Investment Securities

By Carl S. Bjerre*

This year’s Uniform Commercial Code Investment Securities Survey first covers several cases in Article 8’s direct holding system, starting with a case that strengthens an emerging line of good authority on the “actual seizure” requirement in creditor process. The Survey then turns more briefly to Article 8’s indirect holding system, addressing creditor process in that context as well.

Creditor Process in the Direct Holding System

In Huntington National Bank v. Bywood, Inc., a creditor had a judgment against a guarantor of debt, and sought to execute on shares of stock of an issuer that was wholly owned by the guarantor. The shares of stock were certificated, and in such cases U.C.C. section 8-112(a) provides in pertinent part: “The interest of a debtor in a certificated security may be reached by a creditor only by actual seizure of the security certificate by the officer making the attachment or levy.” This provision, known as the “actual seizure” requirement, makes clear that the creditor must have the levying officer carry out a physical seizure of the certificate, and that a constructive approximation thereof does not suffice.

The reason for the actual seizure requirement goes to an idea that has always been at the heart of Article 8, namely that a security certificate (much like a negotiable instrument) does more than simply provide evidence of the rights that it represents; instead the certificate “reifies” or embodies those rights. If execution of a judgment were permitted without actual seizure, a risk to the issuer would be presented: an innocent party might purchase the security from the still-possessing judgment debtor, thereby presenting the issuer with double exposure (to the judgment creditor or a purchaser from it, and to the purchaser from the judgment debtor).

In this case, the judgment creditor was unable to carry out an actual seizure because the security certificate—according to the guarantor—could not be located. (In a judgment debtor’s examination, the guarantor reported that to the

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* Kaapcke Professor of Business Law, University of Oregon School of Law. Member, Uniform Law Commission; member, Permanent Editorial Board for the Uniform Commercial Code. The views expressed here are the author’s own.

best of his knowledge, the certificate was located in a commercial office building that the issuer had formerly owned; however that building had previously been sold by a receiver who, having inspected the building, had found no stock certificates issued by the issuer.) The question thus became whether the judgment creditor, faced with an inability to comply with the actual seizure requirement, was without a remedy.

The answer lies with subsection 8-112(e), which provides:

A creditor whose debtor is the owner of a certificated security . . . is entitled to aid from a court of competent jurisdiction, by injunction or otherwise, in reaching the certificated security . . . or in satisfying the claim by means allowed at law or in equity in regard to property that cannot readily be reached by other legal process.3

The trial court had misused subsection (e), thinking that it somehow empowered the court itself to issue a replacement for the missing certificate for turnover to the sheriff. The appellate court made clear that no such action was authorized by non-U.C.C. state corporate law, and that subsection (e) itself confers no such substantive power.4 The subsection “simply makes clear that a creditor [seeking to reach a certificated security] is entitled to appropriate aid from courts of competent jurisdiction, a proposition that would surely follow from other state law even in [subsection (e)’s] absence.”5 For example, a judgment debtor that is concealing the location of a certificate might be ordered under subsection (e) to produce it, or a judgment debtor with a certificate located outside of the jurisdiction might be ordered to bring it into the jurisdiction.6

The appellate court also innovatively pointed out, however, that the trial court did have a different power under subsection (e). Specifically, the trial court could order the guarantor to seek—and, if necessary, the issuer to supply—a replacement certificate under U.C.C. section 8-405.7 That section provides that the

3. Id. § 8-112(e).
5. Id. (quoting 7A WILLIAM D. HAWKLAND, JAMES S. ROGERS & CARL S. BJERRE, HAWKLAND’S UNIFORM COMMERCIAL CODE SERIES § 8-112:1 (2017)).
6. E.g., Koehler v. Bank of Bermuda Ltd., 911 N.E.2d 825, 830–31 (N.Y. 2009) (state civil practice provision permits court to order secured party/garnishee to deliver stock certificates owned by judgment debtor to judgment creditor, if court has personal jurisdiction over secured party/garnishee, even if certificates are located outside the state).

Subsection (e) should not be used for ordering the issuer to simply cancel and reissue a certificate that cannot be seized. See, e.g., Detox Indus., Inc. v. Gullett, 770 S.W.2d 954 (Tex. App. 1989), in which the judgment debtor’s only asset was a certificated security that could not be located or seized under the predecessor of subsection 8-112(a), and as an alternative to seizure, the trial court had ordered the issuer to cancel that certificated security and reissue it in the name of a receiver. Id. at 955. On appeal, the majority ruled this order not to be authorized by the predecessor of subsection 8-112(e), because the order would have undermined the actual seizure requirement’s “sound” principle that “all possibility of the security finding its way into a transferee’s hands [be] removed.” Id. at 957 (quoting the comments to section 8-112’s predecessor statute). See also First Nat’l Bank v. Dyes, 638 S.W.2d 957, 959 (Tex. App. 1982) (statute “provides no right to the issuance of a new certificate when the old one cannot be reached”). Yield Dynamics, Inc. v. Zavecz, 2005 WL 3485660, at *1 (Cal. Ct. App. Dec. 21, 2005) (unpublished), is to the contrary, but mistakenly fails to take account of the concerns behind subsection (a)’s actual seizure requirement.
7. U.C.C. § 8-405(a) (2011).
issuer must issue a replacement certificate if its owner claims that the original has been lost, apparently destroyed, or wrongfully taken, provided only that the owner makes the request before the issuer has notice that the original certificate has been acquired by a protected purchaser, files an indemnity bond with the issuer, and satisfies other reasonable requirements imposed by the issuer.\(^8\) This innovative type of subsection (e) order will be unavailing in cases where a judgment debtor does not have assets sufficient to provide the indemnity bond; but in ordinary cases the order could be quite useful, both in preventing false claims that a certificate has been lost, and in backstopping the judgment creditor’s remedy when a certificate truly has been lost.

Ordering the judgment debtor to comply with section 8-405 does impose on the judgment debtor a risk that the indemnity bond will later be drawn on. In such a case the judgment debtor would arguably suffer a double loss: first to the judgment creditor and then to the issuer drawing on the bond. But the first loss is simply the judgment debtor’s fulfillment of its obligations under the judgment; and the second loss, too, is better equitably borne by the judgment debtor than by either the issuer or the protected purchaser of the original certificate, because the judgment debtor is the one that caused the problem by losing the original certificate.

**The Curious Case of the Stolen Certificates that the Victim Didn’t Know He Had Ever Owned**

U.C.C. sections 8-404, 8-405, and 8-406 are related by subject, which is one reason that they are grouped together in the Code. Section 8-404 is a registered owner’s cause of action for wrongful registration (that is, for redress against an issuer’s wrongful deletion of the registered owner from its books and replacement with a new purported owner).\(^9\) Section 8-405 sets forth a registered owner’s right to procure from the issuer a replacement for a certificate that has been lost, apparently destroyed, or wrongfully taken.\(^10\) Section 8-406 imposes a time limit on both causes of action.\(^11\) If a security certificate has been lost, apparently destroyed, or wrongfully taken, and if the owner fails to notify the issuer of that fact within a reasonable time after the owner has notice of it, and the issuer registers a transfer of the security before receiving notification, then the owner’s rights under sections 8-404 and 8-405 are lost.\(^12\) One can think of section 8-406 as a form of estoppel. The owner who has notice that the security has been lost or

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8. *Id.* A protected purchaser is one who meets the requirements (including notably possession) for taking the original certificate free of adverse claims. See *id.* § 8-303(a), (b). In this way, section 8-405 is grounded in exactly the same concern as section 8-112(a)’s actual seizure requirement. Subsection (b) of the statute requires the issuer to honor the rights of the protected purchaser, in most cases.

9. *Id.* § 8-404.

10. *Id.* § 8-405.

11. *Id.* § 8-406.

12. *Id.*
the like is in a better position than the issuer to prevent the wrongful registration of the security in favor of a third party.

*Miele v. Franklin Resources, Inc.*\(^{13}\) is an unusually enthralling case that involves all three of the above statutes. It spans over forty years and involves three protagonists: a father who was a good provider but died young; his ne’er-do-well son, Anthony, who became an illegal sports bookie; and the late father’s friend Gene Mulvihill who allegedly converted Anthony’s assets, selling them without Anthony’s permission but nonetheless paying him.\(^{14}\) The assets in question were over 100,000 shares of Franklin Resources, Inc., the New York Stock Exchange-listed company better known as Franklin Templeton Investments, plus over $180,000 in dividends paid thereon over the years.\(^{15}\) The kicker to the story is that the allegedly converted Franklin shares were largely ones that Anthony did not even know he owned in the first place.

Simplifying greatly in ways that do not affect the Article 8 analysis, the father bought 4,000 shares of the stock in 1973; the father died and ownership of the shares passed to Anthony. In 1992, Anthony, who was then aged twenty-one and had become the operator of an illegal sports bookie operation, received a notice from the Internal Revenue Service. The notice proposed to increase Anthony’s 1989 taxes by about $19,000, attributable to alleged dividend income from Franklin shares plus interest and penalties. But Anthony had not received any such dividend payments, apparently because the shares—most of them resulting from stock splits since 1973—had already been converted through the intervention of the father’s friend, Mulvihill.\(^{16}\)

After reading the first three sentences of the IRS notice, Anthony “kind of freaked out” because it “said that he owed money”\(^{17}\) and Anthony was afraid that this related to his illegal and unreported sports bookie income. He called a trusted family friend—none other than Mulvihill—to ask for advice. Mulvihill steered Anthony to an accountant, who Anthony testified told him, “Pay the tax. You have the money. . . . [T]he IRS is like the legal mafia. You don’t want to mess

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\(^{14}\) This and the three following paragraphs present a simplified and selective version of the dense facts and allegations recounted by the court. Readers seeking a fuller version are directed to the court’s opinion cited above.

\(^{15}\) At the time of this writing, 100,000 shares of Franklin Resources, Inc. were valued at over $3 million. See Franklin Resources, Inc., WALL STREET J., http://quotes.wsj.com/BEN (last visited Apr. 9, 2018).

The direct holding system is involved with an NYSE-listed company apparently because the original purchase of the shares, by Anthony’s father, was so many years ago, at a time when direct holding of such shares was still relatively routine.

\(^{16}\) Mulvihill or someone on his behalf seems to have applied to Franklin for replacement certificates (either for the original 4,000 shares and/or for the later ones issued pursuant to stock splits); indorsed Anthony’s name on them (allegedly without authority); sold them; and—in a commendable step that would not, however, seem to negate the alleged conversion—paid the proceeds over to a trust set up in Anthony’s name. Anthony allegedly did not authorize the sale, and allegedly was not informed of the source of the money. *Miele*, 2017 WL 1407703, at *2–5.

\(^{17}\) Id. at *6.
with them. Just pay it.” So Anthony wound up paying taxes on dividends that he evidently had never received, attributable to stock splits for which he had never received certificates.

The last chapter in this story came twenty years later, when Franklin’s founder and then-chairman Charles Johnson got in touch with Anthony’s family, informing them that he (Johnson) had prevented the shares from escheating to the state in 1986 or 1987—by asking Mulvihill to locate the family. At the time, Mulvihill told Johnson that he had done so and that he had paid Anthony (and other family members) or “otherwise ‘taken care of them.” Johnson had been told that the family was grateful for what Johnson had done, but Johnson wondered why he had not heard from them.

With the outlines of the whole saga now seeming clear to him, Anthony brought claims against Franklin under U.C.C. sections 8-404 and 8-405. (No claim based on conversion or otherwise was brought against Mulvihill, who at some point after 1992 had joined his friend, Anthony’s father, in the great beyond.) The court granted summary judgment in favor of Franklin on both claims, based on section 8-406’s time limitation explained above. The court found that Anthony had been put on notice of the wrongful taking by means of the 1992 IRS notice; that Anthony had not notified Franklin of the wrongful taking within a reasonable time thereafter (twenty years being a “plainly unreasonable” length of time even in the posture of a summary judgment motion); and that the wrongfully taken certificates had been registered to another person in the interim.

Beyond its narrative interest and its value as an illustration of the statute, the court’s opinion offers the opportunity to think carefully about the concept of “notice” to a section 8-406 claimant that his, her, or its shares have been lost, stolen or the like. U.C.C. section 1-202 provides in relevant part that a person “has ‘notice’ of a fact if the person: (1) has actual knowledge of it; . . . ; or (3) from all the facts and circumstances known to the person at the time in question, has reason to know that it exists.” The court, however, ignored the section 1-202 definition and focused on “inquiry notice.” The court explained this

18. Id. at *7. Allegedly the accountant did not ask Anthony whether he had in fact received the payments, advise him to track them down via the Forms 1099, or the like.


21. See supra notes 11–12 and accompanying text.


23. Under the transfer agent’s record retention policy, documentation from any point seven years or more preceding the litigation was no longer available, but representatives of the former and current transfer agents testified that there would be no reason for Anthony’s holdings to be reduced to zero (as they were by the end of 1992), other than as the result of transfer or escheat. Id. at *12–13. The court also noted that Mulvihill’s payment to Anthony in trust, see supra note 16, further substantiated the proposition that there had been a sale.

24. By contrast, there is no issue in this case about the other section 8-406 notice issue, namely Anthony’s “notif[ication]” to Franklin. Id. at *9, *12.


concept using terms such as whether a person “has facts sufficient to put them on inquiry which, if pursued, would lead to the discovery of the [fact in question].”

Inquiry notice, then, differs from section 1-202(a)(3)’s “reason to know” standard. Loosely speaking, section 1-202(a)(3) is about connecting the dots that are already known to the person. By contrast, inquiry notice (not defined in the U.C.C.) is about looking under the rocks that are already known to the person—not just conscious connecting but further investigation. As applied to Anthony and his Franklin shares, the court stressed that the IRS notice had put Anthony on notice of not only the existence of the post-split shares but also their alleged conversion. A reasonable person, wrote the court, would not have stopped reading after a mere three sentences but “would have read on.” And “if” Anthony, after reading the notice, “had contacted Franklin,” the facts “would have shown him” that “his (newly discovered)” Franklin holdings had dwindled, “and that someone forged his signature” on the applications for replacement certificates.

On the facts of this case, the outcome in favor of Franklin may not have been affected. (Perhaps “all the facts and circumstances” that were known to Anthony, including but not limited to the IRS notice, caused Anthony to “have reason to know” that the shares both existed and had been converted. Alternatively, perhaps Franklin would prevail on a defense of laches, which it raised but that the court did not reach.) But the difference between inquiry notice on one hand, and the statutory standard under section 1-202(a)(3) on the other, should be borne in mind, and might be decisive in a different case’s outcome.

A Bit More on Missing Certificates

Turning much more briefly to a second case under section 8-405 (but not sections 8-404 or 8-406), in Moore v. Armed Forces Bank, N.A., a husband had agreed to purchase a 5 percent stake in the issuer. A certificate was presumably issued to the husband at that time. Later, the husband agreed to transfer the stock to his spouse as part of a separation agreement, but no registration of transfer apparently took place. Still later, the spouse passed away; no certificate could be found; and the executor of the spouse’s estate joined the husband in asserting, among other causes of action, the right to a replacement certificate under section 8-405. The claimants apparently failed to file the indemnity bond discussed above, and the issuer refused to replace the certificate. Oddly, this impasse de-

27. Id. (quoting In re Dean Witter P’ship Litig., Civ. A. No. 14816, 1998 WL 442456, at *7 (Del. Ch. July 17, 1998) (emphasis in original)); see also id. (“facts sufficient to make him suspicious, or that ought to make him suspicious”); id. at *10 (“had the plaintiffs read further”); id. (noting that in this case, Anthony “had access to information that, if pursued, would have led to the discovery that something was wrong with the Franklin shares”).
28. Id. at *10.
29. Id. at *10–11.
30. See U.C.C. § 8-103(b) (2011) (principles of law and equity supplement the U.C.C.’s provisions unless displaced).
32. See supra note 8 and accompanying text.
volved into litigation, and the court disposed of the litigation in a questionable way.

At the trial court level, the claimants sued the issuer, without alleging that they had provided the indemnity bond. The issuer moved to dismiss, based on the absence of an allegation that the bond had been provided, and the court granted the motion to dismiss—and surprisingly, the grant of the motion was with prejudice. On appeal, the argument was on the silly question of whether the providing of the bond must be pleaded by the claimant as a prima facie element of its case, or whether the absence of the bond was an affirmative defense for the issuer. (It is not clear whether the bond was in fact provided, or at least tendered. If it was, then the issuer was making much ado about nothing. And if it was not, the claimants were wasting everyone’s time once it became clear that the issuer was not going to waive the requirement.) The court held that the pleading was a required element of the claimants’ case, and the appeal was dismissed. 33

The time-based limitation under section 8-406 34 was not relevant in this case. True, the husband’s original purchase was “over 30 years ago” 35; the husband’s agreement to transfer the shares to his spouse was in 1983; the spouse’s death was in 2009; and the claimants made their claim against the issuer at some point between 2009 and the commencing of the lawsuit in 2015. 36 Depending on when the husband (or the spouse or the executor, as the case may be) acquired notice that the certificate was missing, this might indeed be far beyond section 8-406’s “reasonable time” to notify the issuer. 37 But a claimant loses its rights under section 8-406 only if, before the claimant’s notification to the issuer, the issuer registers a transfer of the security (which will usually be a wrongful registration). 38 No such registration of transfer took place here, so there was no reason to penalize the claimant on the ground of delay alone.

**CREDITOR PROCESS IN THE INDIRECT HOLDING SYSTEM**

Providing a nice closing loop to the Huntington National Bank case with which this Survey began, 39 JPMorgan Chase Bank, N.A. v. Herman 40 does a good job of dealing with creditor process in the indirect rather than the direct holding system. The general rule in such cases is that the creditor may reach the debtor’s interest in a security entitlement “only by legal process upon the securities intermediary with whom the debtor’s securities account is maintained.” 41 As a corol-

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33. Moore, 534 S.W.3d at 326–27.
34. See supra notes 11–12 and accompanying text.
35. Moore, 534 S.W.3d at 325.
36. Id.
37. See supra notes 11–12 and accompanying text.
38. See supra notes 11–12 and accompanying text.
41. U.C.C. § 8-112(c) (2011).
lary to this rule, upper-tier attachment (the directing of process against a higher-tier intermediary or clearing corporation) is not permitted.42

JPMorgan Chase had a judgment against Herman issued by a Florida court; registered the judgment in Connecticut; and sought to enforce it by applying for a turnover order against an account maintained for Herman’s benefit by a Connecticut office of UBS.43

Herman objected that the Connecticut court lacked personal jurisdiction over the assets in question because the security certificates were not physically in Connecticut; instead they were in the possession of the Depository Trust Company (“DTC”) in New York. The lower court granted JPMorgan Chase’s application, however, on the common-sense but non-statutory grounds that DTC “would have to have a legal department of 5000 lawyers if it had to litigate every time somebody had to attach a brokerage account by some individual debtor.”44

The appellate court affirmed, correctly applying section 8-112(c) (quoted above) and offering a useful discussion of how that section interacts with concepts of personal jurisdiction.45 In a post-judgment enforcement proceeding, much less of a nexus is required between the state and the judgment debtor than in an underlying in personam action between the state and the defendant. “[O]nce it has been determined by a court of competent jurisdiction that the defendant is a debtor of the plaintiff, there would seem to be no unfairness in allowing an action to realize on that debt in a State where the defendant has property, whether or not that State would have jurisdiction to determine the existence of the debt as an original matter.”46 For assets held in Article 8’s indirect holding system, of course, the question whether the judgment debtor “has” property in a given state is not completely self-evident, and the court rightly noted that the statute does not address personal jurisdiction issues.47 But proceeding against the Connecticut securities account was fair in this case, ruled the court, because the account was managed personally by a financial advisor working out of UBS’s Stamford office, and because even if Connecticut was an inconvenient forum for the judgment debtor, it had been his own decision to evade the judgment debt elsewhere and to utilize the services of a Connecticut broker.48 Not just any UBS office would be fair, irrespective of what office(s) the account was managed from,49 but in this case the granting of the application for the turnover order

42. See Carl S. Bjerre, Investment Securities, 69 Bus. Law. 1215, 1219–26 (2014) (discussing the general prohibition on upper-tier attachment and a very narrow federal exception, applicable in one case only).
43. Herman, 168 A.3d at 517–18. The UBS account was maintained in the name of a self-settled trust of which Herman was the sole beneficiary. JPMorgan Chase had itself been Herman’s broker at one time, but the enforcement of the judgment did not involve a Herman account at JPMorgan Chase.
44. Id. at 519.
45. Id. at 521–22.
46. Id. at 519–20 (quoting Shaffer v. Heitner, 433 U.S. 186, 210 n.36 (1977)).
47. Id. at 521.
48. Id. at 522.
49. Id. at 522 n.6 (quoting Aurelius Capital Partners, LP v. Republic of Argentina, 2010 WL 768874, at *4 (S.D.N.Y. Mar. 5, 2010)).
had been proper. Also, the UBS corporate entity was the proper garnishee, as distinct from the particular office of that entity from which the account was administered and upon which process was served. 50

An enjoyable related sidelight is In re ATP Oil & Gas Corp., 51 in which a bankruptcy trustee sought to recover preferential payments in the form of dividends on the debtor/issuer’s preferred stock. The trustee futilely issued a subpoena first to the issuer; then to the transfer agent; then to Cede & Co.; and finally (and properly) to the bank custodians that had been revealed by a Cede breakdown. But by the time of these last subpoenas, the one-year statute of limitations 52 had passed! As a last resort, the trustee moved for an equitable tolling of the statute of limitations, lamenting that the chain of holdings was a “never ending ‘rabbit hole.”’53 The court, strangely unmoved, denied the motion. 54

50. Id. at 523–25.
54. Id. at *7–8.