

Permanent Editorial Board for the Uniform Commercial Code

PEB COMMENTARY NO. []

**ROLE OF SECTION 1-305(b) IN SUPPORTING ENFORCEMENT OF
RIGHTS AND OBLIGATIONS**

Draft for Public Comment

March 4, 2021

Comments on this draft must be submitted by no later than May 3, 2021.

Comments may be submitted by email to UCCComments@ali.org

**This draft has been approved for publication by the PEB
subject to revisions based on comments received.
The PEB reserves the right to withdraw this proposed PEB Commentary.**

PREFACE TO PEB COMMENTARY

The Permanent Editorial Board for the Uniform Commercial Code acts under the authority of the American Law Institute and the Uniform Law Commission (also known as the National Conference of Commissioners on Uniform State Laws). The Permanent Editorial Board has resolved to issue from time to time supplementary commentary on the Uniform Commercial Code to be known as *PEB Commentary*. These *PEB Commentaries* seek to further the underlying policies of the Uniform Commercial Code by affording guidance in interpreting and resolving issues raised by the Uniform Commercial Code and/or the Official Comments. The Resolution states that:

The underlying purposes and policies of the *PEB Commentary* are those specified in UCC Section 1-103(a). A *PEB Commentary* should come within one or more of the following specific purposes, which should be made apparent at the beginning of the Commentary: (1) to resolve an ambiguity in the UCC by restating more clearly what the PEB considers to be the legal rule; (2) to state a preferred resolution of an issue on which judicial opinion or scholarly writing diverges; (3) to elaborate on the application of the UCC where the statute and/or the Official Comment leaves doubt as to the inclusion or exclusion of, or application to, particular circumstances or transactions; (4) consistent with UCC Section 1-103(a)(2), to apply the principles of the UCC to new or changed circumstances; (5) to clarify or elaborate upon the operation of the UCC as it relates to other statutes (such as the Bankruptcy Code and federal and state consumer protection statutes) and general principles of law and equity pursuant to UCC Section 1-103(b); or (6) to otherwise improve the operation of the UCC.

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INTRODUCTION

UCC § 1-305(b) provides, “Any right or obligation declared by [the Uniform Commercial Code] is enforceable by action unless the provision declaring it specifies a different and limited effect.” This foundational section supports many substantive Code provisions by ensuring that a remedy is available where appropriate, even when no remedy is expressly specified in the substantive provision itself.

DISCUSSION

Section 1-305(b)’s functioning is exemplified by UCC Article 8’s indirect holding system, in which indirect ownership of investment securities or other financial assets is carried out by means of book entries in an entitlement holder’s securities account. Article 8 imposes certain duties on the securities intermediary to provide the entitlement holder with the economic and other incidents of the ownership. In particular:

- UCC § 8-504 requires the securities intermediary to maintain financial assets sufficient on an aggregate basis to satisfy the security entitlements that it has established;
- UCC § 8-505 requires it to take action to obtain payments or distributions made by the issuer;
- UCC § 8-506 requires it to exercise rights related to the security or other financial asset if so directed by the entitlement holder;
- UCC § 8-507 requires it to comply with orders to transfer or redeem the financial asset; and
- UCC § 8-508 requires it to change the security entitlement into another available form of holding.¹

However, Article 8 does not itself directly provide any express remedy to an entitlement holder for violations of these duties by its securities intermediary.² Possible interpretive questions might accordingly arise, but are resolved by reference to § 1-305(b).

Suppose that Broker maintains a securities account for Customer; 1,000 shares of Issuer are credited to that account; Customer wishes to hold the Issuer shares directly in certificated form rather than in the securities account, and directs Broker to debit her securities account and forward her a security certificate; however Broker fails to comply. Assuming no further facts

¹ Each of these duties is generally subject to further specification by agreement between the securities intermediary and the entitlement holder, and is also satisfied by compliance with other statute, regulation or rule if the substance of the duty is the subject of that other statute, regulation or rule. UCC § 8-509(a).

² Section 8-507(b) does contain a provision regarding remedies, but it is a remedy for the securities intermediary’s having acted upon an ineffective entitlement order, rather than having failed to act upon an effective entitlement order under § 8-507(a).

would excuse Broker's failure to comply,³ Broker is in violation of its duty under § 8-508. Section § 1-305(b) accordingly provides that Customer is entitled to enforce her right by action, whether for applicable money damages, equitable relief, or otherwise.

In *Harris v. TD Ameritrade, Inc.*, 805 F.3d 664 (6th Cir. 2015), which involved facts paralleling this illustration at a high level of generality, the court held that the customer – as opposed to perhaps the Securities and Exchange Commission or another governmental agency – had no right of action for the securities intermediary's breach of its obligation under § 8-508. The court's reasoning was that no right of action was stated in § 8-508 itself, and that applicable state law did not permit the court to find an implied private right of action. In this respect the court saw § 8-508 as being on a footing similar to that of SEC Rule 15c3-3 (also invoked by the plaintiffs in the case), for which federal precedents have denied an implied private right of action. But the court mistakenly failed to consider § 8-508 in conjunction with § 1-305(b), which (as noted above) provides that the securities intermediary's obligation to its entitlement holder is “enforceable by action” and thereby creates an express right of action for the entitlement holder.⁴

The same is generally true throughout the Code, including for the other duties of a securities intermediary described above. For example, if Broker had failed to take action to obtain payment for Customer of a dividend declared by Issuer; failed to vote or exercise warrants as directed by Customer; or failed to liquidate holdings of the stock when directed by Customer, then § 1-305(b) would enable Customer to enforce her rights for these violations by action, despite the silence about such enforcement in the respective texts of §§ 8-504, 8-505, 8-506, or 8-507 themselves.⁵

A contrary understanding, in addition to neglecting the express provision of § 1-305(b), would be inconsistent with the purposes and policies of Article 8's and many of the Code's other substantive provisions. See § 1-103(a) (UCC “must be liberally construed and applied to promote its underlying purposes and policies”). The UCC provides the framework for a multitude of consensual business transactions among private parties who routinely rely on the ready enforceability of those transactions. Accordingly, the law cannot generally relegate those parties, if harmed by the violation of a right or the non-fulfillment of an obligation, to possible vindication by governmental rather than independently initiated enforcement.

³ For example, certain securities are available for ownership only in book-entry form, and § 8-508 applies only to forms of holding for which the entitlement holder is “eligible.” Other securities may be available for direct holding only in uncertificated rather than certificated form. Or third parties such as a higher-tier intermediary, transfer agent or indenture trustee may not cooperate in the issuance of the certificate.

⁴ This Commentary expresses no view on whether the court could have reached the same outcome based on other reasoning, such as the express or implied terms of the account agreement.

⁵ A breach of the securities intermediary's duty under § 8-504, unlike under §§ 8-505 through 8-508, is unlikely to result in any loss to the entitlement holder so long as the securities intermediary fulfills its duties under §§ 8-505 through 8-508. The duty under § 8-504 operates at an explicitly “aggregate” level, with the goal of “all” entitlement holders' property interests with respect to a given financial asset being fully adequate to support, when necessary, the economic and other rights for which §§ 8-505 through 8-508 provide. See also §§ 8-501(c) (existence of security entitlement is independent of whether the securities intermediary actually holds the corresponding financial asset); 8-503(b) and (c) (an entitlement holder's property interest under subsection § 8-503(a) is pro rata but enforceable against the securities intermediary only by exercise of the entitlement holder's rights under §§ 8-505 through 8-508).

CONCLUSION

Like all UCC rights and obligations that have no contrary specification, a securities intermediary's Article 8, Part 5 duties are enforceable by action as defined in § 1-201(b)(1). The Official Comments to §§ 1-305 and 8-102 are hereby amended as follows:

§ 1-305, Comment 2

Under subsection (b), any right or obligation described in the Uniform Commercial Code is enforceable by action, even though no remedy may be expressly provided other than in this section, unless a particular provision specifies a different and limited effect. Whether specific performance or other equitable relief is available is determined not by this section but by specific provisions and by supplementary principles. Cf. Sections 1-103, 2-716.

§ 8-102, Comment 17:

“Security entitlement” means the rights and property interest of a person who holds securities or other financial assets through a securities intermediary. A security entitlement is both a package of personal rights against the securities intermediary and an interest in the property held by the securities intermediary. A security entitlement is not, however, a specific property interest in any financial asset held by the securities intermediary or by the clearing corporation through which the securities intermediary holds the financial asset. See Sections 8-104(c) and 8-503. The formal definition of security entitlement set out in subsection (a)(16) of this section is a cross reference to the rules of Part 5. In a sense, then, the entirety of Part 5 is the definition of security entitlement. The Part 5 rules specify the rights and property interest that comprise a security entitlement.

If a securities intermediary does not perform its obligations to its entitlement holder under the Part 5 rules, the entitlement holder has a right of action against the securities intermediary under Section 1-305(b).