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**SFA****BILL ANALYSIS**

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Senate Bill 299 (as introduced 3-11-97)  
Sponsor: Senator Christopher D. Dingell  
Committee: Financial Services

Date Completed: 10-15-97

### **CONTENT**

The bill would amend the Uniform Commercial Code to rewrite Article 5 and Article 8, which govern letters of credit and securities transactions, respectively. Among other things, under the changes to Article 5, a letter of credit could be issued in any form that was a record, and “record” would be defined without reference to a written document. The bill also would incorporate a “standard practice” requirement for issuers of letters of credit; require that a presentation of documents strictly comply with the terms of the letter of credit; require an issuer to notify a beneficiary of discrepancies; and provide that a prevailing party would be entitled to recover attorney’s fees and other expenses of litigation.

In regard to Article 8, the bill would eliminate the current requirement that, to enforce a contract for the sale of securities, there be some form of writing or an admission in court that a contract exists. The bill also would govern the rights and duties between securities intermediaries (e.g., banks and brokers that hold securities for others) and entitlement holders (those who hold financial assets through securities intermediaries); provide that entitlement holders would have a property right in the financial assets; and specify the jurisdiction in which disputes would be resolved.

The bill would take effect on January 1, 1998. A brief overview of some of the bill’s provisions follows.

#### **Article 5**

The bill would define “letter of credit” as “a definite undertaking that satisfies the requirements of section 5104 [described below] by an issuer to a beneficiary at the request or for the account of an applicant or, in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or delivery of an item of value”.

Under Section 5104, a letter of credit, confirmation, advice, transfer, amendment, or cancellation could be issued in any form that was a “record” and was authenticated by a signature and/or in accordance with the agreement of the parties or the standard practice referred to in the bill. “Record” would mean information that was inscribed on a tangible medium, or that was stored in an electronic or other medium and was retrievable in perceivable form.

The bill provides that, except as otherwise provided, an issuer of a letter of credit would have to honor a presentation that, as determined by the standard practice, appeared on its face strictly to comply with the terms and conditions of the letter of credit. (“Presentation” would mean delivery of

a document to an issuer or nominated person for honor or giving of value under a letter of credit.) Except as otherwise provided and unless otherwise agreed with the applicant, an issuer would have to dishonor a presentation that did not appear to comply.

An issuer would have a reasonable time after presentation, but not beyond the seventh business day after receiving documents, to do one or more of the following:

- To honor (i.e., perform the issuer's undertaking in the letter of credit to pay or deliver an item of value).
- To accept a draft or incur a deferred obligation, if the letter of credit provided for honor to be completed more than seven business days after presentation.
- To give notice to the presenter of discrepancies in the presentation.

An issuer would be precluded from asserting as a basis for dishonor any discrepancy if timely notice were not given, or any discrepancy not stated in the notice if timely notice were given. Failure to give the required notice, however, or to mention fraud, forgery, or expiration in the notice would not preclude the issuer from asserting as a basis for dishonor fraud or forgery or expiration of the letter of credit before presentation.

An issuer would have to observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer's observance of the standard practice would be a matter of interpretation for the court. The court would have to offer the parties a reasonable opportunity to present evidence of the standard practice.

The bill provides that reasonable attorney's fees and other expenses of litigation would have to be awarded to the prevailing party in an action in which a remedy was sought under Article 5.

## **Article 8**

### **Writing Requirement**

The bill would repeal a number of sections of Article 8, including a section under which a contract for the sale of securities is not enforceable unless there is some form of writing or an admission in a court proceeding that a contract exists (MCL 440.8319). The bill specifies that a contract or modification of a contract for the sale or purchase of a security would be enforceable whether or not there was a writing signed or record authenticated by a party against whom enforcement was sought, even if the contract or modification were not capable of performance within one year of its making.

### **Rights & Duties of Securities Intermediary & Entitlement Holder**

Part 5 of the proposed Article 8 governs the rights and duties between securities intermediaries and entitlement holders. "Entitlement holder" would mean a person identified in the records of a securities intermediary as the person having a security entitlement against the intermediary. "Security entitlement" would mean the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5. "Securities intermediary" would mean either a clearing corporation or a person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity.

As a rule, a person would acquire a security entitlement if a securities intermediary did one or more of the following:

- Indicated by book entry that a financial asset had been credited to that person's securities

account.

- Received a financial asset from the person or acquired a financial asset for the person and, in either case, accepted it for credit to the person's securities account.
- Became obligated under other law, regulation, or rule to credit a financial asset to the person's securities account.

If any of those conditions had been met, a person would have a security entitlement even though the securities intermediary did not itself hold the financial asset.

The bill states that, to the extent necessary for a securities intermediary to satisfy all security entitlements with respect to a particular financial asset, all interests in that asset held by the securities intermediary would be held by it for the entitlement holders, would not be property of the intermediary, and would not be subject to claims of creditors of the intermediary, except as otherwise provided in the bill.

An entitlement holder's property interest with respect to a particular financial asset would be a pro rata property interest in all interests in that financial asset held by the securities intermediary, without regard to the time the entitlement holder acquired the security entitlement or the time the intermediary acquired the interest in that asset. An entitlement holder's property interest with respect to a particular financial asset could be enforced against a purchaser of the asset or interest in it only if specific circumstances existed.

The bill would require a securities intermediary to do the following:

- Promptly obtain and maintain a financial asset in a quantity corresponding to the aggregate of all security entitlements it had established in favor of its entitlement holders with respect to that asset.
- Take action to obtain a payment or distribution made by the issuer of a financial asset.
- Exercise rights with respect to a financial asset if directed to do so by an entitlement holder.
- Comply with an entitlement order if the order were originated by the appropriate person, the intermediary had had reasonable opportunity to assure itself that the order was genuine and authorized, and the intermediary had had reasonable opportunity to comply with the order. ("Entitlement order" would refer to a notification directing transfer or redemption of a financial asset to which the entitlement holder had a security entitlement.)
- Act at the direction of an entitlement holder to change a security entitlement into another available form of holding for which the holder was eligible, or to cause the asset to be transferred to a securities account of the holder with another intermediary.

### Choice of Law

The bill specifies that the law of the securities intermediary's jurisdiction would govern all of the following:

- Acquisition of a security entitlement from the securities intermediary.
- The rights and duties of the intermediary and entitlement holder arising out of a security entitlement.
- Whether the intermediary owed any duties to an adverse claimant to a security entitlement.
- Whether an adverse claim could be asserted against a person who acquired a security entitlement from the intermediary or a person who purchased a security entitlement or interest in it from an entitlement holder.

The law of the jurisdiction in which a security certificate was located at the time of delivery would govern whether an adverse claim could be asserted against a person to whom the certificate was

delivered.

The law of the issuer's jurisdiction would govern all of the following:

- The validity of a security.
- The rights and duties of the issuer with respect to registration or transfer.
- The effectiveness of registration or transfer by the issuer.
- Whether the issuer owed any duties to an adverse claimant to a security.
- Whether an adverse claim could be asserted against a person to whom transfer of a certificated or uncertificated security was registered or a person who obtained control of an uncertificated security.

MCL 440.5101 et al.

Legislative Analyst: S. Lowe

### **FISCAL IMPACT**

The bill would have no fiscal impact on the Department of Consumer and Industry Services or on the Department of State.

Fiscal Analyst: M. Tyszkiewicz  
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