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STORAGE NAME: fsa-cs.hb344

Date: June 17, 1987

HOUSE OF REPRESENTATIVES  
COMMITTEE ON COMMERCE  
FINAL STAFF ANALYSIS

ENACTED BILL #: CS/HB 344

RELATING TO: Securities

SPONSOR(S): Commerce and Representative Canady

EFFECTIVE DATE: October 1, 1987

BECAME LAW: \_\_\_\_\_

CHAPTER 87-, LAWS OF FLORIDA

COMPANION BILL(S): SB 932, SB 1225

OTHER COMMITTEES OF REFERENCE: (1) None

(2) \_\_\_\_\_

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I. SUMMARY:

This bill revises Chapter 678, Florida Statutes, that portion of the Uniform Commercial Code (UCC) dealing with investment securities (i.e., mutual funds), expanding the scope of the chapter to provide rules to regulate the rights, duties, and obligations of the issuers of, and persons dealing with, uncertificated investment securities. Additionally, the bill revises provisions relating to certificated securities in the areas of transfer by delivery, creditors' rights, and creation, perfection, and termination of security interests

A. Current Law & Present Situation:

This proposed revision of Chapter 678 of Florida's Uniform Commercial Code is an outgrowth of the work of the Committee on Stock Certificates of the Section of Corporation, Banking and Business Law of the American Bar Association. That committee, formed in 1971 in response to the "Paperwork Crunch" in the securities market in the late 1960's, was charged with determining what legislation, if any, would be advisable to facilitate the elimination, or the reduction in use, of stock certificates and with drafting such legislation as was proposed.

B. Effect of Proposed Changes:

Perhaps the best approach to describing the scope of the revision is first to state what it does not do. The revision does not compel the issuance of uncertificated securities by any

issuer. What the revision is intended to accomplish is to set forth a coherent group of rules for the issuers, buyers, sellers, and other persons dealing with uncertificated securities, to the same extent that present Chapter 678 deals with these matters with respect to certificated securities. Although the primary focus of inquiry regarding the possible elimination of certificates has been on corporate stock, the revision is broad enough to cover uncertificated debt securities, should such be issued in the future. It is possible that that particular issues of securities may, temporarily or even permanently, be partly certificated and partly uncertificated. If such be the case, the choice of form will lie with the owner and provisions are made for exchangeability at the owner's option. (See Chapter 678, Section 407).

The present definition of "security" (present Chapter 678, Section 102(1)(a)) is restated, in somewhat changed form but without intended change of substance, as the definition of "certificated security" (Chapter 678, Section 102(1)(a)). A parallel definition of "uncertificated security" is then provided, differing in that it does not require representation by an instrument and somewhat narrower in scope to eliminate the inclusion of some interests. e.g., bank accounts, that a broad construction might otherwise include (Chapter 678, Section 102(1)(b)). It is not intended that either definition coincide with the definition of "security" for other purposes, e.g., the federal securities laws.

There has been a conscious attempt to disturb present Chapter 678 as little as possible. First, the subject matter content and order of the numbered sections of the present statute have been preserved. Only four sections have been added; three of these have no application to wholly certificated systems (Sections 108, 407, and 408).

Secondly, with the exception of only two present sections (313 & 317) and the other new section (321), there has been no attempt to change the law with respect to certificated securities. Finally, the rules governing uncertificated securities have been formulated to conform as closely as possible to the rules for certificated securities, consistent, with such changes as are demanded by the absence on an indispensable instrument. For example, the rights of secured parties (Section 207), the "appropriate person" to initiate requests for registration of transfer (Section 308) and the assurances an issuer may require as a condition to complying with such requests (Section 402) have been structured in a way to produce a minimum of disparity of results and procedures whether certificated or uncertificated securities are involved.

The essential difference between a certificated and an uncertificated security, and that from which the principal difficulties arise, is that the former is represented by an

instrument, which may be treated as the property it represents, and the latter is not. Under present Chapter 678, transfer of a certificated security by purchase, a term which includes all voluntary transfers whether or not for value (present Chapter 671, Section 201(32)), is accomplished by delivery of the certificated security to the purchaser (present Chapter 678, Section 301(1)) or by some other method deemed to constitute delivery to the purchaser (present Chapter 678, Section 313(1)). Obviously, when a security is uncertificated, there is no instrument to deliver.

In the revised Chapter 678, the transfer rules are collected in a single subsection (Section 313(1)) and are expressly made exclusive. The basic rule for certificated securities, transfer by delivery, is restated (Section 313(1)(a)) and a coordinate rule for uncertificated securities, transfer by registration, is added (Section 313(1)(b)). The present rule, that delivery to the purchaser's broker of a certificated security issued in the name of or specially indorsed to the purchaser, is preserved (Section 313(1)(c)), but is expanded to cover such delivery not only to the purchaser's broker but to any financial intermediary acting for the purchaser. A "financial intermediary" is defined to include (in addition to brokers) banks, clearing corporations and other entities which regularly maintain security accounts for their customers (Section 313(4)). The remaining subparagraphs of Section 313 recognize current security-holding practices and provide explicitly for the transfer of ownership of both certificated and uncertificated securities controlled by third parties. Thus, when the controlling party is a clearing corporation (Section 102(3)), transfer is effected merely by book entry (Section 313(1)(g)). When the controlling party is a financial intermediary, but not a clearing corporation, transfer is effected by confirmation to the purchaser accompanied by book entry (Section 313(1)(d)). When the controlling party is not a financial intermediary, transfer is effected by acknowledgment to the purchaser (Section 313(1)(e)&(f)). Three provisions apply only to the creation and release of security interests (Section 313(1)(h),(i)&(j)).

Registration of transfer of a certificated security is requested by presenting the security itself, duly indorsed, to the issuer (Section 401(1)). With uncertificated securities that procedure is unavailable and the request for registration of transfer is made by "instruction" (Section 308(4)) which normally will be a signed writing (Section 308(5)(a)) but which may, under the terms of a written agreement, be in other than written form (Section 308(5)(b)). To be effective, an instruction must be originated by an "appropriate person" who, for an unencumbered security, is the registered owner or his representative (Section 308(7)&(8)).

Upon receipt of an instruction, the issuer is under a duty to effect a duly requested registration (Section 401(401)(1)),

liable for delay or failure to comply (Section 401(2)), entitled to certain assurances (Section 402), and liable for improper registration (Section 404(3)) in much the same manner applicable to requests for registration of transfer of a certificated security.

Within two business days after registration of transfer of an uncertificated security, the issuer must send a written statement confirming the registration to both the transferor (Section 408(5)) and the transferee (Section 408(1)). The statement sent to the transferor will alert him to take appropriate action if the transfer was unauthorized or otherwise improper. The statement sent to the transferee will assure him that the transfer has been properly registered and will also serve as notice to him of any liens (Section 103(b)), restrictions 204(b), or claims (Section 304 (2)) to which the uncertificated security may be subject. Unless a transferee for value is relying on a third party, e.g., his broker, it is anticipated that he may withhold his consideration, in escrow or otherwise, until he receives an appropriate statement from the issuer.

A security interest in a certificated security is normally created by delivery (pledge) of the security, duly indorsed, to the secured party (pledgee). The physical procedure is indistinguishable from an outright transfer. The pledgee may elect to leave the security registered in the name of the debtor or to cause the registration of transfer to himself or his nominee.

A security interest in an uncertificated security may be created by registration of transfer to the secured party, a procedure which involves no concepts distinct from those involved in any outright transfer of an uncertificated security. The secured party will be in essentially the same position as pledgee of a certificated security who obtains registration of transfer to himself.

This revision provides an additional method for evidencing a security interest in an uncertificated security -- registration of pledge (Section 108). This is intended to create a situation analogous to that when the pledgee of a certificated security leaves the security registered in the debtor's name. Registration of pledge is effected by submission of an instruction (Section 308(4)) to the issuer, originated by the registered owner or his representative (Section 308(7)(a) & (8)). The procedure for registration follows that established for registration of transfer. The issuer is obligated to send confirmatory statements to the pledgee and owner immediately following registration (Section 408(2)) and the pledgee, like the buyer, may choose to await receipt of the statement before advancing the loan.

Once a pledge has been registered, the registered owner continues to enjoy all the rights of an owner (dividends, voting rights, notices, etc.) (Section 207(2)) except one -- the power to order transfer. That power passes exclusively to the registered pledgee (Section 207(3)) and only the pledgee or his representative is an appropriate person to originate a transfer instruction (Section 308(7)(b)&(8)). This is substantially the situation that exists when a certificated security is pledged. The still registered owner is recognized as such by the issuer (Section 207(1)), but the pledgee's possession of the duly indorsed certificate achieves the dual purpose of depriving the debtor of his power to transfer and conferring that power on the pledgee. The registered pledgee of an uncertificated security may exercise his transfer power in three ways: by outright transfer free of his pledge (Section 207(4)(a)); by transfer of ownership subject to his pledge (Section 207(4)(b)); or, by transfer of his security interest to another secured party (Section 207(4)(c)).

There is one area of disparity between the pledge of a certificated security and the registered pledge of an uncertificated security. When a certificated security is held by a pledgee without registration to transfer, additional securities distributed with respect to the pledged security, e.g., stock dividends, will necessarily be delivered to the registered owner, since the issuer is unaware of the pledgee's interest. When an uncertificated security is subject to a registered pledge, such additional securities will, if uncertificated, be registered subject to the pledge (Section 207(6)(a)) or, if certificated, will be delivered to the pledgee (section 207(6)(b)). This appears to be a desirable result which is impractical to obtain under the pledge of a certificated security. Similarly, securities issued or money paid in exchange for an uncertificated security will be subject to the pledgee's control (Section 207(6)).

Under the revised Chapter 678, the transfer rules are exclusive and expressly include the transfer of security interests (Section 313(1)). Thus, the creation of security interests is conditioned upon the use of an effective means of transfer (Section 321(1)). The transfer rules include the physical delivery of a certificated security (Section 313 (1)(a)) and the registration of either pledge or transfer of an uncertificated security (Section 313(1)(b)). They also include provisions when securities are controlled by third parties. When the controlling party is a clearing corporation (Section 102(3)), transfer is effected by book entry (Section 313(1)(g)). When the controlling party is a financial intermediary (Section 313(4)), but not a clearing corporation, transfer is effected by confirmation to the secured party accompanied by a book entry (Section 313(1)(d)). When the controlling party is not a financial intermediary, e.g., a prior pledgee, transfer is effected by acknowledgment to the secured party (Section

313(1)(e)&(f)). Security interests created by any of these methods are enforceable even without a written agreement signed by the debtor (Section 321(2)) since they involve either possession by the secured party or the functional equivalent thereof.

In addition, three methods of transfer, applicable only to the creation of security interests, are provided (Section 313(1)(h),(i), and (j)). These methods do require a written security agreement signed by the debtor and are included to permit the continuation of practices which result in perfected nonpossessory security interests under present Chapter 679 (Sections 304(4) & 305)) and to document the creation of a security interest in securities already held in the debtor's account by a financial intermediary.

The security interest of the pledgee of a certificated security is both created (present Chapter 679, Section 203(1)(a)) and perfected (present Chapter 679, Section 304(1)) by the secured party's possession. Possessory security interests are expressly exempted from the normal filing requirements of Chapter 679 (Section 302 (1)(a)). A nonpossessory security interest may be perfected by notice to a bailee (Chapter 679, Section 305) or, under certain conditions and for temporary periods, automatically (present Chapter 679, Section 304(4)&(5)).

Under the revised Chapter 678, a security interest which is effectively created is also perfected (Section 321(2)). If the security interest is created under the provision which corresponds to the present provision of Chapter 679 for temporary automatic perfection (Section 313(1)(i)), perfection expires at the end of the 21 day period unless other steps are timely taken (Section 321(2)). Security interests in securities are expressly excluded from the perfection provisions of Chapter 679 (Sections 302(1)(f), 304(1) & (4) and 305).

The security interest of the pledgee of a certificated security is normally released by redelivery of the security to the debtor. Similarly, the security interest in an uncertificated security created by registration of transfer to the secured party is released by registration of transfer back to the debtor. A security interest in an uncertificated security created by registration of pledge is released by registration of release (Section 108). Registration of release is effected by submission of an instruction (Section 308(4)) to the issuer, originated by the registered pledgee or his representative (Section 308(7)(b)&(8)). The procedure for registration follows that established for registration of transfer or pledge. The issuer is obligated to send confirmatory statements to the pledgee and the owner immediately following registration (Chapter 408(3)) and the owner may choose to make arrangements to withhold his repayment until he has received an appropriate statement.

A security interest in securities controlled by a third party would normally be terminated by a transfer back to the debtor under the same method employed for its creation (Section 313 (1)(d),(e),(f),(g),or (h)). Unless the parties otherwise agree, any such transfer will terminate the security interest. Provision is made for temporary continuation of perfection in the case where a certificated security is redelivered to the debtor for limited purposes (Section 321(4)), analogous to similar provisions in Chapter 679 (Section 304(5)).

When a security is certificated, the security itself, if genuine, is prima facie evidence of the holder's rights (Section 105(3)(c)). When a security is uncertificated, a similar, but distinctly more limited, function is served by the initial transaction statement (hereinafter "ITS"). The ITS is a signed statement sent by the issuer of an uncertificated security upon registration of transfer, pledge or release to the transferee, pledgee or owner, respectively (Section 408(4)). Like certificated securities, an ITS acts as an estoppel statement against the issuer. But unlike certificated securities, an ITS runs in favor of only the addressee and speaks only as of the time of its issuance (Section 105(3)(d)). Consequently, parties other than the addressee, particularly subsequent purchasers, cannot justifiably rely on what an ITS does or does not contain. The statute requires a warning legend to that effect (Section 408(9)).

The purchaser of an uncertificated security is charged with notice of the issuer's right to a lien (Section 103(b)), terms of a security (Section 202(1)), restrictions on transfer (Section 204(b)) and adverse claims (Section 304 (2)) which appear or are referred to in the ITS sent to him. Conversely, the purchaser for value without notice who receives an ITS which does not refer to defects or defenses is normally entitled to assume that none exists. Furthermore, the purchaser for value without notice who receives an ITS is generally entitled to assume that the uncertificated security referred to therein is valid (Section 202(2)(a)), that, in many cases, it has been properly signed, even when it has not (Section 205), that it has been properly completed, even when it has not (section 206(3)(b) and receives the benefit of certain warranties of third party signatories (section 208(1)). Finally, the purchaser for value without notice who receives an ITS enjoys a limitation in the warranties he has made in connection with the presentation of a certificated security to the issuer (section 306(1)) and is shielded from liability to a former owner or pledgee (section 311(a)). In these respects, the ITS serves substantially the same function for the addressee as does a certificated security.

All securities of the same issue, both certificated and uncertificated, are treated as fungible. Thus, when an issue of securities is comprised of both certificated and uncertificated securities, a person obligated to transfer securities of that



issue may perform either by delivering duly registered or indorsed certificated securities to his obligee or by causing the registration of transfer of equivalent uncertificated securities to his obligee (section 107(1)). Similarly, the buyer of securities becomes obligated to pay the price whether the securities transferred to him are certificated or uncertificated (section 107(2)).

The person who requests an issuer to register the transfer of a certificated security, by presenting a duly indorsed certificated security, warrants to the issuer that he has the power to do so, or, in effect, that the chain of indorsements is genuine and complete (section 306(1)). In making that warranty, the presenter, who in the typical case, is, or acts for, the transferee, has before him, as evidence, the security, the indorsements and signature guarantees. On the other hand, the person who requests an issuer to register the transfer (or pledge or release) of an uncertificated security does so by presenting an instruction, which is not even presumptive evidence that the originator is the registered owner or pledgee involved. Hence, the presenter, as such, warrants nothing to the issuer that he will be, at the time of presentation, an appropriate person to originate the instruction and entitled to the requested registration -- facts which he, and perhaps no one else, knows (section 306(5)).

The signature guarantee, which is an essential element of the transfer process for widely-held securities, presents a special problem. The signature guarantor of the indorsement of a certificated security warrants that the indorser is an appropriate person, i.e., that he is, or acts for, the owner (section 312(b)). To make a similar undertaking with respect to the originator of an instruction to transfer (or pledge or release) an uncertificated security, the signature guarantor, without a certificated security, prior indorsements and signature guarantees before him, would have to warrant a fact of which he has no evidence -- that the originator is, or acts for, the registered owner or pledgee. That fact, however, will be known to the issuer and since the issuer is the only person who must act on the instruction, there is no need to require the signature guarantor's warranty. Hence, the warranties of the signature guarantor of an instruction are limited to genuineness, capacity and the fact that the signer is, or acts for, the purported owner or pledgee (section 312(2)). The originator himself warrants to the issuer that he is the appropriate person (section 306(5)).

The concept of bona fide purchase applies to both certificated and uncertificated securities (section 302(1)). The difference is that the purchaser of a certificated security is charged with notice only of what appears when he or a person acting in his behalf takes delivery of the security while the purchaser of an uncertificated security is charged with notice of what appears in the initial transaction statement set to him.

Thus, the purchaser of a certificated security without notice takes free of liens (section 103(a)), terms of a security which may be defenses (section 202(1)), and restrictions (section 204(a)) not noted in the security. He may also take free of any adverse claim (section 302(3)) unless the nature of the claim is such that it would be disclosed by the security itself (section 304(1)). The purchaser of an uncertificated security without notice, however, is charged with notice of liens (section 103(b)), defenses (section 202(1)) and restrictions (section 204(b)) noted in the initial transaction statement sent to him. He is also charged with notice of adverse claims shown in the initial transaction statement (section 304(2)). Only when he has received a clean initial transaction statement can he be sure that he enjoys bona fide purchaser status (section 302(1)(b)).

The treatment of adverse claims presents a very special kind of problem. With certificated securities they are communicated by mere written notification to the issuer (section 403(1)). They do not normally constitute a serious problem because they can be so easily defeated by the transfer of the security to a purchaser without knowledge (section 302(3)). The rules for certificated securities have, therefore, been preserved (section 403(1),(2) &(3)).

With uncertificated securities, however, the rules become unworkable because transfer is accomplished only by communication with the issuer (section 313(1)(b)) and the purchaser is charged with notice of whatever appears in the initial transaction statement sent to him (section 304(2)). Consequently, new rules have been developed for uncertificated securities. They require that a third party claim be embodied in legal process in order to make it cognizable to the issuer (section 403(4)(a)). They also permit, under certain circumstances, the registration of transfer or pledge subject to an adverse claim (section 403(5)). Finally, they provide protection to a registered pledgee who attained bona fide purchaser status prior to the time that notice of a cognizable adverse claim reached the issuer (section 403(6)).

The general rule of present Chapter 678, that no judicial lien on a debtor's interest in a security is valid until the security is actually seized (present section 317(1)) is wholly inapplicable to uncertificated securities and, in light of widespread nominee registration, depository systems and the like, has become inadequate even with respect to certificated securities. That rule is retained only for certificated securities in the debtor's control (section 317(1)). Uncertificated securities registered in the debtor's name may be reached only by service upon the issuer (section 317(2)). The interest of a debtor in either certificated or uncertificated securities under the control of secured parties or financial intermediaries is reached by service upon the controlling party (section 317(3)&(4)). When a debtor's interest in securities controlled by a third party is subject to a judicial lien, provisions are made for the transfer

of such securities, free of the lien, and the shifting of the lien to the proceeds in the hands of the third party (section 317(5)).

The increasing incidence of nominee registration in brokerage accounts, bank custody accounts, security depositories, and otherwise has led to new and expanded provisions regarding the rights of creditors (section 317). The same phenomenon has also led to a revision of the general transfer rules by substituting the broader category of "financial intermediary" (section 313(4)) where only "broker" formerly appeared (section 313(1)(c)&(d),(2)&(3)).

II. ECONOMIC IMPACT:

A. Public:

None

B. Government:

None

III. STATE COMPREHENSIVE PLAN IMPACT:

No significant impact.

IV. COMMENTS:

Statement of Substantial Changes: Five technical and two substantive amendments were added to create Committee Substitute for House Bill 344.

The first substantive amendment adds the language or uncertificated after the word certificated on line 21 of page 12 to provide that the defenses of an issuer of an uncertificated as well as a certificated security are ineffective against a purchaser who did not know about the defense. The second substantive amendment substitutes (d)1. for (d),(i) on line 8 of page 19, so as not to refer to the wrong section of the bill.

V. LEGISLATIVE HISTORY:

A. Enacted Bill:

House Bill 344 was filed by Representative Canady on March 3, 1987 and referred to the Committee on Commerce. The bill was subreferred to the Subcommittee on Banking and Commerce and was taken up on April 15. It was amended and recommended favorably

as a Proposed Committee Substitute. The Full Committee on Commerce reported the bill favorably as a Committee Substitute on April 22.

The Committee Substitute was placed on the Calendar on April 24, and on the Special Order Calendar on April 29, (HJ-00278). On May 6, the bill passed as amended by a 108-0 vote (HJ-00370).

On May 5, the Committee Substitute was received in Messages. On May 19, the bill was referred to the Senate Committee on Commerce and the Senate Committee on Judiciary-Civil (SJ-00331). The Senate Committee on Commerce reported the Committee Substitute favorably on May 25, (SJ-00417). On June 5, the Committee Substitute was withdrawn from Judiciary-Civil and substituted for Senate Bill 1225. It passed by a vote of 33 - 0 and was ordered enrolled.

B. Disposition of Companion:

Senate Bill 932 was filed by Senator Crawford on April 10, 1987. On April 23, it was introduced and referred to the Senate Committee on Commerce and the Senate Committee on Judiciary-Civil (SJ-00148). The bill died in the Senate Committee on Commerce on June 6, 1987.

Senate Bill 1225 was filed by Senator Crawford on April 15, 1987. It was referred to the Senate Committee on Commerce and the Senate Committee on Judiciary-Civil on April 28, (SJ-00212). On May 25, the Senate Committee on Commerce reported the bill favorably (SJ-00417). On June 3, the bill was withdrawn from Judiciary-Civil and placed on the Calendar (SJ-00683). The bill was placed on the Special Order Calendar, laid on the table on June 5 and the identical Committee Substitute for House Bill 344 was taken up (SJ-00829).

VI. PREPARED BY:

Gerry York

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VII. STAFF DIRECTOR:

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