 and should be enacted by the State of New Jersey.

The original Article 8 entitled "Investment Securities," enacted in New Jersey in 1961, is a negotiable instruments law dealing with securities. It covers a limited range of issues concerning the settlement of securities trades. Article 8 does not deal with the process of entering into contracts for the transfer of securities or regulate the rights and duties of those involved in the contracting process. As such, Article 8 is not a comprehensive codification of law governing securities. Securities are largely governed by federal and state securities law and by state corporate and contract law. Consequently, Article 8's field of application is circumscribed to legal issues arising from the settlement of securities trades.

The original Article 8, drafted in the 1940's and 1950's, assumed that the securities industry used a "direct holding system" to define the relationship between the issuer of the security and its owner. In the direct holding system, the issuer records the name of the owner on its books, thus giving rise to the "direct relation" between issuer and owner. The original Article 8 also assumed that securities were "certificated," that is issued in paper form. The rules of original Article 8 covering delivery of securities and the rights and obligations of parties to securities transactions were predicated on the assumption that possession and delivery of physical certificates were the key elements in the securities holding system.

In the 1960's, the securities industry, in response to the paper crunch crisis, adopted the practice of issuing non-paper securities. "The mechanical problems of processing the paperwork for securities transfers reached crisis proportions in the late 1960's, leading to calls for the elimination of the physical certificates and development of modern electronic systems for recording ownership of securities and transfers of ownership."¹ As a result, the NCCUSL promulgated the 1978 amendments to Article 8 concerning uncertificated securities. The 1978 amendments added parallel provisions dealing with uncertificated securities to the existing rules of Article 8 on certificated securities. The system of securities holding contemplated by the 1978 amendments differed from the traditional system only in that ownership of securities would not be evidenced by physical certificates. Instead of surrendering an indorsed certificate for registration of transfer, an instruction would be sent to the issuer directing it to register the transfer. The State of New Jersey enacted the 1978 amendments to Article 8 in 1990.

However, contrary to the assumption of the 1978 amendments that uncertificated securities would become the norm, securities continued to be issued in certificated form. Virtually all forms of publicly traded securities are still issued in certificated form. However, these certificates are held, not by individual investors, but by clearing corporations. This type of securities holding system is called the indirect holding system. "Settlement of securities trading occurs not by delivery of certificates or by registration of transfer on the records of the issuers or their transfer agents, but by computer entries in the records of clearing corporations and securities

¹ Prefatory Note, Revised UCC 8, page 1.

intermediaries."² Thus, even after the 1978 amendments, the rules of Article 8 did not deal effectively with the indirect holding system.³

A large proportion of publicly traded securities are held in the name of the Depository Trust Company (DTC), and the clearing and settling of trades made with these securities is carried out by the National Securities Clearing Corporation.⁴ For example, the shareholder of record for most shares of IBM traded on the New York Stock Exchange is the DTC. The members of the DTC -- about 600 banks and brokers -- have accounts at the DTC that show their respective positions in IBM stock. In turn, the members of DTC hold these IBM shares on behalf of their customers. None of the members have physical stock certificates of IBM that must be handed over to other members when trades are executed each day. Rather, there is an IBM "jumbo certificate" held by DTC and transfers are accomplished by adjustments to the participants' DTC accounts. The DTC members provided analogous clearance and settlement functions to their own customers.

Most securities held through DTC are represented by "jumbo certificates." However, nothing ever happens to these certificates as they are not delivered from person to person. The certificates are "immobilized." Just as nothing happens to these jumbo certificates nothing happens to the official registry of stockholders maintained by the issuers or their transfer agents. "The principal mechanism through which securities trades are settled today is not delivery of certificates or registration of transfers on the issuer's books, but netted settlement arrangements and accounting entries on the books of a multi-tiered pyramid of securities intermediaries."⁵ Since the rules of 1978 amended version of Article 8 are geared to concepts of transfer of physical certificates and registration of transfers on issuer's books, the existing Article 8 rules are out of touch with the reality of the securities market.

To accommodate the indirect holding system, NCCUSL decided to revise Article 8 and appointed Professor James Rogers of Boston College Law School as the Reporter. The drafting approach remained neutral as to the future development of the securities industry. "Revised Article 8 takes a neutral position on the evolution of securities holding practices."⁶ The revision assumes that "the path of development will be determined by market and regulatory forces and that the Article 8 rules should not seek to influence the development in any specific direction." As a result, the rules of

² Id. at 2.

³ Id.

⁴ The 1994 Annual Report of DTC states that it has in custody approximately 78% of shares of companies represented in the Dow Jones Industrial Average, 70% of all NYSE listed U.S. companies, 57% of shares included in the NASDAQ and 50% of American Stock Exchange-listed companies, 85% of the principal amount of outstanding corporate debt listed on the NYSE, and 95% of the principal amount of outstanding municipal bonds. See DTC AR 5 (1993). While the DTC is a major securities depository it is not the only depository in the US. Other depositories, such as those in Philadelphia and Chicago, exist and the Federal Reserve Banks maintain an indirect holding system for the great bulk of Treasury securities.

In a conversation with Carl H. Urist, Deputy General Counsel and vice president of DTC, Mr. Urist stated that the split between DTC and NSCC is of historical origin since banks did not want to become members of NSCC because of NSCC's policy of guaranteeing all trades. The banks did not want to accept the risk of failing brokerage firms. There is no reason why one institution cannot perform both the depository and clearance and settlement tasks. Mr Urist believes that NSCC now has banks as members.

⁵ Prefatory Note page 5.

⁶ Id. at 6.

⁷ Id.

existing Article 8 have been retained for the direct holding system and a new Part 5 added to set forth the commercial law rules for the indirect holding system. In addition, the rules for obtaining a security interest in securities have been moved to Article 9.

Indirect Holding System Rules

The key innovation of Revised Article 8 is the concept of "security entitlement." This concept describes the bundle of rights a person acquires when that person owns a financial asset within an indirect securities holding system.⁸ The security entitlement represents a set of rights by the holder against the securities intermediary that holds the security on behalf of the holder. The term "security entitlement" is defined in Part 1 of Revised Article 8 dealing with general matters. The rules that govern a security entitlement are set forth in Part 5 entitled "Security Entitlements" consisting of eleven sections.

Securities entitlements are claims to securities accounts. They are analogous to claims depositors have on bank accounts, though the analogy is imperfect. Revised Article 5 organizes the concept of security entitlement on the ground of three basic definitions: (1) "securities account," (2) "security entitlement" and (3) "security holder." The particular rights making up the security entitlement are contained in the Part 5 rules. The concept of security entitlement is completely severed from ownership based on the possession of physical security certificates and registration on issuer's books. Therefore it is useful to the indirect holding system.

A "securities account" is "an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset."⁹ A "security entitlement" "means the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5."¹⁰ An "entitlement holder" "means a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary."¹¹

A person acquires a security entitlement when a securities intermediary credits a financial asset, or accepts the financial asset for credit, to the person's securities account.¹² The securities intermediary need not hold the asset itself, since the securities intermediary may hold the asset through another securities intermediary. The security entitlement right in a financial asset is a property right of the security entitlement holder, does not belong to the securities intermediary and is not subject to the claims of creditors of the securities intermediary. An entitlement holder's property interest with respect to a particular financial asset is a pro rata property interest in all interests in that financial asset held by the securities intermediary. The rights of

⁸ The Part 5 rules apply not only to securities, RUCC 8-102(17), but to financial assets RUCC 8-102(9). The term financial asset includes other interests, obligations or property that is held through securities accounts, such as money market instruments. While the latter are not Article 8 securities, since they are governed by Article 3, they are financial assets for purposes of the Part 5 rules of Revised Article 8.

⁹ RUCC 8-501(a).

¹⁰ RUCC 8-102(17).

¹¹ RUCC 8-102(8).

¹² RUCC 8-501(b).

entitlement holders are not determined by the time of acquisition. The right is not to a specific physical object, but a claim to property held by the securities intermediary.¹³

While a security entitlement holder does not have a right to specific financial assets, the securities intermediary has a duty to provide the entitlement holder with all corporate and economic rights of security ownership. Thus, the securities intermediary must "maintain a quantity of financial assets corresponding to the aggregate of all security entitlements it has established."¹⁴ A securities intermediary also has an obligation to obtain payment of dividends and other distributions and pass them to the entitlement holder.¹⁵ In addition, the securities intermediary has an obligation to obey the instructions of the entitlement holder with respect to the financial asset including an order to sell or transfer the asset.¹⁶ However, this duty does not preclude the owner of the security entitlement from conferring discretionary authority on the securities intermediary to manage the financial asset.

Since a security entitlement is a claim against a securities intermediary and not a claim to a specific physical object, an entitlement holder generally cannot assert claims against third parties even when the securities intermediary wrongfully has transferred the interest of the entitlement holder to the third party. A transferee who gave value and obtained control of the financial asset is protected against the claims of the broker's customers unless the transferee acted in collusion with the broker. This rule is justified on grounds of "the fundamental policies of investor protection that underlie [Article 8] and other bodies of law governing the securities business."¹⁷ The Official Comment states:

"The commercial law rules for the securities holding and transfer system must be assessed from the forward-looking perspective of their impact on the vast number of transactions in which no wrongful conduct occurred or will occur, rather than from the post hoc perspective of what rule might be most advantageous to a particular class of persons in litigation that might arise out of the occasional case in which someone has acted wrongfully. ... There is no reason to think that rules permitting customers of an intermediary to trace and recover securities that their intermediary wrongfully transferred work to the advantage of investors in general. To the contrary, application of such rules would often merely shift losses from one set of investors to another. The uncertainties that would result from rules permitting such recoveries would work to the disadvantage of all participants in the securities markets."¹⁸

In cases where the securities intermediary fails, and the securities intermediary does not have enough assets to satisfy both the claims of its secured lenders and the claims of its customers, the customers win unless the secured lender has taken "control" of the asset under Section 8-106. A purchaser under Section 8-106 takes control when "the purchaser becomes the entitlement holder," or when "the securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder." As a practical matter, a secured

¹³ Revised Article 8 does not determine how property is to be distributed on failure of the securities intermediary. "The Bankruptcy Code and Securities Investor Protection Act ("SIPA") provides that all customer property is distributed pro rata among all customers in proportion to the dollar value of their total positions." RUCC Official Comment 1 to RUCC 8-503.

¹⁴ Official Comment 1 to RUCC 8-504; RUCC 8-504(a).

¹⁵ RUCC 8-505(a).

¹⁶ RUCC 8-506 and 507.

¹⁷ Official Comment 3 to RUCC 8-503.

¹⁸ Id.

lender, such as a bank, takes control of securities within an indirect holding system when the secured lender requires the securities intermediary to transfer its holdings at the clearing company to the secured lender. In that case, the secured lender wins in a priority contest with the broker's customers.

However, such a scenario is unlikely to happen, and even if it does occur, the customer is protected against loss through SIPA. First, a securities intermediary is forbidden from granting security interests in its customers' property. Second, Revised Article 8 and SEC regulations require brokers to maintain adequate quantities of financial assets to satisfy customers' claims. Third, SEC and self-regulatory organization inspections enforce these requirements. Fourth, even if a securities intermediary fails and these safeguards have not prevented a shortfall in holdings, customers are insured up to \$500,000 in shortfalls after distribution of the property of the insolvent securities intermediary.

Conclusion

The Law Revision Commission recommends that Revised Article 8 be adopted in New Jersey. Revised Article 8 represents a major improvement over existing law that does not reflect practices of the contemporary securities industry and therefore does not provide useful rules for the resolution of commercial disputes. In addition, like Revised Article 5, Revised Article 8 governs an area of law that is inherently of national stature.