Securities Law and the UCC: When Godzilla Meets Bambi

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I. INTRODUCTION

Federal securities laws affect the lender/borrower relationship and a lender's ability to dispose of its collateral (if the collateral is a security) and should be taken into account in transaction planning, loan documentation, and exercise of remedies.[1] In particular, finance lawyers should be aware of intersections of (and differences between) the securities laws and Uniform Commercial Code ("UCC") Articles 8 and 9.[2] This article discusses three areas of intersection between the securities laws and the UCC:

- Differences between the securities law and UCC definitions of "security"
- SEC no-action letters on how to conduct a disposition of securities held as collateral that is a "public sale" (for purposes of Article 9 self-help remedies available to a secured lender) but does not require registration of the sale under the federal securities laws

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[1] In addition to the intersections between the securities laws and the UCC that are discussed in this article, the securities laws can affect finance transactions in a number of ways. Securities law issues affecting the lender/borrower relationship include: (i) loan agreement terms (e.g. representations and warranties, covenants and defaults relating to securities matters, including the Sarbanes-Oxley Act); (ii) 8-K disclosure requirements applicable to the borrower; and (iii) the effect of the Investment Company Act and the Public Utility Holding Company Act on the enforceability of transactions. The Public Utility Holding Company Act has been repealed, effective in February 2006, by the recently enacted Energy Policy Act of 2005. See Pub. L. No. 109-058, §§ 1263, 1274. The Federal Reserve Board's margin regulations are promulgated under the Securities Exchange Act of 1934 (the "1934 Act"), and may affect the economic terms of finance transactions in which certain types of securities are the direct or indirect security for a loan. Securities law issues are faced by a lender with "inside information" that wants to dispose of securities that it holds as collateral. Many aspects of the effect of the securities laws on finance transactions were addressed at the program titled "When Godzilla Meets Bambi: Securities Law Issues for Finance Lawyers" presented by the Commercial Financial Services Committee at the ABA Business Law Section Spring 2005 Meeting. The materials from that program are available to Section members at http://www.abanet.org/abanet/common/login/securedarea.cfm?areaType=premium&role=cl&url=/buslaw/mo/premium-cl/programs/spr05/45/45.pdf and http://www.buslaw.org/cgi-bin/controlpanel.cgi?committee=CL190000&info=Materials or from the author (lynn.soukup@pillsburylaw.com), who was the program chair. Thanks to Scott Holz, Legal Division, Board of Governors of the Federal Reserve System; Karl Groskaufmanis, Fried, Frank, Harris, Shriver & Jacobson LLP; and Mary Anne O'Connell, Husch & Eppenberger, LLC, for their participation in that program.

[2] References to "Article 9" (or to "section 9-xxx") are to the 2002 Official Text of Article 9 of the UCC, and references to "Former Article 9" (or to "former section 9-xxx") are to the 1995 Official Text of Article 9 of the UCC. References to "Article 1" (or to "section 1-xxx") are to the Official Text of Article 1 of the UCC as it existed prior to the 2001 revisions, and references to "Revised Article 1" (or to "revised section 1-xxx") are to the 2001 Official Text of Article 1 of the UCC. References to "Article 8" (or to "section 8-xxx") are to the 2002 Official Text of Article 8 of the UCC.

References to "Articles," "sections" and "Official Comments" are to Articles and sections of and Official Comments to the UCC, unless otherwise specified. Except where specifically noted, this article does not address state variations from the Official Text of the UCC. A discussion of state variations from the Official Text of Article 9 is provided in Penelope Christophorou, Kenneth Kettering, Lynn Soukup & Steven Weise, *Under the Surface of Revised Article 9: Selected Variations in State Enactments from the Official Text of Revised Article 9*, 34 UCC L.J. 331 (2002).

- Article 8 "protected purchaser" status, notice of adverse claims and SEC Rule 17f-1 (which creates a statutory obligation of certain lenders to confirm that securities to be taken as collateral have not been reported as lost, stolen, missing, or counterfeit)

II. SECURITIES LAW AND UCC DEFINITIONS OF "SECURITY"

The definition of "security" is different under the UCC and the securities laws. [3] This difference is important in describing collateral in security agreements and financing statements, determining the appropriate method of perfecting a security interest (and related priority issues) and determining whether protected purchaser status under Article 8 is available (all of which depend on the UCC definition of security),[4] and determining whether the securities laws will apply to a disposition of the collateral (which will depend on the securities law definition).[5]

This discussion summarizes how the term security is defined in UCC Articles 8 and 9 and under the securities laws, and highlights some of the differences between the two definitions. In any specific transaction or dispute, the specific facts and the applicable legal authority should be reviewed.

A. UCC DEFINITION OF "SECURITY"

Articles 8 and 9 define a "security" as follows:[6]

> "Security," except as otherwise provided in Section 8-103, means an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer:

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[3] For additional discussion of the UCC law definition of "security" and comparison with the securities law definition of "security," see Egon Guttman, Modern Securities Transfers §§1:1-1:20 (3d ed. 2004) (Vols. 28 & 28A, Securities Law Series (West)).

[4] For a discussion of the perfection, priority, and protected purchaser issues, see Lynn A. Soukup, *It's a Matter of Collateral: LLCs, Partnerships and the UCC*, 14 Business Law Today 53 (Jan./Feb. 2005). Protected purchaser status is also discussed in Part IV of this article.

[5] For a discussion of the securities law registration issues relating to disposition of securities that are held as collateral, see Part III of this article and the materials cited in note 1 supra.

[6] Section 8-102(a)(15); section 9-102(b) incorporates the Article 8 definition of "security" into Article 9.

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

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

(iii) which:

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

(B) is a medium for investment and by its terms expressly provides that it is a security governed by this Article [8].[7]

For example, publicly traded stocks and bonds, U.S. government securities, and shares of mutual funds are Article 8 and 9 securities, while money market instruments (e.g. commercial paper, banker's acceptances, and certificates of deposit) may or may not be Article 8 and 9 securities (depending on their specific terms), and publicly traded stock options (issued and cleared through the Options Clearing Corporation) are not securities.[8]

Section 8-103 provides rules for determining whether certain obligations and interests are securities, including:

- a share or similar equity interest issued by a corporation, business trust, joint stock company, or similar entity is a security
- an "investment company security" is a security—investment company security: (i) means a share or similar equity interest issued by an entity that is registered as an investment company under the federal investment company laws, an interest in a unit investment trust that is so registered, or a face-amount certificate issued by a face-amount certificate

[7] See also Official Comment 15 to section 8-102.

[8] See section III.C of the Prefatory Note to Article 8. See also Official Comment 12 to section 9-102 (analyzes certificates of deposit as being deposit accounts or instruments). The definition of "deposit account" in section 9-102(a)(29) specifically excludes "investment property" (which is defined in section 9-102(a)(49) to include a security).

company that is so registered; and (ii) does not include an insurance policy or endowment policy or annuity contract issued by an insurance company

- an interest in a partnership or limited liability company is not a security unless: (i) it is dealt in or traded on securities exchanges or in securities markets; (ii) its terms expressly provide that it is a security governed by Article 8;[9] or (iii) it is an investment company security[10]
- a certificate that meets the requirements of a security under Article 8 is not a negotiable instrument governed by Article 3
- an option or similar obligation issued by a clearing corporation to its participants is not a security

Article 8 distinguishes between a "security" (i.e. an interest, whether certificated or uncertificated, held directly on the books of or maintained for the issuer of the interest—the "direct holding system") and a "security entitlement" (i.e. an interest held through an intermediary, such as a broker or clearing corporation—the "indirect holding system").[11] Whether a security entitlement is a security for purposes of the securities laws depends on what the underlying interest is for securities law purposes.[12]

Section 8-102(d) provides that the characterization of a person, business, or transaction for purposes of Article 8 does not determine the characterization of the person, business, or transaction for purposes of any other law, regulation, or rule.[13]

B. SECURITIES LAW DEFINITION OF "SECURITY"

Section 2(a) of the Securities Act of 1933, as amended (the "1933 Act"), defines a security as:

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[9] "Opting" to have a partnership or LLC interest treated as a security for purposes of Articles 8 and 9 is discussed in Lynn A. Soukup, *It's a Matter of Collateral: LLCs, Partnerships and the UCC*, 14 Business Law Today 53 (Jan./Feb. 2005).

[10] As described below, the securities law treatment of an LLC or partnership interest as a security depends on management control and similar factors rather than the factors established in section 8-103.

[11] Compare section 8-102(a)(15) (definition of security) and section 8-102(a)(17) (definition of "security entitlement"). Section 9-102(b) incorporates the Article 8 definitions of "security" and "security entitlement" into Article 9. The direct and indirect holding systems (and the differences between securities and securities entitlements) are described in the Prefatory Note to Article 8.

> any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

The securities laws apply to "the countless and variable schemes devised by those who seek the use of money of others on the promise of profits."[14] There have been many cases addressing whether an asset is (or is not) a security for purposes of the securities laws—for example, based on the facts of a particular case, assignments of oil leases, interests in orange groves, pooled receipts from rental condominiums shared on a pro rata basis, contracts for the purchase of lots

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[12] Sections 8-102(a)(9) (defining "financial asset" to include any property a securities intermediary has agreed to treat as a financial asset) and 8-501 (acquisition of a securities entitlement occurs through crediting of a financial asset to the customer's account) make clear that many types of property can be a security entitlement. See Howard Darmstadter, *A Brief Historical Introduction to Article 8* (giving the example of a crate of oranges becoming a financial asset), included in the program materials for the ABA Business Law Section Spring 2003 Meeting program "Even If You are a Real Estate/ Securities/ Corporate/ Partnership/ Emerging Company/ Finance Lawyer: What Every Lawyer Needs to Know About UCC Article 8" (April 4, 2003) (available from the author (lynn.soukup@pillsburylaw.com)) and included in the materials for the June 25, 2003 ABA Center for Continuing Legal Education program "What Every Lawyer Needs to Know About UCC Article 8" (program information available at www.abanet.org/cle/programs/nosearch/tuccmo.html).

[13] See section III.C.12 of the Prefatory Note to Article 8 ("Traded stock options are also a good illustration of the point that the classification issues under Article 8 are very different from classification under other law, such as the federal securities laws. See Section 8-102(d). Stock options are treated as securities for purposes of federal securities laws, but not for purposes of Article 8.").

[14] *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 299, 66 S. Ct. 1100, 90 L. Ed. 1244, 163 A.L.R. 1043 (1946).

in a real estate development involving mutual shared risks, variable annuity contracts, viatical settlements, flexible fund annuities, warehouse receipts, withdrawable capital shares in a savings and loan association and an interest in a jumbo certificate of deposit have been held to be securities, while shares of "stock" in a nonprofit housing cooperative and other types of cooperatives, interests in a noncontributory compulsory pension plan and some promissory notes have been held not to be securities.[15]

In evaluating what assets are securities for purposes of the securities laws, the courts have primarily addressed three areas:[16]

(1) whether an asset is an "investment contract" and therefore included in the definition of security (the *Howey* test),[17]

(2) when an asset called "stock" is a security (the *Landreth* test);[18] and

(3) when a note is a security (the *Reves* test).[19]

In applying the *Howey* test to determine whether an asset is an "investment contract" and therefore a security, the courts have looked for "the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."[20]

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[15] For a detailed analysis of the definition of security under the federal securities laws and related case law, see II Louis Loss & Joel Seligman, Securities Regulation Chapter 3.A (3d ed. 1999 and 2005 Supp). See also Steven Mark Levy, Regulation of Securities: SEC Answer Book Q 1:7-Q 1:10, 1-7 to 1-10 (3d. ed. 2004).

[16] See II Louis Loss & Joel Seligman, Securities Regulation Chapter 3.A (3d ed. 1999 and 2005 Supp).

[17] *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 299, 66 S. Ct. 1100, 90 L. Ed. 1244, 163 A.L.R. 1043 (1946); *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 95 S. Ct. 2051, 44 L. Ed. 2d 621, Fed. Sec. L. Rep. (CCH) P 95206 (1975).

[18] *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 105 S. Ct. 2312, 85 L. Ed. 2d 692, Fed. Sec. L. Rep. (CCH) P 92047 (1985).

[19] *Reves v. Ernst & Young*, 494 U.S. 56, 110 S. Ct. 945, 108 L. Ed. 2d 47, Blue Sky L. Rep. (CCH) P 73213, Fed. Sec. L. Rep. (CCH) P 94939 (1990).

The three tests are not exclusive—even if a note or stock is not a security under the tests specific to those assets types, the investment contract test and other aspects of the definition of security should also be considered. See II Louis Loss & Joel Seligman, Securities Regulation 924-31 (3d ed. 1999 and 2005 Supp).

[20] *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852, 95 S. Ct. 2051, 44 L. Ed. 2d 621, Fed. Sec. L. Rep. (CCH) P 95206 (1975).

With respect to whether an asset that is called "stock" is a security, the *Landreth* case states that such an asset is a security if it has some of the significant characteristics typically associated with stock:

(1) the right to receive dividends contingent on an apportionment of profits;

(2) negotiability;

(3) the ability to be pledged or hypothecated;

(4) the conferring of voting rights in proportion to the number of shares owned; and

(5) the capacity to appreciate in value.[21]

There is no definitive test for how many of these factors must be present—the determination is whether there are enough of these indicia associated with the stock that it is a security.[22] Shares with fixed dividend preferences, mandatory redemption provisions or transfer restrictions, and nonvoting stock can still be a security.[23] Stock in a housing or other cooperative corporation often is not a security.[24]

With respect to whether an asset called a "note" is a security, the *Reves* case creates a presumption that a note is a security unless it bears a "strong resemblance" to one of the following types of instruments (which are not securities):

(1) a note delivered in a consumer financing;

(2) a note secured by a mortgage on a home,

(3) a short-term note secured by a lien on a small business or some of its assets;

(4) a note relating to a "character" loan to a bank customer;

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[21] *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 686, 105 S. Ct. 2312, 85 L. Ed. 2d 692, Fed. Sec. L. Rep. (CCH) P 92047 (1985).

[22] *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 686, 105 S. Ct. 2312, 85 L. Ed. 2d 692, Fed. Sec. L. Rep. (CCH) P 92047 (1985).

[23] See *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 686-87, n.2, 105 S. Ct. 2312, 85 L. Ed. 2d 692, Fed. Sec. L. Rep. (CCH) P 92047 (1985) ("various types of preferred stock may have different characteristics and still be covered by the [1933 Act]").

[24] See, e.g., *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852, 95 S. Ct. 2051, 44 L. Ed. 2d 621, Fed. Sec. L. Rep. (CCH) P 95206 (1975).

(5) a note that formalizes an open-account indebtedness incurred in the ordinary course of business;

(6) a short-term note secured by an assignment of accounts receivable; or

(7) a note given in connection with a loan by a commercial bank to a business for current operations.[25]

The *Reves* case then sets out a four-factor test used to determine if a particular note bears a "strong resemblance" to any of the foregoing types of instruments that are not securities:

(1) the court examines the transaction to assess the motivations that would prompt a reasonable seller and buyer to enter into it;

(2) the court examines the "plan of distribution" of the note to determine whether it is an instrument in which there is common trading for speculation or investment;

(3) the court examines the reasonable expectations of the investing public; and

(4) the court examines whether some factor (such as the existence of another regulatory scheme) significantly reduces the risk of the instrument, thereby rendering application of the securities laws unnecessary.[26]

While the Article 8 and 9 definition of security is similar to the securities law definition, there are some differences. For example, under the securities laws, whether a partnership or LLC interest is a security is primarily determined by the degree of managerial control that the holder exercises over the entity—in most cases a general partnership interest (or LLC interest involving a similar managerial role) is not a security, while a limited partnership interest (or LLC interest involving a similar managerial role) would be, although the label placed on an interest is not dispositive and in each case the functions that the holder of the interest performs must be evaluat-

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[25] *Reves v. Ernst & Young*, 494 U.S. 56, 65-67, 110 S. Ct. 945, 108 L. Ed. 2d 47, Blue Sky L. Rep. (CCH) P 73213, Fed. Sec. L. Rep. (CCH) P 94939 (1990).

[26] *Reves v. Ernst & Young*, 494 U.S. 56, 66-67, 110 S. Ct. 945, 108 L. Ed. 2d 47, Blue Sky L. Rep. (CCH) P 73213, Fed. Sec. L. Rep. (CCH) P 94939 (1990). The UCC has a comparable concept, distinguishing between an "instrument" (as defined in section 9-102(a)(47)) and a security (as defined in section 8-102(a)(15), as described above).

ed.[27] Stock options are generally securities for securities law purposes, but may not be for purposes of Article 8 and 9.[28]

III. UCC PUBLIC SALE AND SECURITIES LAW REQUIREMENTS

If a lender's collateral is a security under the securities laws, then the securities laws may affect how the lender can dispose of that collateral.

Section 9-610 permits a secured party to dispose of any or all of its collateral after default; the disposition of collateral may be through either a public sale or a private sale.[29].

Section 9-610(c) provides that a secured party may purchase the collateral: (i) at a public disposition;[30] or (ii) at a private disposition only if the collateral is of a kind that is customarily sold on a recognized market[31] or the subject of widely distributed standard price quotations.[32] The term "public disposition" is not defined by Article 9; Official Comment 7 to section 9-610 states that, for purposes of Article 9, a public disposition "is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding. 'Meaningful opportunity' is meant to imply that some form of advertisement or public notice must precede the

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[27] See, e.g., *S.E.C. v. Continental Wireless Cable Television, Inc.*, 110 F.3d 69 (9th Cir. 1997) (unpublished opinion) (general partnership interests were securities); *K.B.R., Inc. v. L.A. Smoothie Corp., Inc.*, 1996 WL 156874, *5-6 (E.D. La. 1996), aff'd, 136 F.3d 1328 (5th Cir. 1998) (general partnership or joint venture interest can be a security within the meaning of the 1933 Act if the investor can establish that an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership, which has long been held to be an investment contract; also if the partner or venturer lacks the business experience and expertise necessary to intelligently exercise partnership powers, or the partner or venturer is so dependant on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the promoter or manager or otherwise exercise meaningful partnership or venture power, the partnership interest may be an investment contract); *Keith v. Black Diamond Advisors, Inc.*, 48 F. Supp. 2d 326, Fed. Sec. L. Rep. (CCH) P 90458 (S.D. N.Y. 1999) (LLC interest not a security, since LLC was a member-managed LLC and purchaser intended to retain some control over and be involved in management of LLC; cites additional cases). As described above, the UCC treatment of an LLC or partnership interest as a security does not depend on management control but on other factors set out in section 8-103.

[28] See note 13 supra.

[29] Section 9-610(a) and (b). Section 9-504 of Former Article 9 contained comparable provisions.

sale (or other disposition) and that the public must have access to the sale (disposition)." The need for advertising or public notice raises concerns that the secured party's public disposition may not qualify for an exemption from the registration requirements under the 1933 Act.[33]

Official Comment 8 to Section 9-610 recognizes that:

> [d]ispositions of investment property [including securities] may be regulated by the federal securities laws. Although a "public" disposition of securities under this Article [9] may implicate the registration requirements of the Securities Act of 1933, it need not do so. A disposition that qualifies for a "private placement" exemption under the Securities Act of 1933

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[30] As discussed in Official Comment 7 to section 9-610, Part 6 of Article 9 makes only two distinctions between "public" and other dispositions: (1) the secured party's ability to purchase at a nonpublic disposition is subject to limitations (as provided in section 9-610(c)(2) and discussed below); and (2) the debtor is entitled to notification of "the time and place of a public disposition" and notification of "the time after which" a private disposition or other intended disposition is to be made (as provided in section 9-613(1)(E)). Official Comment 7 to section 9-610 also notes that, in particular, Article 9 does not retain the distinction made in former section 9-504(4), under which transferees in a noncomplying public disposition could lose protection more easily than transferees in other noncomplying dispositions; instead section 9-617(b) adopts a unitary standard.

In addition to its self-help remedies under 9-610, (i) a secured party may purchase at an execution sale (see section 9-601(f) and Official Comment 8 to section 9-601) and (ii) if a security agreement covers both real and personal property, a secured party may proceed as to both in accordance with the rights with respect to real property (see section 9-604(a)(2) and Official Comment 2 to section 9-604).

[31] A "recognized market" is one in which the items sold are fungible and prices are not subject to individual negotiation (e.g. the New York Stock Exchange). A market in which prices are individually negotiated or the items are not fungible is not a recognized market, even if the items are the subject of widely disseminated price guides or are disposed of through dealer auctions. See Official Comment 9 to section 9-610.

[32] Section 9-610(c) is not one of the provisions of Article 9 that section 9-602 expressly provides cannot be waived or varied by agreement of the parties, but that is not the relevant analysis with respect to whether the parties can agree that the secured party may buy the collateral at a private sale. Official Comment 2 to section 9-624 states "transactions [in which a secured party buys at its own private disposition] are equivalent to 'strict foreclosures' and are governed by Sections 9-620, 9-621, and 9-622," and sections 9-602(10) and 9-624 provide that (with a limited exception in consumer transactions) the provisions of sections 9-620, 9-621, and 9-622 cannot be altered by agreement of the parties.

[33] The requirement to register sales and other transfers of securities (unless an exemption is available) is discussed in I & II Louis Loss & Joel Seligman, Securities Regulation Chapter 2 (3d ed. 1999 and 2005 Supp.) and exempt securities and transactions are discussed in III Louis Loss & Joel Seligman, Securities Regulation Chapter 3.B-C (3d ed. 1999 and 2005 Supp).

> nevertheless may constitute a "public" disposition within the meaning of this section. Moreover, the "commercially reasonable" requirements of subsection [9-610](b) need not prevent a secured party from conducting a foreclosure sale without the issuer's compliance with federal registration requirements.[34]

The SEC has issued a number of no-action letters[35] that establish the steps to be taken so that a disposition of securities that qualifies as a public disposition of collateral for Article 9 purposes will not require registration under the 1933 Act.[36] The no-action

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[34] Section 9-610(b) provides that "Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private proceedings, by one or more contracts, as a unit or in parcels, and at any time and place and on any terms." The requirements of section 9-610(b) cannot be waived or varied by agreement of the debtor and the secured party (see section 9-602(7)), but the parties may determine by agreement the standards measuring the fulfillment of the duties of a secured party if the standards are not manifestly unreasonable (see section 9-603(a)). See Exhibit A for sample language from a security agreement setting standards relating to the federal securities law aspects of a disposition of securities.

For additional discussion of foreclosure on collateral consisting of securities, see Egon Guttman, Modern Securities Transfers §§ 6a:21-6a:23 (3d ed. 2004) (Vols. 28 & 28A, Securities Law Series (West)); II Louis Loss & Joel Seligman, Securities Regulation 1138.56-.66 (3d ed. 1999 and 2005 Supp.); and the materials cited in note 1 supra. For purposes of assessing whether the securities laws apply to a disposition of collateral, the determination of whether the collateral is a security will be governed by the securities laws (and not by the UCC). See Part II of this article for a discussion of the types of assets that are securities for purposes of the securities laws. In addition, there are securities that are exempt from some or all of the 1933 Act, including government securities and short-term commercial paper (see section 3 of the 1933 Act), and transactions in securities that are exempt from the registration requirements of the 1933 Act, including a private placement of securities (see section 4 of the 1933 Act). See III Louis Loss & Joel Seligman, Securities Regulation Chapter 3.B-C (3d ed. 1999 and 2005 Supp.)

[35] For a discussion of the value of no-action letters as precedent, see Robert J. Haft & Arthur F. Haft, Analysis of Key SEC No-Action Letters, Preface, at vii-ix (2004-2005 ed.).

[36] See Exhibit B for a list of no-action letters addressing this issue; the list is not a complete list of all no-action letters on this issue. See also *A.D.M. Corp. v. Thomson*, 707 F.2d 25, 26-27, Fed. Sec. L. Rep. (CCH) P 99206 (1st Cir. 1983) (citing no-action letters stating that the pledgee's foreclosure sale of securities did not require registration under the 1933 Act as well as authorities critical of that view); Robert J. Haft & Arthur F. Haft, Analysis of Key SEC No-Action Letters § 7:34 (2004-2005 ed.) (discussing no-action letters relating to disposition of securities held as collateral through a sale that is a "public sale" for Article 9 purposes and concluding that, while not expressly stated in the staff responses, the likely basis for the position taken in the no-action letters is the so-called "4(1 1/2)" exemption, with an easing of its restrictions against general solicitation or advertising to accommodate Article 9 requirements for a "public disposition").

letters generally impose the following requirements on the conduct of the sale:[37]

- the pledged securities will be sold only as a block to a single purchaser, and will not be split up or broken down[38]
- the purchaser will represent that the securities will be taken with investment intent (i.e. that the securities are being acquired for the purchaser's own account and not with a view toward the sale or distribution thereof and will not be sold unless pursuant to an effective registration statement under the 1933 Act and applicable state securities laws or under a valid exemption from such registration)
- the securities will be subject to transfer restrictions (e.g. certificates for the pledged securities, when issued to the purchaser, will bear an appropriate legend to the effect that the securities represented thereby may not be sold or transferred without reg-

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[37] See, e.g., *Telehub Technologies Corp., Terabridge Technologies Corp.*, 2000 WL 1283644 (Sept. 11, 2000); *Face Int'l Corp.*, 1999 SEC No-Act. LEXIS 772 (Sept. 21, 1999); Gaoming Int'l Ltd., 1999 WL 176954 (Mar. 31, 1999); *Capitol Meat Co.*, 1996 WL 200604 (Apr. 25, 1996); *Citizens Bank, Kilgore, Texas*, 1990 WL 286366 (Apr. 13, 1990). See also Robert J. Haft & Arthur F. Haft, Analysis of Key SEC No-Action Letters § 7:34 (2004-2005 ed.) (discussing no-action letters relating to disposition of securities held as collateral through a sale that is a "public sale" for Article 9 purpose). Some of the variations in the no-action letters are described in this article; when dealing with a specific case, a review of the case law and of the no-action letters for relevant variations should be made.

[38] Some early no-action letters permitted more than a single purchaser. For example, in *McJunkin Corp.*, 1982 WL 29577 (Oct. 4, 1982), the secured lender intended to sell to "one purchaser or to a small number of purchasers not to exceed 3," and no-action relied was granted; the original request had indicated that the number of purchasers would be not more than 35 and was subsequently reduced to not more than three. Similarly, in *Crime Control, Inc.*, 1985 WL 54411 (Oct. 17, 1985), the secured lender intended to sell to "one purchaser or to a small number of purchasers not to exceed five in number," and no-action relief was granted. In a more recent letter, however, while the original request referred to a sale to no more than five purchasers, this was subsequently reduced to a single purchaser. *Security Pacific Bank Arizona*, 1992 WL 159159 (June 26, 1992).

More flexibility in the number of purchasers has been allowed where the stock of more than issuer, or stock pledged by more than one pledgor, is involved. In *Telehub Technologies Corp., Terabridge Technologies Corp.*, 2000 WL 1283644 (Sept. 11, 2000), the secured lender held stock of two different issuers as collateral and intended to sell each issuer's stock as a block to a single purchaser, and no-action relief was granted. In *Madison Plaza Assocs.*,1988 WL 233561 (Jan. 8, 1988), the secured party held securities pledged by about 15 defaulting investors to secure financing for their purchase of the securities and proposed to sell the stock of each defaulting investor as a separate block, and no-action relief was granted.

istration under the 1933 Act and applicable state laws or the availability of a valid exemption from such registration)[39]

- the seller will provide on request to any prospective purchaser the information that the seller has concerning the issuer of the securities[40]
- the public auction of the pledged securities will be conducted as prescribed under the UCC.

The requesting letters commonly recite the following additional facts:[41]

- the lender believed that the loan would be repaid in accordance with the loan documents and there would be no need to foreclose on the collateral for the loan (including the pledged securities)[42]
- the lender is not an affiliate of the pledgor or the issuer of the pledged stock (e.g. the lender's only relationship with the pledgor was an arm's length lender-borrower/guarantor/

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[39] See *Russell Ranch*, 1995 WL 476256 (Aug. 11, 1995) for an analogous procedure for securities not represented by a physical certificate (i.e. limited partnership interests).

[40] *Security Pacific Bank Arizona*, 1992 WL 159159 (June 26, 1992) involved a proposed foreclosure on shares of a 1934 Act reporting company, and in its request for no-action relief the secured party stated that the notice of sale would advise prospective purchasers where publicly available information about the issuer of the pledged securities could be obtained and that the secured party would deliver a packet of the most recent public information to prospective bidders. See also *Crime Control, Inc.*, 1985 WL 54411 (Oct. 17, 1985) (notice of sale would indicate where public information could be obtained and the lender would disclose to prospective purchasers material information about the issuer in the lender's possession).

[41] See, e.g., no-action letters cited in notes 37, 38, 39, and 40 supra.

[42] In cases where the collateral was taken with the expectation that it would be sold to repay the loan, the registration requirements of the 1933 Act have been held to apply. See *Securities and Exchange Commission v. Guild Films Co.*, 279 F.2d 485, 490 (2d Cir. 1960) (based on facts available to them, banks that took stock as collateral "should have known that immediate sale was almost inevitable if they were to recoup their loans from the security received" and therefore sale was not exempt from registration requirements of the 1933 Act); *A.D.M. Corp. v. Thomson*, 707 F.2d 25, 26-27, Fed. Sec. L. Rep. (CCH) P 99206 (1st Cir. 1983) (citing additional cases and other authorities); *U.S. v. Abrams*, 357 F.2d 539, 542-49 (2d Cir. 1966) (discussion of pledge of stock used as means of distribution and statutory underwriter status for purposes of section 4(1) of the 1933 Act); *Neuwirth Inv. Fund Ltd. v. Swanton*, 422 F. Supp. 1187, Fed. Sec. L. Rep. (CCH) P 95372 (S.D. N.Y. 1975) (discussion of statutory underwriter status and distribution for purposes of section 4(1) of the 1933 Act); see generally II Louis Loss & Joel Seligman, Securities Regulation 1138.56-.66 (3d ed. 1999 and 2005 Supp).

pledgor relationship)[43] and the transaction was entered into in the ordinary course of business of the lender

- notice of the sale will be given to every person required by applicable law and will be published in one or more newspapers and might also be published in trade or business journals or other periodicals[44] or provided to selected prospective purchasers
- the notice of sale will state that the secured party reserves the right to bid for and purchase the pledged securities and to credit the purchase price against the expenses of sale and the secured obligations
- the lender is likely to be the purchaser of the pledged securities at the foreclosure sale[45]
- no public market exists for the shares[46]

The SEC has refused no-action relief under the following circumstances:

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[43] *General Electric Capital Corp.*, 1993 SEC No-Act. LEXIS 1111 (Nov. 19, 1993) discusses a sale by a secured party that was, at the time of the sale, an affiliate of the issuer of the pledged stock; the secured party was not an affiliate at the time that the loan was made and the stock was pledged, and the loan and pledge of stock were a bona fide lending transaction entered into by the lender in the ordinary course of its business.

[44] In *Madison Plaza Assocs.*,1988 WL 233561 (Jan. 8, 1988), the secured party stated that the advertising of the foreclosure sale would "be accomplished in a manner that will be consciously limited, yet will meet the standard of commercial reasonability. Advertisements will not be placed on prominent financial pages, and thus will not attract those looking for securities offerings."

[45] In *Union Chelsea Nat'l Bank*, 1990 WL 286603 (May 16, 1990), the secured party did not expect to be the purchaser at the foreclosure sale (but wanted to preserve its right to purchase at the sale).

Often, the secured party is conducting a public disposition of collateral under Article 9 because it wishes to purchase the collateral and does not believe that the collateral is of a type that the secured party is permitted to buy at a private sale under section 9-610(c)(2) (or former section 9-504(3)), as discussed above. Section 9-620 provides more flexibility than did former section 9-505(b) with respect to a strict foreclosure (e.g. expressly permitting a partial strict foreclosure and not limiting strict foreclosure to property in the possession of the secured party) and may permit the secured party to acquire the property without a public sale.

[46] In *Security Pacific Bank Arizona*, 1992 WL 159159 (June 26, 1992), the pledged stock was described as "publicly traded" but was also stated not to be the subject of widely distributed standard price quotations that would allow the secured party to buy the pledged stock at a private sale.

- the notes secured by the securities were received as part of the initial purchase price of the pledged securities and affiliated parties were involved in the transaction[47]
- litigation was currently pending involving the lender, the issuer of the pledged stock, the SEC, and certain other persons.[48]

IV. ARTICLE 8 "PROTECTED PURCHASER," NOTICE OF ADVERSE CLAIMS AND SEC RULE 17F-1

If the lender's collateral is a security (or securities entitlement) for purposes of the UCC, the lender may obtain protection for its interest not available for many other types of collateral.[49]

Generally, a purchaser of property cannot acquire better title than its transferor had—the principle of nemo dat quod non habet. Article 8 creates one of the few exceptions to this general principle—Article 8 contains provisions to protect the finality of transactions involving securities[50] and securities entitlements that in some cases override the general rule of nemo dat. Article 8 provides this protection to a "protected purchaser" of a security and to certain persons that acquire security entitlements.

A. "PROTECTED PURCHASER" OR EQUIVALENT STATUS

A purchaser is a person that takes by "sale, discount, negotiation, mortgage, pledge, lien, security interest, issue or re-issue, gift or any other voluntary transaction creating an interest in property."[51] A secured party is a purchaser.[52]

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[47] *TM Pacifica Tam O'Shanter, Ltd.*, 1987 WL 107552 (Feb. 17, 1987).

[48] *Cavanagh Communities Corp.*, 1981 WL 26317 (Apr. 3, 1981).

[49] For a discussion of other benefits that may be available to a lender if its collateral is a security for UCC purposes, see Lynn A. Soukup, *It's a Matter of Collateral: LLCs, Partnerships and the UCC*, 14 Business Law Today 53 (Jan./Feb. 2005).

[50] As described in Part II of this article, the UCC definition of securities (which is different from the securities law definition) would be used in determining whether a purchaser is eligible for protected purchaser status or similar protections under Article 8.

[51] See section 1-201(32) and (33) and Official Comment 32 to section 1-201. The definition of purchaser in Revised Article 1 is similar. See revised section 1-201(b)(29) and (30) and Official Comments 29 and 30 to revised section 1-201. See also section 8-116, which describes when a securities intermediary is a purchaser for value and may obtain the benefits of protected purchaser status under section 8-303.

A purchaser that meets the requirements to qualify as a "protected purchaser": (1) acquires all the rights in a certificated or uncertificated security[53] that its transferor had or had power to transfer; and (2) also acquires its interest in the security free of any adverse claim.[54]

Section 8-303(a) provides that a "protected purchaser" is a purchaser of a certificated or uncertificated security, or of an interest therein, who:

(1) gives value;

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

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

Section 8-502 provides analogous protection for a person (including a secured party) that acquires a security entitlement if specified conditions are met, including absence of notice of an adverse claim to the acquired asset.[55]

B. NOTICE OF ADVERSE CLAIMS AND DUTY OF INQUIRY

Section 8-105(a) specifies when a person has "notice of an adverse claim" for purposes of meeting the section 8-303(a) requirements to qualify as a protected purchaser (or the equivalent requirement in section 8-502 applicable to a person that acquires a security entitlement):[56]

(1) the person knows[57] of the adverse claim;

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[52] See section 1-201(32) and Official Comment 32 to section 1-201 ("purchase" includes taking by pledge or security interest). The definition in Revised Article 1 is similar. See revised section 1-201(b)(29) and Official Comment 29 to revised section 1-201.

[53] Part 5 of Article 8 provides analogous protection for a person that acquires a security entitlement, as discussed below.

[54] See sections 8-302, 8-303(b). Section 8-302(b) provides that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. Where the protected purchaser is a secured lender, a previously perfected security interest in a security will only be subordinated (by operation of section 9-328) rather than extinguished under the "takes free" language in section 8-303. See Official Comment 1 to section 9-331, which states that "whether a holder or purchaser referred to in section 9-331 [including a protected purchaser] takes free or is senior to a security interest depends on whether the purchaser is a buyer of the collateral or takes a security interest in it."

[55] See section 8-502 and Official Comments 1-4 to section 8-502.

[56] The general Article 1 definition of "notice" does not apply to the interpretation of "notice of adverse claim." See Official Comment 1 to section 8-105.

(2) the person is aware of facts sufficient to indicate that there is a significant probability that the adverse claim exists and deliberately avoids information that would establish the existence of the adverse claim (the "willful blindness" test); or

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

Official Comment 5 to Section 8-105 elaborates on the "duty" to investigate in the context of notice of an adverse claim:

> Paragraph [8-105](a)(3) provides that a person has notice of an adverse claim if the person would have learned of the adverse claim by conducting an investigation that is required by other statute or regulation. This rule applies only if there is some other statute or regulation that explicitly requires persons dealing with securities to conduct some investigation. The federal securities laws require that brokers and banks, in certain specified circumstances, check with a stolen securities registry to determine whether securities offered for sale or pledge have been reported as stolen. If securities that were listed as stolen in the registry are taken by an institution that failed to comply with requirement to check the registry, the institution would be held to have notice of the fact that they were stolen under paragraph [8-105](a)(3). Accordingly, the institution could not qualify as a protected purchaser under Section 8-303. The same result has been reached under the prior version of Article 8. See *First Nat'l Bank of Cicero v. Lewco Securities*, 860 F.2d 1407 (7th Cir. 1988).[58]

C. SECURITIES LAW CREATES DUTY OF INQUIRY

In the case of certificated securities, section 17(f) of the Securities Exchange Act of 1934, as amended (the "1934 Act") and Rule 17f-1 adopted under the 1934 Act create a duty to conduct an investigation of the type referred to in section 8-105(a)(3) and Official Comment 5 to section 8-105.[59]

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[57] A person knows a fact when he has actual knowledge of it. Section 1-201(25); see also Official Comment 3 to section 8-105. The definition of "knows" in Revised Article 1 is similar. See revised section 1-202(b).

Rule 17f-1(d) provides that:

(1) Every reporting institution[60]... shall inquire of the [Securities and Exchange] Commission or its designee [the Securities Information Center ("SIC")][61] with respect to every securities certificate[62] which comes into its possession or keeping, whether by pledge, transfer or otherwise, to ascertain whether

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[58] In *First Nat. Bank of Cicero v. Lewco Securities Corp.*, 860 F.2d 1407, 7 U.C.C. Rep. Serv. 2d 10 (7th Cir. 1988), the Seventh Circuit examined the effect of a duty to inquire imposed by the federal securities laws (Rule 17f-1 under the 1934 Act, which is discussed below) on a lender's status as a bona fide purchaser that would take free of adverse claims under Former Article 8. The elements of bona fide purchaser status under Former Article 8 are somewhat different from the elements of protected purchaser status under Article 8 (and the lender's failure to make inquiry was analyzed in the context of the Former Article 8 requirements in effect at the time of the loan transaction). The lender (a bank subject to Rule 17f-1) had accepted bonds as collateral for a loan but had not made the inquiry required by Rule 17f-1. The lender later discovered that the bonds had been stolen. One owner of the bonds had filed a notice of theft with the Securities Information Center (which handles inquiries and reporting under Rule 17f-1) two days before the bonds were accepted as collateral and the related loan funded. In a proceeding by the lender to determine whether the lender was a bona fide purchaser that took free of this owner's claim to the bonds, the Seventh Circuit upheld the grant of summary judgment to the owner.

[59] For a further discussion of Rule 17f-1 and protected purchaser status, see Egon Guttman, Modern Securities Transfers §§ 7:13-7:16, 16:2-16:4 (3d ed. 2004) (Vols. 28 & 28A, Securities Law Series (West)). *First Nat. Bank of Cicero v. Lewco Securities Corp.*, 860 F.2d 1407, 1414-16, 7 U.C.C. Rep. Serv. 2d 10 (7th Cir. 1988), and *A.G. Edwards & Sons, Inc. v. Centocor, Inc.*, 1992 WL 37114, *2, *5-6 (E.D. Pa. 1992) discuss the consideration given by the SEC to placing a limited burden on the securities markets in establishing the inquiry requirements of Rule 17f-1(d). Three lower court decisions in *First National Bank of Cicero* also discuss the adoption of Rule 17f-1 and its inquiry requirements. See *First Nat. Bank of Cicero v. U.S.*, 625 F. Supp. 926, 2 U.C.C. Rep. Serv. 2d 1664 (N.D. Ill. 1986), on reconsideration, 653 F. Supp. 1312, 3 U.C.C. Rep. Serv. 2d 218 (N.D. Ill. 1987), on reconsideration in part, 664 F. Supp. 1169, 5 U.C.C. Rep. Serv. 2d 695 (N.D. Ill. 1987), judgment aff'd, 860 F.2d 1407, 7 U.C.C. Rep. Serv. 2d 10 (7th Cir. 1988) and judgment vacated, 860 F.2d 1407, 7 U.C.C. Rep. Serv. 2d 10 (7th Cir. 1988); *First Nat. Bank of Cicero v. U.S.*, 653 F. Supp. 1312, 3 U.C.C. Rep. Serv. 2d 218 (N.D. Ill. 1987), on reconsideration in part, 664 F. Supp. 1169, 5 U.C.C. Rep. Serv. 2d 695 (N.D. Ill. 1987), judgment aff'd, 860 F.2d 1407, 7 U.C.C. Rep. Serv. 2d 10 (7th Cir. 1988) and judgment vacated, 860 F.2d 1407, 7 U.C.C. Rep. Serv. 2d 10 (7th Cir. 1988); *First Nat. Bank of Cicero v. U.S.*, 664 F. Supp. 1169, 5 U.C.C. Rep. Serv. 2d 695 (N.D. Ill. 1987), judgment aff'd, 860 F.2d 1407, 7 U.C.C. Rep. Serv. 2d 10 (7th Cir. 1988).

[60] A "reporting institution" is defined in Rule 17f-1(a)(1) to include "every national securities exchange, member thereof, registered securities association, broker, dealer, municipal securities dealer, government securities broker, government securities dealer, registered transfer agent, registered clearing agency, participant therein, member of the Federal Reserve System and bank whose deposits are insured by the Federal Deposit Insurance Corporation." This definition is broad enough to cover most financial institutions.

such securities certificate has been reported as missing, lost, counterfeit or stolen,[63] unless:

> (i) The securities certificate is received directly from the issuer[64] or issuing agent at issuance;
>
> (ii) The securities certificate is received from another reporting institution or from a Federal Reserve Bank or branch;
>
> (iii) The securities certificate is received from a customer[65] of the reporting institution, and: (A) is registered in the name of such customer or its nominee; or (B) was previously sold to such customer, as verified by the internal records of the reporting institution;
>
> (iv) The securities certificate is received as part of a transaction which has an aggregate face value of $10,000 or less in the case of bonds, or market value of $10,000 or less in the case of stocks; or
>
> (v) The securities certificate is received directly from a drop which affiliated with a reporting institution for the purposes of receiving or delivering certificates on behalf of the reporting institution.

In addition, Rule 17f-1(f) provides that the following types of securities are not subject to the inquiry requirement of Rule 17f-1(d):

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[61] See SEC Release No. 34-48931, 68 Fed. Reg. 74390 (Dec. 16, 2003), available at http://www.sec.gov/rules/final/34-48931.htm; SEC Release No. 34-13832, 42 Fed. Reg. 41,022, 41,022 (1977).

[62] "Securities certificate" is defined in Rule 17f-1(a)(6) as "any physical instrument that represents or purports to represent ownership in a security that was printed by or on behalf of the issuer thereof" and includes any such instrument that is or was: (1) printed but not issued; (2) issued and outstanding (including treasury securities); (3) cancelled; or (4) counterfeit or reasonably believed to be counterfeit.

[63] The requirement that reporting institutions report securities certificates as stolen, lost, missing, or counterfeit is set out in Rule 17f-1(c).

[64] "Issuer" is defined in Rule 17f-1(a)(7) to include the issuer's transfer agents, paying agents, tender agents, and persons providing similar services and corporate predecessors and successors.

[65] "Customer" is defined in Rule 17f-1(a)(4) as "any person with whom the reporting institution has entered into at least one prior securities-related transaction." "Securities-related transaction" is defined in Rule 17f-1(a)(5) as "a purchase, sale or pledge of investment securities, or a custodial arrangement for investment securities."

(1) security issues not assigned CUSIP numbers (eliminating some privately placed securities);

(2) bond coupons;

(3) uncertificated securities; [66]

(4) global securities issues[67] (eliminating some securities held through DTC or similar systems);[68] and

(5) any securities issue for which neither record nor beneficial owners can obtain a negotiable securities certificate.

Rule 17f-1(d)(3) provides that a reporting institution shall make required inquiries by the end of the fifth business day after a securities certificate comes into its possession or keeping, provided that such inquiries shall be made before the certificate is sold, used as collateral, or sent to another reporting institution.[69] Rule 17f-1 does

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[66] "Uncertificated security" is defined in Rule 17f-1(a)(2) as "a security not represented by an instrument and the transfer of which is registered upon books maintained for that purpose by or on behalf of the issuer;" this definition is comparable to the Article 8 definition of uncertificated security in section 8-102(a)(15) and (18).

[67] The term "global certificate securities issue" is defined in Rule 17f-1(a)(3) as "a securities issue for which a single master certificate representing the entire issue is registered in the nominee name of a registered clearing agency and for which beneficial owners cannot receive negotiable securities certificates."

[68] The requirement to make an inquiry under Rule 17f-1(d) is based on a securities certificate coming into the possession of the lender, which would more generally exclude securities held through DTC or similar systems from the inquiry requirement. See Rule 17f-1(d) ("Every reporting institution... shall inquire of the Commission or its designee with respect to every securities certificate which comes into its possession or keeping, whether by pledge, transfer or otherwise.").

[69] Subparagraph (3) of Rule 17f-1(d) was added to the rule effective as of January 22, 2004. See SEC Release No. 34-48931, 68 Fed. Reg. 74390 (Dec. 16, 2003), available at http://www.sec.gov/rules/final/34-48931.htm. Before the addition of this provision, as noted in *First Nat. Bank of Cicero v. Lewco Securities Corp.*, 860 F.2d 1407, 1416 n.14, 7 U.C.C. Rep. Serv. 2d 10 (7th Cir. 1988), the "Federal regulations do not in so many words prescribe the precise time at which inquiry of the SIC is required. Obviously, if the regulatory scheme is to have even marginal impact, inquiry should be made at the time collateral is received and before any loan proceeds are released." See also *First Nat. Bank of Cicero v. U.S.*, 625 F. Supp. 926, 930, 2 U.C.C. Rep. Serv. 2d 1664 (N.D. Ill. 1986), on reconsideration, 653 F. Supp. 1312, 3 U.C.C. Rep. Serv. 2d 218 (N.D. Ill. 1987), on reconsideration in part, 664 F. Supp. 1169, 5 U.C.C. Rep. Serv. 2d 695 (N.D. Ill. 1987), judgment aff'd, 860 F.2d 1407, 7 U.C.C. Rep. Serv. 2d 10 (7th Cir. 1988) and judgment vacated, 860 F.2d 1407, 7 U.C.C. Rep. Serv. 2d 10 (7th Cir. 1988) (citing additional sources).

not provide any other requirement as to how far in advance of taking securities as collateral the institution should make its inquiry.[70]

Rule 17f-1(e) also permits inquiries to be made that are not required by Rule 17f-1; in promulgating this provision, the SEC stated that it did not, by allowing permissive inquiries, intend to incorporate an inquiry requirement into all transactions for purposes of determining bona fide purchaser status (the equivalent in Former Article 8 to the protected purchaser concept and protection of persons that acquire security entitlements that are found in Article 8).[71]

V. CONCLUSION

In addition to the UCC and other commercial law issues applicable to finance transactions, the securities laws should be considered when the collateral for a transaction is a security. The applicability of the securities laws to a lender's collateral can affect the documentation of the loan and the lender's rights to its collateral, as well as establish the process that the lender may be required to follow to dispose of its collateral.

EXHIBIT A: SAMPLE SECURITY AGREEMENT PROVISION

The Pledgor recognizes that the Lender may be unable to effect a public sale of all or a part of the Collateral by reason of certain prohibitions contained in the Securities Act of 1933, as amended (the "1933 Act"), or other relevant securities laws in any jurisdiction, and may be compelled to resort to one or more private sales to

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[70] In particular, there is no provision of the rule that requires that the inquiry not be made significantly in advance of the loan closing, although it may be good practice for the institution to make an inquiry reasonably close in time to taking the securities as collateral. Rule 17f-1(d) does not expressly require subsequent inquiries prior to subsequent disbursements secured by securities that were the subject of a prior inquiry. See Rule 17f-1; see also *First Nat. Bank of Cicero v. Lewco Securities Corp.*, 860 F.2d 1407, 1416 n.14, 7 U.C.C. Rep. Serv. 2d 10 (7th Cir. 1988) ("Perhaps surprisingly, no inquiry is mandated prior to subsequent disbursements secured by previously authenticated collateral."). The SEC release relating to the addition of subparagraph (3) to Rule 17f-1(d) in 2004 does not indicate that the addition (while broadly worded) was intended to change this interpretation. See SEC Release No. 34-48931, 68 Fed. Reg. 74390 (Dec. 16, 2003), available at http://www.sec.gov/rules/final/34-48931.htm.

[71] SEC Release No. 34-13832, 42 Fed. Reg. 41,022, 41,023-24 (1977) (implementation of program under Rule 17f-1); see also SEC Release No. 34-13053, 41 Fed. Reg. 54,923, 54,924 (1976) (adopting release for Rule 17f-1). See also *First Nat. Bank of Cicero v. Lewco Securities Corp.*, 860 F.2d 1407, 1415 n.12, 7 U.C.C. Rep. Serv. 2d 10 (7th Cir. 1988).

a restricted group of purchasers (or to a single purchaser) who will be obligated to agree, among other things, to acquire the Collateral for their own account, for investment, and not with a view to the distribution or resale thereof. The Pledgor acknowledges that private sales so made may be at prices and on other terms less favorable to the seller than if the Collateral were sold at public sale, and that the Lender has no obligation to delay the sale of any Collateral for the period of time necessary to permit the registration of the Collateral for public sale under the 1933 Act or other relevant securities laws in any jurisdictions or to qualify for any other exemption from registration under the 1933 Act or other relevant securities law or to sell the collateral in more than one transaction to qualify for any such exemption. The Pledgor agrees that a private sale or sales made under the foregoing circumstances shall not be deemed to be commercially unreasonable by virtue of such circumstances.

If any consent, approval or authorization of, or filing with, any governmental authority or any other Person is necessary to effect any disposition of the Collateral, including, without limitation, under any federal or state securities laws, the Pledgor agrees to execute all such applications, registrations and other documents and instruments as may be required in connection with securing any such consent, approval or authorization, and will otherwise use commercially reasonable efforts to secure the same. The Pledgor further agrees to use its best efforts to effectuate such sale, or other disposition of the Collateral, as the Lender may deem necessary or desirable pursuant to the terms of this Agreement.

Notwithstanding any other provision of the loan documents or any other obligation of the Lender, in connection with any disposition of the Collateral the Lender may disclose to prospective purchasers all of the information relating to the Collateral (and the issuer thereof) that is in the Lender's possession or otherwise available to the Lender.

Exhibit B: ***SEC No-Action Letters on UCC Public Sales***[1]

Name	Date	Cite
Telehub Technologies Corp., Terabridge Technologies Corp.	Sept. 11, 2000	2000 SEC No-Act. LEXIS 842
Face Int'l Corp.	Sept. 21, 1999	1999 SEC No-Act. LEXIS 772
Gaoming Int'l Ltd.	Mar. 31, 1999	1999 SEC No-Act. LEXIS 370
Capitol Meat Co.	Apr. 25, 1996	1996 SEC No-Act. LEXIS 446
Russell Ranch	Aug. 11, 1995	1995 SEC No-Act. LEXIS 635
General Electric Capital Corp.	Nov. 19, 1993	1993 SEC No-Act. LEXIS 1111
One Fine Corporation and Champion Ventures	Apr. 1, 1993	1993 SEC No-Act. LEXIS 577
Angelo K. Tsakopoulos	Feb. 5, 1993	1993 SEC No-Act. LEXIS 150
First National Bank in Port Lavaca	Oct. 30, 1992	1992 SEC No-Act. LEXIS 1020
Security Pacific Bank Arizona (sometimes cited as Inter-Tel, Inc.)	June 26, 1992	1992 SEC No-Act. LEXIS 767
Texas National. Bank	Apr. 14, 1992	1992 SEC No-Act. LEXIS 570
Oak Park Bank	Apr. 3, 1992	1992 SEC No-Act. LEXIS 486
Bluebonnet Savings Bank FSB	Sept. 30, 1991	1991 WL 199477 (S.E.C. No-Action Letter)
Citizens Bank, Kilgore, Texas	Apr. 13, 1990	1990 SEC No-Act. LEXIS 668
Union Chelsea Nat'l Bank	May 16, 1990	1990 SEC No-Act. LEXIS 787
Sunbelt National Bank	Nov. 27, 1989	1989 SEC No-Act. LEXIS 1166
Deposit Guaranty Bank	July 19, 1989	1989 SEC No-Act. LEXIS 840
City Bank and Trust Company of Oklahoma City	May 24, 1989	1989 SEC No-Act. LEXIS 706
First Continental Bank & Trust Company	June 10, 1988	1988 SEC No-Act. LEXIS 725
Scooters Mason Road, Inc.	May 20, 1988	1988 SEC No-Act. LEXIS 745
First Security Mortgage Company	Mar. 25, 1988	1988 SEC No-Act. LEXIS 384
Madison Plaza Associates	Jan. 8, 1988	1988 SEC No-Act. LEXIS 18
Albuquerque Federal Savings and Loan Association	Oct. 26, 1987	1987 SEC No-Act. LEXIS 2586

[1] This is not a complete list of no-action letters on this issue.

Name	Date	Cite
TM Pacifica Tam O'Shanter, Ltd.	Feb. 17, 1987	1987 SEC No-Act. LEXIS 1603
First National Bank of Omaha	Nov. 28, 1986	1986 SEC No-Act. LEXIS 2936
Republic Bank of Oklahoma City (sometimes cited as Sooner State Farms, Inc.)	Dec. 1, 1986	1986 SEC No-Act. LEXIS 2974
Lapeer County Bank & Trust Co. (sometimes cited as Pioneer Bankshares, Inc.)	Oct. 27, 1986	1986 SEC No-Act. LEXIS 2848
BancTexas Westheimer	June 16, 1986	1986 SEC No-Act. LEXIS 2397
Flagstone Petroleum Corporation	Apr. 21, 1986	1986 SEC No-Act. LEXIS 2024
Texas American Bank, West Side	Feb. 14, 1986	1986 SEC No-Act. LEXIS 1749
Crime Control, Inc.	Oct. 17, 1985	1985 SEC No-Act. LEXIS 2605
Gibson Distributing Co., Inc.	Mar. 27, 1984	1984 SEC No-Act. LEXIS 2008
Hanlon-Gregory Industries, Inc.	Feb. 27, 1984	1984 SEC No-Act. LEXIS 1775
Harbor Properties, Inc.	Sept. 22, 1983	1983 SEC No-Act. LEXIS 2829
Virginia National Bank (sometimes cited as Self-Serv Food Markets, Inc.)	Aug. 12, 1983	1983 SEC No-Act. LEXIS 2705
Sue-Ann, Inc.	May 13, 1983	1983 SEC No-Act. LEXIS 2350
Exxon Company, U.S.A. (sometimes cited as HOR Energy Co.)	Feb. 24, 1983	1983 SEC No-Act. LEXIS 1880
McJunkin Corporation	Oct. 4, 1982	1982 SEC No-Act. LEXIS 2866
Capital Facilities Corporation	July 8, 1982	1982 SEC No-Act. LEXIS 2599
Everest & Jennings	Nov. 19, 1981	1981 SEC No-Act. LEXIS 4298
Blue Hill Farms, Inc.	July 13, 1981	1981 SEC No-Act. LEXIS 3747
Cavanagh Communities Corp.	Apr. 3, 1981	1981 SEC No-Act. LEXIS 3351
Consumers Coal Company	Oct. 6, 1980	1980 SEC No-Act. LEXIS 3759
Buttrey Stores, Inc. (American National Bank & Trust Co.)	May 19, 1980	1980 SEC No-Act. LEXIS 3260
American Security Bank (sometimes cited as Mobile Fuel Shipping, Inc.)	May 29, 1980	1980 SEC No-Act. LEXIS 3341
Coventry Care, Inc.	July 16, 1979	1979 SEC No-Act. LEXIS 3134
Astro Manufacturing Co.	Jan. 15, 1979	1979 SEC No-Act. LEXIS 2047
International Electronics Corp.	Oct. 23, 1978	1978 SEC No-Act. LEXIS 2107

Name	Date	Cite
United Properties of America	June 9, 1978	1978 SEC No-Act. LEXIS 1369
Fandel Co.	Jan. 5, 1978	1978 SEC No-Act. LEXIS 343
Goldfield Corp.	Sept. 22, 1977	1977 SEC No-Act. LEXIS 2393
First National Bank (sometimes cited as UTL Corporation)	Apr. 6, 1977	1977 SEC No-Act. LEXIS 1028
Land & Leisure, Inc.; Hanover Investments	Apr. 1, 1976	1976 SEC No-Act. LEXIS 773
Investors Mortgage Group, Inc.	Feb. 9, 1976	1976 SEC No-Act. LEXIS 261
York Terrace Lessee Venture	Dec. 11, 1975	1975 SEC No-Act. LEXIS 2487
Banner Publishers, Inc.	Nov. 14, 1975	1975 SEC No-Act. LEXIS 2282
Hi-Port Industries, Inc.	Nov. 7, 1975	1975 SEC No-Act. LEXIS 2226
Optivision, Inc.	Mar. 19, 1975	1975 SEC No-Act. LEXIS 523
The Valley Development at Vail, Inc.; Tayvel Environment Land Company	Feb. 6, 1975	1975 SEC No-Act. LEXIS 194
Inner City Broadcasting Corp.	Nov. 20, 1974	1974 SEC No-Act. LEXIS 807
Elwill Development Limited	Aug. 14, 1974	1974 SEC No-Act. LEXIS 20
Narda Microwave Corp.	Jan. 15, 1973	1973 SEC No-Act. LEXIS 3694
Arby's, Inc.	Mar. 27, 1972	1972 SEC No-Act. LEXIS 1343
Narda Microwave Corp.	Feb. 25, 1972	1972 SEC No-Act. LEXIS 813
Vogue Instrument Corp.	Jan. 17, 1972	1972 SEC No-Act. LEXIS 211