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PROBLEMS OF TEXAS ISSUERS UNDER ARTICLE 8 —  
INVESTMENT SECURITIES —  
OF THE UNIFORM COMMERCIAL CODE

by

Thomas A. Morris\* and George Slover, Jr.\*\*

I. INTRODUCTION

ARTICLE 8 of the Uniform Commercial Code<sup>1</sup> represents a much more limited departure from existing Texas law and practice than other parts of the new code.<sup>2</sup> It is, however, broader in scope than any single previous Texas statute in this field, and it contains several innovations which deserve careful study by Texas issuers and their counsel.<sup>3</sup>

The antecedents of article 8 are such statutes as the Negotiable Instruments Law,<sup>4</sup> the Uniform Act for Fiduciary Security Transfers<sup>5</sup> (referred to herein as the "Fiduciary Transfer Act"), and, in particular, the Uniform Stock Transfer Act<sup>6</sup>—all of which had been enacted in Texas. Section 10-102 of the code, however, expressly repeals both the Negotiable Instruments Law and the Uniform Stock Transfer Act while section 10-104(2) specifically preserves the Fiduciary Transfer Act.<sup>7</sup>

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<sup>1</sup> Enacted as Tex. Acts 1965, 59th Legislature, ch. 721; approved June 18, 1965 effective at midnight June 30, 1966. References by section number are to the Texas statute. References to the official comments of the draftsmen of the code are to the 1962 *Official Text and Comments of the Uniform Commercial Code* as appearing in *Uniform Laws Annotated*.

<sup>2</sup> There have been a number of articles written on the general scope and applicability of article 8. Texas lawyers should find particularly helpful Wozencraft, *Investment Securities Under the Uniform Commercial Code—Guidelines for Business Lawyers*, 44 TEXAS L. REV. 669 (1966). There is also a comprehensive treatment of article 8 in a series of articles by Carlos M. Israels reprinted in ABA, UNIFORM COMMERCIAL CODE HANDBOOK 211 (1964). A brief review of article 8 appears beginning at page 8-1 in WILLIER & HART, UNIFORM COMMERCIAL CODE IN TEXAS (1965).

<sup>3</sup> While this article focuses on the Texas issuer, most of the comments are applicable to issuers of any other state which has adopted the Uniform Commercial Code. All of the popular states for incorporation have now adopted the code. However, the code will not become effective in Delaware until July 1, 1967.

<sup>4</sup> Former arts. 5932-48, Tex. Rev. Civ. Stat. Ann. (1962).

<sup>5</sup> TEX. REV. CIV. STAT. ANN. art. 582-1 (1964).

<sup>6</sup> Former arts. 1302-6.01—6.26, Tex. Rev. Civ. Stat. Ann. (1962).

<sup>7</sup> Section 10-104(3) also expressly preserves the Texas Securities Act. In the case of both the Fiduciary Transfer Act and the Securities Act, the code specifies that, if there is any inconsistency between one of such prior statutes and the code, the prior statute shall control.

An inadvertent result of the general repeal of the Stock Transfer Act was the repeal of

Section 8-106 adopts the usual conflict of laws rule that the validity of a security and the rights and duties of the issuer with respect to registration of transfer are governed by the law of the jurisdiction of organization of the issuer.

In essence, article 8 represents a comprehensive codification of the law relating to the transfer of all kinds of investment securities. It also relates to some aspects of the issue of securities, although it is not a securities or a blue sky law. "It may rather be likened to a negotiable instruments law dealing with securities."<sup>8</sup> Article 8 by itself does not purport to give all of the answers to questions relating to validity of securities and registrations of transfers which might be encountered by Texas issuers. In addition to any relevant constitutional provisions, it is also necessary to consider such other statutes as the Texas Business Corporation Act or other applicable incorporating act, federal and state securities laws, the Fiduciary Transfer Act, and any special laws that may relate to the particular type of issuer. In considering the possible applicability of other Texas statutes in such situations, however, it must be remembered that section 10-103 of the code is a general repealer which with certain limited exceptions (including preservation of the Fiduciary Transfer Act and the Texas Securities Act) repeals all acts inconsistent with the code.

In analyzing article 8, as in studying other parts of the code, it is of primary importance to consider first the definitions provided by the statute. In addition to the general definitions contained in article 1, article 8 contains several important definitions. Of particular significance is the definition of "security," not only for what it includes but also for what it does not include. Section 8-102(1)(a) provides:

- (a) A 'security' is an instrument which
  - (i) is issued in bearer or registered form; and
  - (ii) is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and
  - (iii) is either one of a class or series or by its terms is divisible into a class or series of instruments; and
  - (iv) evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.

Section 8-102(1)(b) expressly excludes money from the definition of "security" and further provides that any writing within the above definition is governed by article 8 and not by article 3 ("Commercial Paper") even though it may also meet the requirements of

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Former art. 1302-6.04B, Tex. Rev. Civ. Stat. Ann. (1962) relating to joint ownership of shares which was enacted at the same legislative session as the code.

<sup>8</sup> See official comments to § 8-101.

the latter article.<sup>9</sup> The definition of securities is broad enough to cover some items such as bearer bonds which would have been within the scope of the former Negotiable Instruments Law rather than the former Uniform Stock Transfer Act. On the other hand, the definition is not as broad as the typical blue sky law definition which extends to various types of investment contracts. By the terms of the definition, the usual promissory note is also excluded. The statute broadly defines "issuer" so as to include persons other than corporations. However, in the usual case there will be a corporate issuer, and in this discussion it is assumed that the issuer is a corporation.

Securities governed by article 8 are termed "negotiable instruments" in section 8-105 (1). This is not an expressly defined term in the code, but much of article 8 is devoted actually to explaining what is meant by negotiability of securities subject to the article.

Definitions in article 8 are not the only provisions of overriding applicability to be found in the code. For instance, section 1-203 succinctly states, "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." "Good faith" is defined to mean honesty in fact in the conduct or transaction concerned;<sup>10</sup> however, "honesty in fact" is itself not defined. Section 1-203 could very well have an adverse effect upon the certainty which might otherwise be expected from the detailed provisions of the code since it means that a difficult fact issue lurks in the background of every transaction. Another important general provision outside of article 8 is section 1-205 relating to course of dealing and usage of trade. These principles could well be applicable in an article 8 situation. Article 2 ("Sales") applies by its terms only to transactions and goods,<sup>11</sup> "unless the context otherwise requires."<sup>12</sup> This broad application conceivably might leave the way open to application in article 8 situations of some article 2 sections, such as section 2-302 (relating to unconscionable contracts).

Article 8 uses terminology differing from the traditional manner of describing stock transfers. The piece of paper evidencing the shares is a "security" rather than a "certificate." The "transfer" is considered to be made between the parties. The holder of the registered security accomplishes a "transfer" by an "indorsement" of the security and not through the creation of an agency relationship by execution of a "stock power" to assign the security on the books of

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<sup>9</sup> Section 3-103 contains a parallel exclusion stating that article 3 does not apply to investment securities.

<sup>10</sup> Section 1-201(19).

<sup>11</sup> By § 2-105(1) goods are defined to exclude investment securities.

<sup>12</sup> Section 2-102.

the issuer. The issuer or its transfer agent "registers" the transfer which has already been made by the holder. However, the transfer agent is still called the "transfer agent" presumably to keep from confusing it with the registrar. The new terminology better expresses what actually happens on a transfer, even under the prior law, and should cause no difficulties. Moreover, the usual certificate forms developed according to prior law should continue to be usable under the new code even though all of the wording may not be entirely appropriate.

Part 3 of article 8 contains comprehensive provisions governing the rights among those who are parties to transfers of securities and among adverse claimants; however, such provisions are outside the scope of this article which has been limited to particular problems facing the issuer. The problematical areas for an issuer may be divided into two general categories: the rights of a purchaser for value against the issuer of securities, dealt with primarily in part 2 of article 8; and the registration of transfers of securities, dealt with mostly in part 4 of article 8. The two categories of course interrelate since the issuer (or its transfer agent) must issue a new security as one step in the registration of a transfer.

## II. ISSUANCE OF SECURITIES

General corporate law will continue to govern in most respects the form and content of corporate securities.<sup>13</sup> However, there are several sections of article 8 that are pertinent. Section 8-103, for example, provides that a lien upon a security in favor of an issuer thereof is valid against a purchaser only if the right to such lien is noted conspicuously on such security. Similarly, section 8-204 provides that any restriction on transfer imposed by the issuer is ineffective unless the terms of the restriction are noted conspicuously on the security or unless parties to a transfer have actual knowledge of any such restriction. The statute does not require that such liens and restrictions be set forth in full on the security but requires merely that they be noted. This technique has generally been considered acceptable for stock certificates under the applicable provisions of the Texas Business Corporation Act<sup>14</sup> and the Uniform Stock Transfer

<sup>13</sup> E.g., TEX. BUS. CORP. ACT ANN. arts. 2.19, 2.22 (1956); TEX. REV. CIV. STAT. ANN. art. 1302-2.05 (1962). In the case of listed securities, the stock exchanges may impose additional requirements.

<sup>14</sup> TEX. BUS. CORP. ACT ANN. arts. 2.19F, 2.22A (1956). Under article 2.22A, any restrictions on transfer should be noted on the face of the stock certificate. Both article 2.22A and § 8-204 apply by their terms only to restrictions on transfer imposed by the issuer.

Act.<sup>15</sup> The code, however, adds a new feature by expressly requiring that the notation be "conspicuously" made.<sup>16</sup>

Another provision relating to the form and content of securities is section 8-202 (1) dealing with incorporation by reference. The Texas Business Corporation Act has permitted incorporation by reference in stock certificates, but it has not expressly explained the effect of such a reference.<sup>17</sup> The code's broad definition of securities also makes incorporation by reference available now for instruments other than stock certificates. Under section 8-202 (1), even against a purchaser for value, the terms of a security include not only those stated on the security but also those made part thereof by reference. It is expressly provided though that such a reference does not of itself charge a purchaser for value with notice of a defect going to the validity of the security even though the security might expressly state that a person accepting the security admits such notice. It is not required that such a reference be "conspicuous" unless it refers to a lien or a restriction on transfer imposed by the issuer.

In general, the code throws the burden of an improperly issued certificate on the issuer.<sup>18</sup> With the few exceptions enumerated in sections 8-202 and 8-205, all defenses of the issuer, including non-delivery and conditional delivery of the security, are ineffective under section 8-202 (4) against a purchaser for value who has taken without notice of the particular defense. The code does not, aside from the general definition of "notice"<sup>19</sup> and section 8-203 relating to staleness as notice, elaborate on what will constitute notice of a defect; but in view of the general approach of article 8 to encourage free transferability of securities, presumably the facts and circumstances known to the purchaser will have to be rather clear to constitute notice.<sup>20</sup>

A security which is not genuine of course still has no standing

<sup>15</sup> TEX. REV. CIV. STAT. ANN. art. 1302-6.16 (1962)

<sup>16</sup> Conspicuous is defined at § 1-201 (10) as follows:

'Conspicuous': A term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it. A printed heading in capitals (as: NON-NEGOTIABLE BILL OF LADING) is conspicuous. Language in the body of a form is 'conspicuous' if it is in larger or other contrasting type or color. But in a telegram any stated term is 'conspicuous'. Whether a term or clause is 'conspicuous' or not is for decision by the court.

<sup>17</sup> TEX. BUS. CORP. ACT ANN. art. 2.19F (1956).

<sup>18</sup> See official comments to §§ 8-202, 8-205.

<sup>19</sup> Section 1-201 (25).

<sup>20</sup> Article 8 should overrule such decisions as *Williams v. Terminal Hotel Co.*, 280 S.W. 505 (Tex. Comm. App. 1926) which held that when one buys stock "from a stockholder of a corporation who is also an officer thereof, authorized to sign the stock certificate, such a purchaser must make reasonable inquiry to see that the bylaws of the company relating to the transfer of its stock have been complied with."

even if it has come into the hands of a purchaser for value without notice of the invalidity.<sup>21</sup> However, a signature which is placed on a security without authority by a person entrusted with the responsible handling of the security<sup>22</sup> or a defect not involving violation of a constitutional provision<sup>23</sup> does not provide any defense against a purchaser for value. In fact section 8-202(2)(a) says that even if the defect does involve violation of a constitutional provision it will be valid in the hands of a subsequent purchaser for value who has no notice of the defect.

The Texas constitutional provision most likely to be violated in the issuance of securities is the requirement in the first clause of article XII, section 6 that stock or bonds be issued only for "money paid, labor done, or property actually received." The second clause of article XII, section 6 goes further and provides that "all fictitious increase of stock or indebtedness shall be void." However, in the past the Texas courts have not construed this latter language to void stock issued contrary to the first clause of section 6 but have instead reasoned that the first clause of section 6 is distinct from the second and does not contain the term "void."<sup>24</sup> Consequently, section 8-202(2)(a) should be effective in protecting a bona fide purchaser for value in the usual case of constitutional invalidity, but it seems to have engendered constitutional difficulties insofar as it purports to validate securities in the hands of a bona fide purchaser for value in the unlikely event that such securities are issued in violation of the second clause of article XII, section 6.<sup>25</sup>

If a security contains the signatures necessary to its issue or transfer but is incomplete in any other respect, any person may complete it by filling in the blanks as authorized; and even though the blanks are incorrectly filled in, the security as completed is enforceable by a subsequent purchaser who takes it for value and without notice of such incorrectness.<sup>26</sup> Even fraudulent alteration of an already completed security does not invalidate it; it remains enforceable according to its original terms.<sup>27</sup>

The lesson in all of this for the issuer is to be very careful in safe-

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<sup>21</sup> Section 8-202(3).

<sup>22</sup> Section 8-205.

<sup>23</sup> Section 8-202(2)(a).

<sup>24</sup> *Washer v. Smyer*, 109 Tex. 398, 211 S.W. 985 (1919); *Houston Fire & Marine Ins. Co. v. Swain*, 114 S.W. 149 (Tex. Civ. App. 1908).

<sup>25</sup> Query if the possible conflict of § 8-202(2)(a) of the code with the second clause of § 6 of article XII and perhaps other sections of the Texas Constitution would be held to invalidate completely the code section. Hopefully not, since this section is an important part of the pattern established by part 2 of article 8.

<sup>26</sup> Section 8-206(1).

<sup>27</sup> Section 8-206(2).

guarding securities and in conferring authority to handle securities. This is not a wholly new lesson since Texas courts in the past have protected the bona fide transferee for value against the issuer.<sup>28</sup> In any event, it is not unreasonable to require that the issuer accept the responsibility for securities improperly issued through those persons it selects to handle them or that it keep its corporate house in order to avoid defects in issue which in the ordinary course of events could not possibly be known to a purchaser of the security.

In a further extension of this approach, section 8-104 contains novel provisions relating to "overissue" of securities—that is, the issue of securities in excess of the amount which the issuer has corporate power to issue. Under traditional corporate law, securities involved in an overissue have been considered invalid,<sup>29</sup> and the code does not seek to change that result.<sup>30</sup> Instead, if article 8 would otherwise validate or compel the issue or reissue of a security involved in an overissue, the person entitled to the issue or to valid securities may compel the issuer to purchase and deliver to him, if reasonably available, an identical security which does not constitute an overissue. If such a security is not available, then the person entitled to issue or validation may recover from the issuer the price he or the last purchaser for value paid for it with interest from the date of his demand.

### III. TRANSFER OF SECURITIES

Registration of ownership of a registered security is the focal point of the rights and duties of the issuer with respect to such security under article 8. Section 8-207 explicitly provides that, prior to the due presentment for registration of a transfer of a security in registered form, the issuer may treat the presently registered owner as the person exclusively entitled to vote, to receive notifications, and otherwise to exercise all the rights and powers of an owner.<sup>31</sup> The code does not specify what constitutes "due presentment" for registration, and this could be a difficult fact issue. Moreover, there is some doubt as to whether an issuer may with impunity rely blindly on the broad literal language of section 8-207.<sup>32</sup> Consequently, the prudent issuer

<sup>28</sup> See, e.g., *Fidelity & Deposit Co. v. Wiseman*, 103 Tex. 286, 124 S.W. 621, 126 S.W. 1109 (1910); *Baker v. Wasson*, 59 Tex. 140 (1883); and cases cited *supra* note 24.

<sup>29</sup> *Williams v. Terminal Hotel Co.*, 280 S.W. 505 (Tex. Comm. App. 1926).

<sup>30</sup> See official comments to § 8-104.

<sup>31</sup> Section 8-107 is not intended to interfere with the common practice of closing the transfer books or taking a record date for dividends, voting and other purposes, as authorized by TEX. BUS. CORP. ACT ANN. art. 2.26 (1956). See official comments to § 8-107.

<sup>32</sup> Section 6 of the Uniform Stock Transfer Act [former art. 1302-6.04, Tex. Rev. Civ. Stat. Ann. (1962)] contained a provision similar to § 8-107, and it has been customary to include in corporate bylaws clauses of like import. Nonetheless, in *Cooper v. Citizens Nat'l*

and registrar should be advised not to ignore adverse claims which foreseeably may generate future difficulties. Since section 8-207 is permissive rather than mandatory, before taking such action as the payment of dividends, the issuer should, if on notice of an adverse claim, investigate and require proof of ownership.<sup>33</sup>

One of the basic purposes of article 8 is to simplify and facilitate the process of registering transfers of securities. Section 8-401 requires the issuer, or its transfer agent, to register a transfer when (i) the security is properly indorsed and reasonable assurance is given that the indorsements are genuine and effective; (ii) the user has no notice of any adverse claims; (iii) all tax collection statutes are complied with; and (iv) the transfer is in fact rightful or is to a bona fide purchaser. The issuer is liable to the presenting party for any loss resulting from unreasonable delay in registration or from failure or refusal to register. Article 8 substantially reduces the issuer's area of responsibility, but it also serves to limit its possible defenses. Once the issuer, or its transfer agent, is satisfied that the indorsements are genuine, and there is no notice of adverse claims, there is no further duty of inquiry into the rightfulness of the transfer; and the issuer is expressly released from liability to the owner or any person suffering loss resulting from registration of the transfer.<sup>34</sup> The issuer's duty to investigate the rightfulness of the transfer before registration is limited to two specific situations: (i) where an adverse claimant has given written notification to the issuer which affords the issuer reasonable time and opportunity to act prior to issuance of a new security, or where the issuer is otherwise on notice of an adverse claim,<sup>35</sup> and (ii) where the issuer has required more documentation and proof of validity than necessary.<sup>36</sup>

Since, as noted above, section 8-404 expressly relieves the issuer of

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Bank, 267 S.W.2d 848 (Tex. Civ. App. 1954), *error ref. n.r.e.*, the court stated that requirements that a stock transfer be recorded on the corporate books is to protect the corporation in cases where it has no notice that the transfer has been effected and that if it has notice of the rights of a transferee, it must pay dividends to the transferee even though the stock has not been transferred on the corporate books. In that case there had been a presentment of the certificate for registration of the transfer, so the result is consistent with § 8-107, even though some of the language of the court speaks in terms of notice of transfer, not presentment.

<sup>33</sup> Cf. § 8-403 discussed *infra* at text accompanying notes 35, 36.

<sup>34</sup> Section 8-404.

<sup>35</sup> Section 8-403(1)(a). While § 8-403(1)(a) refers only to written notification from an adverse claimant, there are a number of circumstances in which it seems probable that the issuer would be chargeable with notice of an "adverse claim." For example, anytime securities standing in the name of a person in a control relationship with the issuer are presented for transfer, the issuer must be alert to the possibility that sales of unregistered securities by such person will constitute a violation of § 5 of the Securities Act of 1933. See discussion *infra* at notes 63, 64.

<sup>36</sup> Section 8-403(1)(b).

liability to even a true owner if it has complied with any duty of inquiry and the security is properly indorsed, the primary assurance to the issuer is a guarantee as to the genuineness and effectiveness of the indorser's signature. The guarantor may be any person "reasonably believed by the issuer to be responsible." The issuer may adopt any reasonable standards of responsibility,<sup>37</sup> and, presumably, the accepted rules and customs of the particular market in which the issuer's securities are traded will be the standard required. The signature guarantor warrants to the issuer that (i) the signature is genuine; (ii) the signer was an appropriate person to indorse; and (iii) the signer had the legal capacity to indorse at the time of signature.<sup>38</sup> The guarantor of signature does not otherwise warrant the rightfulness of the transfer. However, a guarantee of the indorsement, as distinguished from a guarantee of the signature, warrants not only the signature but also that the transfer is rightful in all respects.<sup>39</sup>

Where an indorsement is unauthorized, or is forged, the rightful owner can assert its ineffectiveness against the issuer and can demand delivery of a like security which is valid.<sup>40</sup> Accordingly, the issuer must look to the signature guarantor for protection from unauthorized indorsements and forgeries. The issuer who acts without a professional transfer agent has the added responsibility of determining that the guarantee itself is authorized and not a forgery. The issuer which does not employ a transfer agent must take care to establish internal procedures for checking the adequacy and genuineness of each guarantee of signature.<sup>41</sup>

A major advantage provided by section 8 is a simplified registration of transfers by fiduciaries. The amount of documentation required by issuers, as well as the risks facing issuers, have now been reduced. In fact, the issuer is well advised to limit its inquiry to essential instruments to avoid being charged with notice of information contained in unnecessary documents. Under section 8-402, the issuer may require the following assurance that each indorsement is genuine and effective:

- (a) in all cases, a guarantee of the signature (subsection (1) of Section 8-312) of the person indorsing; and
- (b) where the indorsement is by an agent, appropriate assurance of authority to sign;

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<sup>37</sup> Section 8-402(2).

<sup>38</sup> Section 8-312.

<sup>39</sup> Section 8-312(2). Note that the issuer cannot require a guarantee of indorsement as a condition of registration of the transfer.

<sup>40</sup> Section 8-404(2).

<sup>41</sup> See generally *Israels, How to Handle Transfers of Stock, Bonds and Other Investment Securities*, 19 *BUS. LAW.* 90 (1963).

- (c) where the indorsement is by a fiduciary, appropriate evidence of appointment or incumbency;
- (d) where there is more than one fiduciary, reasonable assurance that all who are required to sign have done so;
- (e) where the indorsement is by a person not covered by any of the foregoing, assurance appropriate to the case corresponding as nearly as may be to the foregoing.<sup>42</sup>

Section 8-402 further provides that "appropriate evidence of appointment or incumbency" means, in the case of a court-appointed fiduciary, a certificate issued by or under the direction of the court dated within sixty days of the date of the presentation for transfer. In the case of a fiduciary that is not appointed by a court, a copy of the controlling document or instrument showing the incumbency of the fiduciary is sufficient evidence. But, even in this event, the signature guarantee is of paramount importance to the issuer. While the indorsement is effective even though the fiduciary is no longer serving at the time of registration,<sup>43</sup> his incumbency at the time of signature must be established. If the issuer has reasonable assurance that the security is indorsed by appropriate persons and has no undischarged duty of inquiry as to adverse claims, it has a duty to register the transfer. Where it requires a copy of a controlling instrument, *i.e.*, trust agreement, will or partnership agreement, for any reason other than proof of incumbency, the issuer is charged with notice of all matters contained in the instrument respecting the transfer, and may, for all practical purposes, bear the risk of the rightfulness of the transfer.<sup>44</sup> It has been suggested that the issuer, wherever possible, avoid the use of original documentation.<sup>45</sup> If a local bank or brokerage house with which the transferor does business will certify to the authority of an agent or to the incumbency of a fiduciary, the issuer, in the absence of any notice of adverse claims, would be advised to register the transfer.<sup>46</sup> As a practical matter, the issuer's risks are eliminated where a

<sup>42</sup> Section 8-402(1).

<sup>43</sup> Section 8-308(6), (7).

<sup>44</sup> Section 8-402(4).

<sup>45</sup> *Israels, supra*, note 41. See also *Israels, Investment Securities as Negotiable Paper Article 8 of the Uniform Commercial Code*, 13 *BUS. LAW* 676, 688 (1958).

<sup>46</sup> Section 8-402(3)(b) provides that "appropriate evidence of appointment or incumbency" under § 8-402(1)(c), in the case of a non-court appointed fiduciary means:

[A] copy of a document showing the appointment or a certificate issued by or on behalf of a person reasonably believed by the issuer to be responsible or, in the absence of such a document or certificate, other evidence reasonably deemed by the issuer to be appropriate. The issuer may adopt standards with respect to such evidence provided such standards are not manifestly unreasonable. The issuer is not charged with notice of the contents of any document obtained pursuant to this paragraph (b) except to the extent that the contents relate directly to the appointment or incumbency.

Accordingly, the issuer can safely rely on an acceptable certificate of incumbency, together with the guarantee of signature which, under § 8-312(1)(b), warrants that the signer is

party who would be an acceptable signature guarantor has certified as to the incumbency of the party presenting the security for transfer.

An issuer can safely register a transfer effected by a Texas independent executor, guardian or administrator in reliance upon letters testamentary or of administration or guardianship dated within sixty days as evidence of incumbency.<sup>47</sup> Even where, under the Probate Code, court approval of a transfer is required, the indorsement is effective, although the fiduciary has failed to obtain the requisite court approval.<sup>48</sup>

The Texas Probate Code provides several procedures for probating a will or settling an estate where no administration is necessary. These include probate as a muniment of title,<sup>49</sup> collection of small estates,<sup>50</sup> and actions to determine heirship.<sup>51</sup> In each of these instances, the issuer is faced with a peculiar problem in determining who is the proper party to indorse a security for transfer, since there is no representative of the decedent's estate. The Uniform Commercial Code provides that an "appropriate person" indorsing a security includes: "(f) a person having power to sign under applicable law or controlling instrument . . ."<sup>52</sup> The official comment to the code takes the position that the above section is designed to deal with small estates statutes similar to the Texas Probate Code provisions. It appears that, in ascertaining who an "appropriate person" is under the small estates provisions or when a will has been probated as a muni-

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an appropriate person to sign. Note also that the language of § 8-402(3) is substantially the same as § 4 of the Fiduciary Transfer Act, TEX. REV. CIV. STAT. ANN. art. 582-1(4) (1964).

<sup>47</sup> Section 8-402(3)(a).

<sup>48</sup> Section 8-403(3)(b). *Cf.*, § 8-308(7). See also TEX. REV. CIV. STAT. ANN. art. 582-1(3) (1964). Once the issuer is satisfied as to the incumbency of the fiduciary, it can rely not only on the code provisions, but also §§ 6, 7 of the Fiduciary Transfer Act, TEX. REV. CIV. STAT. ANN. art. 582-1 (1964), which provide that no liability is incurred by the issuer or its transfer agent acting under the act. As noted above, the code requirements and the requirements of the Fiduciary Transfer Act, are substantially the same. See *supra* note 13. Further, TEX. PROB. CODE ANN. § 188 (1956) provides:

When an executor or administrator, legally qualified as such, has performed any acts as such executor or administrator in conformity with his authority and the law, such acts shall continue to be valid to all intents and purposes, so far as regards the rights of innocent purchasers of any of the property of the estate from such executor or administrator, for a valuable consideration, in good faith, and without notice of any illegality in the title to the same, notwithstanding such acts or the authority under which they were performed may afterward be set aside, annulled, and declared invalid.

TEX. PROB. CODE ANN. § 188 (1956). While it is not clear that this provision protects the issuer or transfer agent; *cf.*, TEX. PROB. CODE ANN. § 89 (1956), taken with the Fiduciary Transfer Act, the issuer's risk would seem to be eliminated.

<sup>49</sup> TEX. PROB. CODE ANN. § 89 (1956).

<sup>50</sup> TEX. PROB. CODE ANN. §§ 137-44 (1956).

<sup>51</sup> TEX. PROB. CODE ANN. §§ 48-56 (1956).

<sup>52</sup> Section 8-308(3)(f).

ment of title, the issuer may require documentation which at a later time might be determined to be "unnecessary documentation" sufficient to charge the issuer with notice of an improper transfer. A possible solution might be afforded by reliance upon an opinion of counsel satisfactory to the issuer, or a guarantee of the indorsement, as distinguished from a guarantee of signature.<sup>53</sup> As a practical matter, the issuer will seldom be faced with problems arising from a transfer under either the statutory provisions for small estates or actions to declare heirship. The small estates procedure is available only for estates of less than one thousand dollars,<sup>54</sup> and actions to declare heirship are generally used only where the estate is comparatively small and there is no necessity for administration.<sup>55</sup> Under these circumstances, the issuer's possible exposure to risk will be generally very small.

Section 89 of the Probate Code provides that where there is no necessity for administration or there are no unpaid debts (other than debts secured by liens on real estate), a will may be admitted to probate as a muniment of title.<sup>56</sup> The issuer should be able to rely on the order admitting the will to probate<sup>57</sup> and an indorsement by all of the legatees named, if the signatures are properly guaranteed<sup>58</sup> and if

<sup>53</sup> See *supra* note 6. Note, however, that while the issuer may request a guarantee of indorsement, it is precluded from requiring such a guarantee by § 8-312(2).

<sup>54</sup> TEX. PROB. CODE ANN. § 137(c) (1956). Note that TEX. PROB. CODE ANN. § 138 (1956) purports to release any person making a transfer or issuance pursuant to an affidavit for collection of a small estate "to the same extent as if made to a personal representative of the decedent."

<sup>55</sup> Where an administration is in fact pending, an action to declare heirship cannot be utilized. See *Wells v. Gray*, 241 S.W.2d 183 (Tex. Civ. App. 1951) *error ref.* The issuer is protected to some extent in relying on § 55 which provides that judgment in an action to declare heirship is conclusive on all parties to the action. The issuer may still bear a substantial risk if there is any defect in the proceeding. *Cf.*, *Wilson v. Wilson*, 378 S.W.2d 156 (Tex. Civ. App. 1964) (where the requisite affidavits were not attached to plaintiff's original petition, the court held there was no jurisdiction in the original proceeding).

<sup>56</sup> TEX. PROB. CODE ANN. § 89 (1956). It should be noted that § 73 of the Probate Code provides that no will may be probated more than four years after the testator's death unless the party applying for probate can show he was not in default in failing to apply within the prescribed period. In no event can letters testamentary be issued after four years by virtue of TEX. PROB. CODE ANN. § 73 (1964). Accordingly, where there has been no probate within the four year period, even a party not in default can obtain probate only as a muniment of title. See, *e.g.*, *Fortinberry v. Fortinberry*, 326 S.W.2d 717 (Tex. Civ. App. 1959) *error ref. n.r.e.*

<sup>57</sup> Section 89 of the Probate Code provides in part:

The order admitting a will to probate as a Muniment of Title shall constitute sufficient legal authority to all persons owing any money, having custody of any property, or acting as registrar or transfer agent of any evidence of interest, indebtedness, property, or right belonging to the estate, and to persons purchasing from or otherwise dealing with the estate, for payment or transfer to the persons described in such will as entitled to receive that particular asset without administration. The person or persons entitled to property under the provisions of such will shall be entitled to deal and treat with the properties to which they are so entitled in the same manner as if the record of title thereof were vested in their names.

<sup>58</sup> *Supra* note 38.

it has no other notice of possible adverse claims. The legatees should be "appropriate person[s]" to indorse under the code,<sup>59</sup> and the will and order of probate should be construed to constitute reasonable proof of incumbency. As noted above, the issuer should be advised to return the documents promptly, and, in any event, to make clear that they are required only as reasonable evidence of incumbency to avoid being charged with notice of other matters contained in the instruments.<sup>60</sup>

In addition to the danger that it may require documentation that might later be determined to be beyond that specified in section 8-402, the issuer is also faced with the possibility that a court might hold that the code provision relating to the incumbency of fiduciaries is not applicable to situations arising under the Texas probate procedure discussed above. In each instance, the party making the transfer is not in fact a fiduciary but an heir or legatee acting in his own behalf. However, even if the fiduciary provisions are not applicable, it would appear that the suggested issuer's requirements mentioned above are authorized by section 8-402 which provides that the issuer may, when none of the other provisions apply, require "assurance appropriate to the case corresponding as nearly as may be to the foregoing."<sup>61</sup>

It is clear that any instrument which meets the definition of "security" under article 8 falls within the broader definitions of the Texas Securities Act<sup>62</sup> and the federal Securities Act of 1933,<sup>63</sup> and such securities laws are always a problem for the issuer. Anytime securities held by a person in a control relationship with the issuer are presented for transfer, the issuer must be alert to the possibility that sales of unregistered securities by such person will constitute a violation of section 5 of the Securities Act of 1933.<sup>64</sup> Accordingly,

<sup>59</sup> See § 8-308(2)(f) and discussion *supra* note 52.

<sup>60</sup> Section 8-402(4) and discussion *supra* note 45. Section 8-402(3)(b) provides that in the absence of a document showing appointment or a certificate of incumbency the issuer may require other reasonable appropriate evidence and the issuer ". . . may adopt standards with respect to such evidence provided such standards are not manifestly unreasonable. The issuer is not charged with notice of the contents of any document obtained pursuant to this paragraph (b) except to the extent that the contents relate directly to the appointment or incumbency."

<sup>61</sup> Section 8-402(1)(e).

<sup>62</sup> TEX. REV. CIV. STAT. ANN. art. 581-4 (1964).

<sup>63</sup> 48 Stat. 78 (1933), 15 U.S.C. § 77b (1958).

<sup>64</sup> 48 Stat. 77 (1933), 15 U.S.C. § 77e (1958). Probably the two most frequently relied on exemptions to the Securities Act of 1933 which authorize transfers by controlling persons without registration are the limited exemption for "broker's transactions" under § 4(4) of the act and rule 154 of the Securities and Exchange Commission, 78 Stat. 580 (1964), 15 U.S.C. § 77d(4) (1965) and 17 C.F.R. § 230.154(b) (1954), and a type of "private offering" under § 4(2) of the act. While technically the statutory brokers' transaction exemption covers only the broker, if all requirements are met and the controlling person is not an underwriter or engaged in a distribution, he is also protected. See SEC Securities Act Release No. 4818, Jan. 21, 1966. With respect to brokers' transactions see generally ISRAELS,

the issuer will take a substantial risk if it registers the transfer by such a controlling person without satisfying itself that no violation of the act is involved. Under some circumstances responsibility for a violation of the Securities Act of 1933 by failure to register securities falls upon the issuer, even though the sale may be made by persons or under circumstances then beyond the issuer's control.<sup>65</sup> To protect itself, it is recommended that the issuer take at least two initial steps to avoid possible inadvertent violations of the securities acts in registering transfers of securities held by controlling persons or issued in reliance upon the "private offering" exemption. First, certificates issued to persons in reliance on the "private offering" exemption of the 1933 Act, including stock issued upon the exercise of stock options (unless registered under the act)<sup>66</sup> should be conspicuously stamped with a legend giving notice to any subsequent purchaser or broker-dealer to whom the security may be delivered for transfer that the issuer will refuse to register a transfer until it receives satisfactory assurance that no violation of the act is involved.<sup>67</sup> Secondly, to protect the issuer against the transfer of shares not stamped with notice by reason of earlier distribution, or shares acquired by a controlling person in the open market,<sup>68</sup> the issuer should place a so-called "stop-transfer notice" with the transfer agent, applicable to specific certificates registered in specific names. Even if the security is presented for transfer by a bona fide purchaser, the possibility of violation of the Securities Act constitutes an "adverse claim," and the issuer

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S.E.C., PROBLEMS OF CONTROLLING STOCKHOLDERS AND IN UNDERWRITINGS 44, 46-68 (1962); ISRAELS & DUFF, WHEN CORPORATIONS GO PUBLIC 30-32 (1962).

<sup>65</sup> See, e.g., Crowell-Collier Publishing Co., SEC Securities Act Release No. 3825, Aug. 12, 1957; Skiatron Electronics Corp., SEC Securities Act Release No. 4282, Oct. 3, 1960.

<sup>66</sup> As a matter of practice, a substantial number of issuers either request or require that individuals exercising stock options acquire the underlying securities as an investment and not for distribution. If the securities are not covered by an effective registration statement, their distribution violates the act. 48 STAT. 77 (1933); 15 U.S.C. § 77e (1958).

<sup>67</sup> It has been suggested that such securities should be stamped with the following legend:

The shares represented by this certificate have not been registered under the Securities Act of 1933. The shares have been acquired for investment and may not be sold or offered for sale in the absence of an effective Registration Statement for the shares under the Securities Act of 1933 or an opinion of counsel to the company that such registration is not required."

Israels, *Stop-Transfer Procedures and The Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 RUTGERS L. REV. 158 (1962). Once the certificates have been so stamped, it would appear that any subsequent purchaser is on notice that the issuer will refuse registration of the transfer until appropriate assurances have been delivered.

<sup>68</sup> In the past, the Securities and Exchange Commission has taken the position that securities of the same class are fungible, and if a person holds "investment letter stock," any stock sold by him will be presumed to be that held under investment representations, even though the certificates actually delivered were originally acquired in the open market. See generally, ISRAELS, S.E.C. PROBLEMS OF CONTROLLING STOCKHOLDERS AND IN UNDERWRITINGS 36-37.

may delay registration for a thirty-day period and take appropriate steps to protect itself.<sup>69</sup>

Generally, where a "stop-transfer notice" has been placed with the transfer agent, or the issuer has shares registered in the name of a person whose disposition might raise blue sky or securities act questions, the presentation for registration will be made by the seller's broker.<sup>70</sup> Since securities are generally treated as fungible, the seller contracts to deliver certificates representing the agreed number of shares duly indorsed or registered in the name of the buyer.<sup>71</sup> Under the rules and customs of the organized markets, "good" delivery is limited to securities in "street name," or in the name of a living individual or a partnership, which are duly indorsed and with the signature guaranteed.<sup>72</sup> Accordingly, the issuer or its transfer agent is not faced with a request to register a transfer from a bona fide purchaser, but from the seller or his broker. Under these circumstances, counsel for the issuer should request a "no-action letter" from the Securities and Exchange Commission and satisfy himself that all relevant facts set forth in the seller's request for the "no-action letter" are accurate.<sup>73</sup>

Even if presentment for registration is made by a bona fide purchaser after transfer, the issuer may delay the registration for up to thirty days in order to determine whether the transfer would violate the Securities Act.<sup>74</sup> The code provides that a transferor warrants to his purchaser that his transfer is "effective and rightful."<sup>75</sup> Since a transfer in violation of the act clearly breaches this warranty, the bona fide purchaser may either stand on his claim to registration or return the certificates to the seller who must purchase an equivalent certificate not subject to the restrictions for delivery. As a practical matter, the issuer should be able to persuade the seller's broker to purchase and deliver unrestricted securities to the bona fide purchaser.<sup>76</sup>

<sup>69</sup> Section 8-403(2). See text accompanying note 74 *infra*.

<sup>70</sup> It may be presumed that the same will be true in the other so-called "hard" cases, *i.e.*, fiduciaries and cases where there is some question as to who is an appropriate person to indorse. *Israels, Investment Securities Problems*, 11 *How. L.J.* 120 (1965). Note that the presenting broker warrants to the issuer that the transfer is rightful. Section 8-306(5).

<sup>71</sup> Sections 8-301, 8-302.

<sup>72</sup> The organized markets have specific rules. See *Rules of the Board of Governors of the New York Stock Exchange for the Settlement of Contracts; Rules of the American Stock Exchange for Delivery of Securities*, reprinted in 2 *CHRISTY, TRANSFER OF STOCK*, app. D. (1960 ed.). See also the *Uniform Practice Code of the National Association of Securities Dealers, Inc.* §§ 15-39, reprinted in *N.A.S.D. Manual* (March 1964).

<sup>73</sup> *Cf.*, *Kanton v. United States Plastics, Inc.*, 248 F. Supp. 353 (D.N.J. 1965).

<sup>74</sup> Section 8-403.

<sup>75</sup> Section 8-306(2)(a). See also *supra* note 37.

<sup>76</sup> *Israels, Stop-Transfer Procedures and the Securities Act of 1933—Addendum to Uniform Commercial Code—Article 8*, 17 *RUTGERS L. REV.* 158 (1962), reprinted in *ABA, UNIFORM COMMERCIAL CODE HANDBOOK* 247 (1964).

The purchaser is thus made whole, and the issuer's exposure is eliminated. In view of the disciplinary powers of the Securities and Exchange Commission, it is unlikely that the selling broker would refuse to purchase the unrestricted securities for delivery.<sup>77</sup>

It must be kept in mind that, throughout the registration process, the issuer, its transfer agent and its registrar are under a duty to exercise good faith.<sup>78</sup> It seems unlikely that proper notice to the issuer or transfer agent of an adverse claim can be "forgotten" in good faith.<sup>79</sup> The issuer, if it acts without a professional transfer agent, must establish internal procedures for determining (i) what to require before registering, (ii) a means of checking signature guarantees, and (iii) a satisfactory system of noting adverse claims and restrictions on transfer. The code permits the issuer to discharge its duty of inquiry in most cases in a comparatively simple manner.<sup>80</sup> Its greatest exposure to liability lies in the possibility of carelessness with respect to a signature guarantee or overlooking notice of adverse claims.

#### IV. CONCLUSION

Article 8 reduces the scope of an issuer's exposure to liability in connection with the issuance and transfer of securities but also limits its defenses—and all parties concerned are still faced with the same securities laws problems. The issuer must exercise care in the issuance of securities to comply with its articles of incorporation and the provisions of the Business Corporation Act, and to "note conspicuously" any restrictions imposed on transfer. If the issuer does not employ a professional transfer agent, it is essential that the issuer establish regular procedures for registering transfers and thoroughly inform its employees of its responsibilities. Transfers involving fiduciaries are simplified for the issuer, as well as the seller and buyer. In practice, there will be little, if any, change in the procedure for handling most transfers other than those involving fiduciaries. Article 8 codifies, to a great extent, existing law and the customs and practices of the securities markets; and to the extent that it brings innovations, these are generally for the purpose of making securities transactions more expeditious and certain.

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<sup>77</sup> See, e.g., *Tager v. S.E.C.*, 344 F.2d 5 (2d Cir. 1965).

<sup>78</sup> Cf., § 8-406. See also *supra* note 10.

<sup>79</sup> Compare *Graham v. White-Phillips Co.*, 296 U.S. 27 (1935) with *First Nat'l Bank v. Fazzari*, 10 N.Y.2d 394, 179 N.E.2d 493 (1961).

<sup>80</sup> Section 8-403(2).

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