New Article 8 of the Uniform Commercial Code: Are Certificated Shares Subject to a Perfected Security Interest If Held in Escrow?

Claire Moore Dickerson
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INTRODUCTION

A standard form of securing the payment of debt arising from the sale of securities is to pledge the purchased securities and to place them physically in escrow. This form is traditionally used in leveraged buyouts, in which a corporation, for example, sells part of its business to those responsible for the management part of the business. The purchasers will typically buy the assets, subject to specified liabilities, through a corporate vehicle. Although part of the purchase price will be in cash, the substantial majority is usually in the form of debt. The lender can be the selling corporation or a financial institution, such as a commercial bank. The debt is evidenced by notes. The corporate purchaser will secure payment of the notes by granting a security interest in all of its assets, which may include the pledging of its own shares to the lender.

Until the mid-1970's there had been considerable uncertainty

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1. See American Law Inst. & National Conf. of Comm'rs on Uniform State Laws, Uniform Commercial Code: 1972 Official Text with Comments and Appendix § 9-305 (1972) [hereinafter 1972 Official Text] (stating that "[a] security interest . . . may be perfected by the secured party's taking possession of the collateral."); see also In re Kontaratos, 10 Bankr. 956, 960 n.11 (Bankr. D. Me. 1981) (stating that there is "no authority for the proposition that a security interest in certificated stock may be perfected . . . by any means except possession." (emphasis in original)). See generally R. Henson, Handbook on Secured Transactions § 4-26, at 102-07 (2d ed. 1979) (discussing perfection by possession).

2. By its simplest definition, a leveraged buyout is a takeover of a company, usually using the target company's assets as security for the loans taken out by the acquiring firm, loans which are repaid out of the cash flow of the acquired company. J. Friedman, Barron's Dictionary of Business Terms 323 (1987).
about whether shares pledged to a lender in this manner created a perfected security interest in favor of that lender if the certificates representing the pledged securities were physically placed in escrow, rather than being delivered to the pledgee-lender.³

The answer to that issue can be very significant because borrowers often insist that the pledged share certificates be placed in escrow with a third-party escrowee⁴ rather than having those securities held by the pledgee-lender or its agent. The use of an escrowee gives the borrower more comfort that the pledge will be acted upon only if the conditions precedent, such as default by the debtor, have been satisfied.

Conversely, creditors are legitimately concerned that the assets in which they have been granted a putative security interest will be available to them as security if those conditions precedent are indeed satisfied. The rights of the creditors must therefore be good not only against the debtor with whom they are in privity, but also good against third parties.⁵ Judicial decisions of the 1970's regarding the use of the escrow mechanism varied in result.⁶ However, this Article demonstrates that the American Law Institute's 1977 proposed revisions to Article 8 of the Uniform Commercial Code⁷ restrict the applicability of those decisions.

The expressed purpose for the 1977 revision of Article 8 was to create a system less burdensome on the securities industry as the industry becomes less dependent on paper, i.e. as an increasing

³. See infra text accompanying notes 40-53 (discussing the uncertainty under the common law of security as to whether an escrow could create a valid security interest).

⁴. An "escrowee" is "an intermediary with obligations to parties on both sides of the transaction, as distinguished from an agent acting exclusively in the interest of and pursuant to the authority of the seller." Estate of Kamm v. Commissioner, 349 F.2d 953, 956 (3d Cir. 1965) (citation omitted); see also infra text accompanying notes 50-51 (distinguishing a pledgee from an escrowee holding pledged securities)

⁵. These third parties include other creditors of the debtor and, in the event that the debtor goes into bankruptcy, against the bankruptcy trustee or the person standing in the trustee's shoes.


⁷. See AMERICAN LAW INST. & NATIONAL CONF. OF COMM'RS ON UNIFORM STATE LAWS, UNIFORM COMMERCIAL CODE: 1978 OFFICIAL TEXT WITH COMMENTS AND APPENDICES (1978) [hereinafter 1978 OFFICIAL TEXT]. The 1978 official text includes the proposed 1977 revisions to Article 8. See id. preface at III.

⁸. See 1978 OFFICIAL TEXT, supra note 7, foreword at XLI. Herbert Wechsler, Chairman of the Permanent Editorial Board of the Uniform Commercial Code, notes that "the
number of transfers of securities are reflected by mere entries on corporate books or notations made by brokers on their own books.\(^9\)

Hence, part of the focus of the 1977 Article 8 is on the so-called "uncertificated" securities.\(^{10}\) New Article 8 was also intended, and does apply, to standard "certificated" securities.\(^{11}\) Consequently, the 1977 version of Article 8 can have a significant impact on a familiar form of securing the risk of financing the purchase and sale of certificated securities.\(^{12}\) The purpose of this Article is to show how the 1977 changes to Article 8 create a substantial risk that creditors using the traditional pledge and escrow of certificated securities will no longer benefit from the protection which exists under the pre-1977 Uniform Commercial Code.\(^{13}\) The discussion shows that this new risk exists despite the fact that the pledge and escrow mechanism was approved by the weight of judicial and scholarly authority under the pre-1977 Code.

The 1977 revisions to Article 8, or a variant thereof, have been adopted by thirty-five states, including such major commercial centers as California, New York, and Delaware.\(^{14}\) Further, under the conflicts of law principles applicable to the perfection of a security interest in certificated shares, the law that will govern is the law of the jurisdiction where the share certificate was located "when the last event occurs on which is based the assertion that the security


10. See 1B U.C.C. Serv. (MB) § 14A.01[3], at 14A-9 (1988) (defining "uncertificated securities" as those shares or bonds "which are not represented by an instrument but ... are evidenced only as notations on the issuer's books.")

11. 1978 Official Text, supra note 7, reporter's introductory comment, app. 1 at 779, 780.

12. For a complete discussion by Professor Coogan of other problems arguably caused by the 1977 revision to Article 8, see 1B U.C.C. Serv. (MB) chs. 14A-14B (1988).

13. See infra text accompanying notes 193-354 (examining new Article 8 and explaining its effect on escrows).

interest is perfected or unperfected." As this Article demonstrates, transfer of possession, within the meaning of the new Article 8, will be the means of perfecting a security interest in a certificated security. Hence, the laws of the state of incorporation of the corporation whose shares are to be pledged will not necessarily control. An understanding of the 1977 revisions to Article 8 is therefore important, not only for a person located in a state having adopted those revisions, but also for any creditor doing business that involves such a state.

I. History

In order to understand the impact of the 1977 amendments to Article 8 on pledged and escrowed certificated securities, it is first necessary to review how creditors obtained security interests in certificated securities under that Article's predecessors.

A. Pre-Uniform Commercial Code

1. General Pre-Code History.— Prior to any state's adoption of the 1962 proposed version of the Uniform Commercial Code, the common law of security, as modified by state statutes, governed the creation of a security interest in shares. As reflected in the Restatement of Security, the common law made no distinction between certificated shares and shares representing ownership participation or bonds representing an interest as a creditor, this Article will refer only to "shares." This is to reduce the confusion between the "security" which is being pledged, and the "security interest" which is being granted.

15. 1978 Official Text, supra note 7, § 9-103(1)(b). This subsection is unchanged from the 1972 version of the U.C.C. See 1972 Official Text, supra note 1, § 9-103(1)(b). Section 9-103(1) of both prior and present versions of the U.C.C. specifies that subsection (1)(b) applies to "instruments." See 1978 Official Text, supra note 7, § 9-103(1); 1972 Official Text, supra note 1, § 9-103(1). The 1972 version of Article 9 states that "instrument" includes securities. See id. § 9-105(1)(i). On the other hand, the 1978 version further specifies that "instrument" includes only securities which are "certificated." See 1978 Official Text, supra note 7, § 9-105(1)(i). Therefore, whether or not the relevant jurisdiction has adopted the 1977 amendments modifying the 1972 official text, certificated shares will be subject to the conflicts of law rules of U.C.C. § 9-103(1)(b). For a general discussion of the conflicts of law issues relating to certificated securities, see 1B U.C.C. Serv. (MB) § 14B-04, at 14B-16 to -22 (1988).

16. See infra text accompanying notes 199-291.

17. Although this analysis will apply to all certificated securities, whether they are shares representing ownership participation or bonds representing an interest as a creditor, this Article will refer only to "shares." This is to reduce the confusion between the "security" which is being pledged, and the "security interest" which is being granted.

18. See generally Restatement of Security (1941) (embODYING the common law of security). The Restatement defines a "pledge" as "a security interest in a chattel or in an intangible represented by an indispensable instrument, the interest being created by a bailment for the purpose of securing the payment of a debt or the performance of some other duty." Id. § 1.
ation and perfection of a security interest.\textsuperscript{19} If a security interest could be created, then it was automatically perfected.\textsuperscript{20} The usual way to create such a security interest in a certificated share was by delivery of the certificate representing that share.\textsuperscript{21} The most standard and certain way of creating the security interest was to have the debtor deliver his shares to the creditor, or, to put it in the nomenclature, to have the pledgor of the shares deliver the pledged shares to the pledgee.\textsuperscript{22} As explained by the Restatement of Security, this required "manual delivery . . . to a pledgee by a pledgor" of the certificates representing the shares.\textsuperscript{23}

Two other accepted methods of pledging shares were also permitted. First, manual delivery could be by the pledgor to an agent of the pledgee, which is tantamount to delivery to the pledgee himself.\textsuperscript{24} Second, if the share certificates had previously been placed in the hands of a third person, then, if the pledgor agreed, upon receipt by that third person of notification to the effect that he was holding for the benefit of the pledgee, a valid and therefore perfected security interest could be created.\textsuperscript{25}

The Restatement of Security illustrates the importance of knowing whether delivery had been effectively made to the pledgee, his agent, or to the bailee-with-notice on behalf of the pledgee. Section 10(1) of the Restatement expressly provides that if the creditor and debtor merely contracted for the pledge of the shares by the debtor in favor of the creditor but did not effect delivery, the creditor would not have an enforceable interest against either "a bona fide purchaser [or] against attaching or levying creditors who have become creditors of the intended pledgor without notice of the [pledgee's] equitable interest."\textsuperscript{26} Thus, a subsequent creditor of the same debtor could receive a perfected security interest in the shares.

\begin{itemize}
\item 19. See G. Gilmore, Security Interests in Personal Property § 14.2, at 435 (1965) (noting that the term perfection "does not appear in any of the older security statutes, but Article 9 of the [Uniform Commercial] Code makes a basic distinction between a 'perfected' and an 'unperfected' security interest.").
\item 20. See Restatement of Security §§ 4-8 (1941).
\item 21. See id. § 5; id. § 4 comment a.
\item 22. See id. § 5.
\item 23. Id. Section 5 refers to manual delivery of a "chattel," which, in turn, is defined in § 1, comment d, to include "instruments." Id. § 1 comment d. The Restatement further defines an "indispensable instrument" to include share certificates. Id. § 1 comment e.
\item 25. See Restatement of Security § 8 (1941).
\item 26. Id. § 10(1).
\end{itemize}
unless, of course, he had notice of the prior interest.\textsuperscript{27} This result was particularly dangerous to creditors since the Bankruptcy Act then in force\textsuperscript{28} treated the trustee in bankruptcy or his representative as though he had become the holder of a valid, perfected security interest as of the date of bankruptcy.\textsuperscript{29} Consequently, any interest which was not a perfected security interest throughout the statutorily prescribed preference period immediately preceding bankruptcy and including the date of bankruptcy was vulnerable to attack in the event that the debtor subsequently became bankrupt.\textsuperscript{30}

Thus, if there was no delivery, there would be no security interest, and no protection for the creditor against third parties. As between a debtor and a creditor, however, if it had been intended that the debtor was supposed to pledge shares but “delivery” of the collateral was nevertheless not effected, a different result would obtain. The \textit{Restatement of Security} emphasized that in this situation an “equitable interest” in favor of the creditor would be created.\textsuperscript{31} The result of this equitable remedy is comparable to the modern unperfected security interest which is valid as between the parties, but generally not as against third parties, including a trustee in bankruptcy.\textsuperscript{32}

Nevertheless, under common law rules, no security interest whatsoever would be created unless the pledged shares were delivered to the pledgee, his agent, or to a bailee-with-notice.\textsuperscript{33} Further, a writing was not essential to the creation of a pledge.\textsuperscript{34} Delivery of the shares provided both the evidence that the debtor did in fact intend to give a security interest to the creditor and a manifestation sufficient to put the world on notice that the creditor had an interest in the pledged shares.\textsuperscript{35}

\begin{itemize}
\item \textsuperscript{27} \textit{See id.}
\item \textsuperscript{28} Act of July 1, 1898, ch. 541, 30 Stat. 544 (as amended) (repealed 1978).
\item \textsuperscript{29} Act of June 22, 1938, ch. 575, § 70(c), 52 Stat. 840, 881 (repealed 1978).
\item \textsuperscript{30} Sections 60(a) and 60(b) of the Bankruptcy Act of 1898, as modified by the Chandler Act, Act of June 22, 1938, ch. 575, 52 Stat. 840 (repealed 1978), specified a preference period consisting of the four months prior to the filing of a petition in bankruptcy. \textit{See id.} §§ 60(a)-(b), 52 Stat. at 869-70.
\item For a description of the evolution of the bankruptcy law from 1898 to 1938 and beyond, see \textit{G. Gilmore, supra} note 19, § 14.4, at 445-49.
\item \textsuperscript{31} \textit{Restatement of Security} § 10 (1941).
\item \textsuperscript{32} \textit{See infra} text accompanying notes 70-133 (discussing attachment versus perfection under the pre-1977 Uniform Commercial Code).
\item \textsuperscript{33} \textit{See supra} text accompanying note 26 (discussing § 10(1) of the \textit{Restatement of Security}).
\item \textsuperscript{34} \textit{Restatement of Security} § 9 (1941).
\item \textsuperscript{35} \textit{See G. Gilmore, supra} note 19, § 14.1, at 438-39; \textit{see also} 1B U.C.C. Serv. (MB) §
\end{itemize}
What is "delivery" in this context? At what point does the pledgor give up sufficient indicia of possession and at what point does the pledgee acquire sufficient indicia? To answer these questions, this Article focuses on the type of pledge transaction which uses the escrow mechanism, or a structure having many of the same characteristics.  

2. Pre-Code History as it Applies to Escrows.— As previously discussed, delivery was the critical factor in the creation of a security interest. The comment to section 5 of the Restatement of Security provides that an item in a locked box will be deemed delivered if the key to the box is relinquished, so long as there are no significant obstacles to obtaining "possession and control" of that box. The focus is on whether the pledgee-lender can gain control over the pledged item and not on whether the pledgor has relinquished simultaneous control of that item. However, in order to unambiguously evidence the pledgor's intent to grant a security interest to the pledgee and to manifest to third parties that the pledgor no longer has unencumbered rights to the item in the box, the pledgor must be prepared to share his ability to reach that item and compromise his independent ability to do so.


36. See generally Restatement of Security § 4 (1941) (providing that a pledge is created by a variety of methods enumerated in § 5 through § 8 or any other method sufficient to create a bailment for the purpose of security).

37. See supra text accompanying notes 21-35.

38. Restatement of Security § 5 comment a (1941).

39. Cf. id. § 6 comment a (providing that "[w]hether there has been an assumption of control by the pledgee sufficient to create a pledge and whether the requisite notoriety to bind third persons has been attained are questions of fact."). This portion of the comment is in the context of field warehousing, an area in which the issue often arose as to whether delivery had been made to an agent of the pledgee or to an alter ego of the putative pledgor. See G. Gilmore, supra note 19, § 6.4, at 162-68 (discussing field warehousing litigation).

It is important to note that the 1941 Restatement of Security was drafted at a time when Benedict v. Ratner, 268 U.S. 353 (1925), was still considered valid law. Benedict involved a loan purportedly secured by the assignment of receivables. Id. at 357-58. Justice Brandeis wrote that the rule forcing invalidation of the assignment of receivables "rests not upon seeming ownership [by the debtor] because of possession retained . . . . It imputes fraud conclusively because of the reservation of dominion [by the debtor] inconsistent with the effective disposition of title and creation of a lien." Id. at 363; see also In re Prudence Co., 88 F.2d 420, 421-22 (2d Cir. 1937) (assuming without comment that Benedict extended to pledges of real estate mortgages but distinguishing Benedict on the facts). See generally G. Gilmore, supra note 19, §§ 8.2-8, at 253-86 (discussing Benedict and its progeny).

In other words, Justice Brandeis did not focus on whether there was evidence of a transfer of dominion sufficient to put third parties on notice, which is the common law analogue to perfection. See infra text accompanying notes 110-33 (discussing perfection). Rather, Justice
The application of this concept is clear when limited to the idea that transfer by the pledgor to his own agent is not sufficient to constitute delivery by the pledgor. A question arises, however, whether the pledgor "delivers" an item when he places it with an escrow holder. The Restatement (Second) of Agency recognizes that "[a]n escrow holder is not as such an agent of either party to the transaction until the event occurs which terminates the escrow relation."\(^{40}\) Even if the escrowee is not immediately an agent of the pledgor, however, an issue arises as to whether the escrowee's receipt of the item to be pledged constitutes sufficient evidence of transfer by the pledgor to the pledgee, and of receipt by the pledgee, to effect "delivery."\(^{41}\)

The common law cases deal with the circumstances in which the item in question is in the hands of a third party who is neither the pledgor nor the pledgee, but they do not treat an escrowee as a stand-in for the pledgee. The Restatement of Security does expressly permit the bailee-with-notice concept, but only in the case of goods too bulky to be physically transferred,\(^{42}\) or in the case where the bailee is already in possession of the goods before the attempt to pledge them has been commenced.\(^{43}\) The first circumstance does not apply to certificates representing shares since shares are not goods too bulky to be physically transferred; the second circumstance is not a typical escrow situation where the shares are delivered to the escrowee.

This second circumstance would encompass the situation where the debtor already has borrowed from creditor one and has pledged, and therefore delivered, share certificates to him, but where the value of those shares exceeds the amount of the debt. The debtor later seeks to borrow from creditor two against the equity left in the already-pledged shares in the possession of creditor one. Clearly, any rights of creditor two would be subordinate to those of creditor one.\(^{44}\)

Brandeis focused on what was necessary to create the lien, which is the analogue to attachment. See infra text accompanying notes 76-109 (discussing attachment).


41. As a practical matter, the amount of evidence required from possession may be reduced to the extent that the debtor's intent is reflected in a written agreement with the creditor. See infra text accompanying notes 70-133 (discussing attachment versus perfection under the U.C.C.).

42. See Restatement of Security § 6 comment a (1941).

43. See id. § 8.

44. See Pierce v. National Bank of Commerce, 268 F. 487, 495 (8th Cir. 1920) (stating that "[t]he owner of personal property subject to a prior pledge . . . may lawfully pledge his remaining interest therein . . . "); Robinson v. Exchange Nat'l Bank, 31 F. Supp. 350, 351
Under common law, however, such an arrangement did create a security interest in favor of creditor two, as long as creditor one was notified that he was holding the pledged shares for the benefit of creditor two as well as himself.  

The pre-Uniform Commercial Code cases provide no evidence that a security interest can be created in favor of the pledgee by pledging the property and simultaneously transferring the pledged property to a third party. For an item held by a third party to be deemed delivered, the item had to be one already held by that third party. Simultaneous delivery is a hallmark of the escrow arrangement, and it had been expressly held that an escrow transaction did not constitute a pledge. This conclusion was necessitated by the fact that the pledge depended on the pledgee acquiring control of the item to be pledged, a result incompatible with the escrow structure.  

A practical distinction can be drawn between a first pledgee and an escrowee holding pledged securities. Since the first pledgee will normally have an interest relatively adverse to the debtor, third parties will have reasonably unambiguous notice that the debtor does not have sole control of the item. On the other hand, while the

(N.D. Okla. 1940) (stating that an "instrument previously pledged and in the possession of the pledgee, may be again pledged by the owner to another person subject to the pledge lien of the first pledgee ... ").

45. See Pierce, 268 F. at 495; Schram v. Sage, 46 F. Supp. 381, 383 (E.D. Mich. 1942); see also G. Gilmore, supra note 19, § 14.2, at 440-41 (noting that pledged collateral in the possession of a third party becomes perfected when that party receives notice of the pledgee's intent from the pledgee or pledgor).

46. See, e.g., Qualley v. Snoqualmie Valley Bank, 136 Wash. 42, 238 P. 915 (1925). In Qualley, the debtor placed in escrow a note payable to the creditor, together with a note payable to the debtor as security for the debtor's obligation to the creditor. Id. at 42-45, 238 P. at 915-16. The escrowee was a bank who received those items at the time of the loan by the principal creditor to the debtor. Id. at 43, 238 P. at 915. The Supreme Court of Washington held that no pledge had been created because "[o]ne of the prime requisites of a pledge is that the pledgor[-debtor] has parted with his property and that the pledgee[-creditor] has possession or control over the property." Id. at 48, 238 P. at 917. The court further emphasized that, as escrowee, the bank was holding for both the debtor and the creditor, and that it would be only after the occurrence of one or more of the contingencies specified in the escrow agreement that either would acquire an "unqualified possession or right of possession." Id. at 49, 238 P. at 917.

47. See Restatement of Security § 8 (1941).

48. Qualley, 136 Wash. at 48-50, 238 P. at 917.

49. See id.

50. The bailee-with-notice scenario satisfies the perfection part of the task. See supra text accompanying note 25. But what about attachment? The notice to the first pledgee that it is also holding on behalf of the second pledgee may be given by either the pledgor or the second pledgee. See Restatement of Security § 8 (1941); G. Gilmore, supra note 19, § 14.2, at 440-41. But there must exist an underlying intent of the pledgor to create the second
pledgee would be willing to hold the pledged item, and may be willing to allow a person adverse to the debtor to hold it even if that person is not technically an agent of the pledgee, the pledgee is not normally the party who will suggest that the item be held by an escrowee, who is a relatively neutral party. It is the pledgor who does not wish to give up too much control over the item and who, therefore, will make the proposal that the item be held by an escrowee instead of the pledgee. The use of the escrow mechanism arguably evidences the pledgor's intent to transfer to the pledgee fewer rights than were traditionally required for "delivery." It is also less clear to third parties that the pledgor has indeed relinquished substantial rights to the item to be pledged.\textsuperscript{61}

Therefore, with respect to share certificates, pre-Uniform Commercial Code common law required the pledgor to give up substantial control over the item to be pledged before a pledge could be created.\textsuperscript{62} Specifically, the creditor could acquire a right which is good against third parties only upon receipt of "delivery" of those share certificates in all circumstances except where the certificates were already in the hands of a party substantially adverse to the pledgor.\textsuperscript{63}

B. Security Interests and Escrow Agreements under the pre-1977 Uniform Commercial Code

1. General pre-1977 Code History.— The principal Article of the Uniform Commercial Code covering the creation and perfection

\textsuperscript{51} See infra text accompanying notes 134-92 (discussing whether the use of the escrow mechanism weakens the evidence of the pledgor’s intent to pledge, or the notice to be given to third parties of the existence of the pledge, or both).

\textsuperscript{52} Cf. Restatement of Security § 7 (1941) (contemplating a pledge created by the pledgee’s retention of the item to be pledged). This scenario is not studied here since it is incompatible with the escrow mechanism which is the focus of this Article. For further discussion, see G. Gilmore, supra note 19, § 14, at 438-61.

\textsuperscript{53} But cf. supra note 31 and accompanying text (discussing how the equitable lien is good as between the debtor and the creditor).
of security interests, and determining their effect, is Article 9. As an official comment to the Uniform Commercial Code expressly states, Article 9 "applies to all transactions intended to create security interests in personal property . . . ." The official comments, however, also emphasize that "[t]his does not mean that the old forms may not be used," but that even when they are used, "the rules of this Article govern." The focus of this section of the analysis is the pre-1977 Uniform Commercial Code, and thus the 1972 official version will be the focal point.

As previously stated, Article 9 will govern the pledging of certificated shares, except to the extent that the statute specifically states otherwise. Prior section 9-102(1)(a) specifies that the Article applies "to any transaction . . . which is intended to create a security interest in . . . instruments." "Instruments" are defined in section 9-105(1)(i) to include securities. Prior section 8-102 defines a "security" as being, in effect, an instrument evidencing participation in the issuer, being in bearer or registered form, and being of a type commonly dealt in upon securities exchanges or commonly recognized as a medium for investment.

54. 1978 OFFICIAL TEXT, supra note 7, §§ 9-101 to -507; see also G. Gilmore, supra note 19, § 10.1, at 295-97 (discussing the comprehensive nature of Article 9).
55. 1978 OFFICIAL TEXT, supra note 7, § 9-101 official comment.
56. Id.
57. Id. § 9-102 official comment 1.
58. In order to avoid confusion with the 1977 version, the text will refer to the 1972 version as the "prior" Article, text, or section of the Uniform Commercial Code.
59. 1972 OFFICIAL TEXT, supra note 1. Uniform Commercial Code §§ 9-101, 9-102, 9-103(1), 9-203, 9-304, and 9-305 are the Article 9 sections on which this Article focuses. The only difference between those sections in the 1972 Official Text and the 1978 Official Text is that in the latter, certificated shares are excluded from §§ 9-203, 9-304, and 9-305. See infra text accompanying notes 193-215 (discussing the effect of the exclusion of certificated shares from new Article 9).
60. 1972 OFFICIAL TEXT, supra note 1, § 9-102(1)(a). The section applies unless the type of collateral is excluded by § 9-104. Id. § 9-102(1). Since instruments are not expressly excluded under § 9-104, see id. § 9-104, they are impliedly included.
61. Id. § 9-105(1)(i).
62. Id. § 8-102(1)(a). Section 8-102(1)(a) of the 1972 text reads as follows: A "security" is an instrument which
   (i) is issued in bearer or registered form; and
   (ii) is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and
   (iii) is either one of a class or series or by its terms is divisible into a class or series of instruments; and
   (iv) evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.
What is the significance of Article 9 governing certificated securities? Under prior Article 9, a perfected security interest in certificated shares is created in two parts. The security interest must "attach," and must be "perfected." The importance of having a perfected security interest in certificated shares under prior Article 9 and the Bankruptcy Reform Act of 1978 is comparable to the significance of having created a valid pledge under pre-Uniform Commercial Code common law and the Bankruptcy Act of 1898.

To give a simple but typical example, unless the security interest has been perfected more than ninety days (in most cases) prior to the filing in bankruptcy, the transfer of payment by the debtor on the debt which was either unsecured or secured but unperfected is "avoidable" by the trustee in bankruptcy as a "preference." As a result, in the event of the debtor's bankruptcy, unless the security interest has been both created and perfected, the creditor will find himself in no better position than a wholly unsecured creditor.

Under the Bankruptcy Code, a transfer of property, including the granting of a security interest in property neither realty nor fixtures, is considered to have been perfected only when no creditor can acquire a judicial lien superior to the interest of the secured creditor. Whether an interest is perfected, for the purposes of the Bankruptcy Code, consequently depends on applicable state law. The

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Id.

There has been discussion as to whether the shares of a closely held corporation constitute "securities" for purposes of Article 8. In other words, are the shares in a family corporation "of a type" commonly traded or used for investment? The first case to answer in the negative was Zamore v. Whilten, 395 A.2d 435, 441 (Me. 1978). Other courts, however, have generally not followed Zamore. See, e.g., In re Kontaratos, 10 Bankr. 956, 960 (Bankr. D. Me. 1981). In Kontaratos, decided under pre-1977 Articles 8 and 9, the court sought to distinguish the facts at hand by noting that the corporation in question was not family-held; however, the opinion rejected the Zamore analysis in the interests of "[s]implicity, clarity and uniformity." Id. Further, the Kontaratos opinion suggests that even if family-held stock were not a "security" for purposes of Article 8, it would be an "instrument" for purposes of Article 9. Id. at 960 n.11; see also 1972 OFFICIAL TEXT, supra note 1, § 9-105(1)(i) (defining "instrument").

63. 1972 OFFICIAL TEXT, supra note 1, § 9-203.
64. Id. §§ 9-304 to -305.
66. See supra text accompanying notes 28-30 (discussing the vulnerability to attack of an unperfected security interest if the debtor became bankrupt).
69. See In re Gulino, 779 F.2d 546, 550 (9th Cir. 1985) (stating that "what is necessary to perfect a transfer of an interest in real property depends entirely on state law."); In re
question thus becomes whether a judgment creditor, under state law, would have rights superior to those of the subject secured creditor. Thus, the analysis of the Uniform Commercial Code again becomes relevant.

Under Article 9 there are reasons outside of the bankruptcy area why the attachment of a security interest, and the perfection of a security interest, can be of critical importance. In this context, it is important to keep in mind that, under common law, a pledge was created only if was perfected; it was not possible to have an unperfected pledge. Article 9 provides that the secured party may, inter alia, foreclose on or repossess the collateral in the event of default by the debtor, if there is a valid security interest. These Article 9 foreclosure proceedings or rights to repossess are available as long as the security interest has attached, whether or not it has been perfected. In fact, it is not only the senior secured creditor who may take these actions.

Therefore, the creation of a security interest and its perfection are both important, but, under prior Article 9, attachment and perfection can have substantially different consequences. This Article studies sequentially the attachment and then the perfection of a security interest in certificated shares under prior Article 9.

Before the analysis turns to what constitutes attachment and perfection under prior Article 9 as it applies to certificated shares, it should be noted that where a transfer of possession was required, prior Article 8 defines “delivery” of a certificated share as the time when the acquiror receives rights in the share, and prior section 8-
313(1) describes when the delivery occurs.\footnote{Id. § 8-313(1); see also infra note 239 (concerning the extent to which the subsections of prior § 8-313(1) were retained by the 1977 amendments to § 8-313(1)).}

2. Attachment under the pre-1977 Uniform Commercial Code.— Under prior Article 9, a security interest is created, or, to use the Article 9 language, attaches, pursuant to section 9-203. Specifically, a security interest in certificated shares will attach and, therefore, will be enforceable against the debtor only if the following three criteria have been met: "(a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral . . . ; (b) value has been given; and (c) the debtor has rights in the collateral."\footnote{1972 OFFICIAL TEXT, supra note 1, § 9-203(1).}

The requirement that the debtor have rights in the collateral before he can give away rights is not surprising, and the requirement that he must have been given value by the secured party before the debtor grants him a security interest is essentially an issue of consideration.\footnote{See In re Reliable Mfg. Corp., 703 F.2d 996, 1000 (7th Cir. 1983) (discussing value as consideration); United States v. Cahall Bros., 674 F.2d 578, 581 (6th Cir. 1982) (same).} Critical to this analysis is that in addition, the creditor must have possession of the collateral pursuant to an agreement or the debtor must have signed a security agreement.\footnote{1972 OFFICIAL TEXT, supra note 1, § 9-203(1)(a).}

Turning first to the requirement that the certificate be in the possession of the secured party pursuant to an agreement, mere possession by the creditor would not alone be sufficient since the debtor might have meant the creditor to hold the item for a wholly unrelated purpose. In other words, the debtor must have agreed with the creditor that the latter will have possession of the item for the purpose of having a security interest in that collateral which would attach in favor of that creditor. However, as official comment 3 to the 1972 version of section 9-203 makes clear, if the collateral is in the possession of the secured party, that fact can be the only evidence of the existence of the underlying agreement.\footnote{Id. § 9-203 official comment 3.} This is comparable to the common law rule that no written agreement was required.\footnote{See RESTATEMENT OF SECURITY § 9 (1941); see also supra text accompanying note 34.}

While not required, the official comment notes that proper business practice suggests that a written record be maintained.\footnote{1972 OFFICIAL TEXT, supra note 1, § 9-203 official comment 3.}
Before the focus turns to what constitutes "possession" sufficient to satisfy prior section 9-203(1)(a), the alternate method of satisfying the agreement criterion for attachment, the signing by the debtor of a "security agreement" describing the collateral, should be considered. "Security agreement" is defined in section 9-105(1) as "an agreement which creates or provides for a security interest," meaning that it evidences the debtor's intent to grant the interest. Further, it is clear that this agreement must be in writing since section 9-203(1)(a) states that the debtor must have signed it.

The important concept for present purposes is that a debtor can, under prior Article 9, cause a security interest to attach in his certificated shares by signing an agreement which evidences his intent to create such an interest in those shares. Since the secured party need not be given possession under this alternative, the debtor can cause a security interest to attach in shares without relinquishing his own possession of the certificates representing the shares.

Turning back to the mere transfer of possession as the means of causing the security interest to attach in the certificated shares, the analysis relating to the security agreement should help focus on the purpose of the possession. If there is no written manifestation of the debtor's agreement to grant a security interest, the collateral should be sufficiently "in the possession of the secured party" to unambiguously evidence the debtor's intent to grant that interest.

As prior section 9-203 expressly provides, the creditor himself may have possession. Further, possession by an agent of the creditor is sufficient, although not expressly permitted by Article 9, since section 1-103 provides for the continued validity of concepts of agency law "[u]nless displaced by the particular provisions" of the Uniform Commercial Code. Courts have also systematically recognized the existence of a security interest where the creditor's agent is in possession of the collateral. Thus far, the result has been identi-
cal to that at common law. As Professor Coogan points out, possession (whether by the creditor or his agent) for the purposes of proving attachment should require a relatively high level of "secured party involvement," since the higher the level of involvement, the more likely that the debtor's acquiescence was, as a practical matter, necessary. If the facts indicate a high likelihood that the debtor had to agree, then they should constitute satisfactory evidence of the debtor's agreement to grant a security interest to the secured party.

Prior section 9-205, however, expressly states that a "security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use, commingle or dispose of all or part of the collateral." The comments to section 9-205 emphasize that this section is intended to repeal Benedict v. Ratner and its successors. That pre-Uniform Commercial Code line of cases held that the debtor had to relinquish dominion and control over the collateral in order to create the equivalent of a perfected security interest.

Under common law, pledges of certificated securities could not exist unless created and perfected. Therefore, it is unclear whether the Benedict rule focused on the early analogue to attachment or to perfection. Since section 9-205 is located in Part 2 of Article 9, entitled "Validity of Security Agreement and Rights of Parties Thereto," it is certain that the draftsmen felt that the repeal of Benedict should impact possession as a means of creating the secu

91. See supra text accompanying notes 21-35 (discussing delivery of a pledge by three methods: to the pledgee, to his agent, or to a bailee-with-notice).
92. Professor Peter F. Coogan was a member of the American Law Institute's Permanent Editorial Board for the Uniform Commercial Code at the time of the drafting of the 1977 Code. See 1978 OFFICIAL TEXT, supra note 7, at ix.
94. See id.
95. 1972 OFFICIAL TEXT, supra note 1, § 9-205.
96. 268 U.S. 353 (1925), discussed supra note 39.
97. See 1972 OFFICIAL TEXT, supra note 1, § 9-205 official comments 1, 4.
98. See, e.g., Pierce v. National Bank of Commerce, 268 P. 487, 492-93 (8th Cir. 1920) (noting that dominion and control can be relinquished to a third party in possession of the collateral); Qualley v. Snoqualmie Valley Bank, 136 Wash. 42, 48, 238 P. 915, 917 (1925) (stating that it is necessary that "the control and dominion over the property passes from the pledgor into the absolute control and dominion of the pledgee."); see also supra note 39 (discussing Benedict in the context of pledges).
99. See supra text accompanying notes 19-20 (discussing the common law's lack of distinction between the creation of a security interest and its perfection).
100. See 1972 OFFICIAL TEXT, supra note 1, § 9-205.
ity interest equalling attachment. Consequently, a security interest can be created under the Uniform Commercial Code even when the possession acquired by or on behalf of the secured creditor does not entail relinquishment by the debtor of dominion and control.

This repeal of Benedict makes perfect sense if the attachment is effected by means of a written agreement, since the evidentiary aspect of possession for attachment is not then relevant. Indeed, the case law seems to focus on circumstances where possession was necessary for perfection rather than attachment. The repeal, however, should theoretically also apply in the case where there is no writing amounting to a security agreement. In such a situation, because Benedict has been repealed, the analysis should no longer consider whether the debtor did or did not retain dominion and control. Rather, the analysis should merely determine whether the possession transferred by the debtor constitutes sufficient evidence of the debtor's intent to create the security interest.

Under prior Article 9, therefore, a security interest in certificated shares would attach if there was a valid, written security agreement. It also would attach if the debtor delivered possession of the certificates to the creditor or his agent, in a manner sufficiently unambiguous to evidence the debtor's intent to create the interest. In both scenarios, delivery could be achieved even if the pledgor retained more dominion and control than would have been permissible under common law; however, the proof of attachment by possession would as a practical matter be problematic.

As previously stated, there existed three ways to create a pledge under common law—either the creditor, his agent, or a bailee—notice could receive possession of the collateral. The analogues of the first two alternatives under the prior Article 9 have just been

101. Id. § 9-205 official comment 6 (stating that the last sentence of § 9-205 is intended to clarify that the "common law rules on the degree and extent of possession which are necessary to perfect a pledge interest . . . are not relaxed by this or any other section of this Article.").


103. 1B U.C.C. Serv. (MB) § 14.03[2][c], at 14-23 to -24 (1988). The proper inquiry thus focuses upon "whether the debtor's retained control is such that it raises doubt concerning the debtor's intent to grant to the secured party a security interest in the collateral." Id. at 14-24.

104. See 1972 Official Text, supra note 1, § 9-203(1)(a).

105. See id. § 9-305 official comment 2.

106. See supra text accompanying notes 22-25.
analyzed. It is interesting to note that under common law, a pledge to a bailee-with-notice would apparently be valid only if the bailee had already held the item to be collateralized at the time when the subject pledge was being created. Prior section 9-203, which sets forth the conditions to attachment, does not contemplate this structure.

3. Perfection under the pre-1977 Uniform Commercial Code.—After describing certain types of collateral in which security interests can be perfected by filing, prior section 9-304(1) states that a “security interest in . . . instruments . . . can be perfected only by a secured party’s taking possession.” Therefore, a security interest in certificated shares can be perfected only by transfer of possession. But what is meant by the secured party’s taking possession? Actual possession is one way of satisfying the criterion, but it is clear that, as is the case regarding attachment, possession by the secured party includes possession by his agent. This is comparable to pre-Uniform Commercial Code common law.

There is also a second statutorily permitted manner for the secured party to take possession. Prior section 9-305 specifies that if a certificated share “is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party’s interest.”

This section first focuses on perfection effected by having the creditor or his agent take possession, and then examines the bailee-with-notice alternative. Once again, the purpose of possession is evidentiary. In the context of perfection, however, the fact to be proved is not the debtor’s agreement with the secured party to create a security interest. Rather, possession serves the purpose of putting third parties on notice that the debtor has given up unencumbered rights to the collateral.

In re Bialk is a case in which the debtor and the secured

107. See supra text accompanying notes 78-105.
108. See supra text accompanying notes 46-47.
109. See 1972 OFFICIAL TEXT, supra note 1, § 9-203(1).
110. Id. § 9-304(1).
111. See id. § 9-305 official comment 2 (stating that “[p]ossession may be by the secured party himself or by an agent on his behalf . . . ”); see also supra text accompanying notes 89-94 (discussing the carryover of agency law).
112. See supra text accompanying notes 18-35.
113. 1972 OFFICIAL TEXT, supra note 1, § 9-305.
party entered into a written agreement by which the debtor purported to grant a security interest in medals and coins which were located in a bank safe deposit box.\textsuperscript{116} The debtor also gave to the creditor the only set of keys he had to the box, but, because the debtor never changed the signature cards at the bank, the secured party in fact could not obtain access to the medals in the deposit box.\textsuperscript{117} Furthermore, standard bank practices permitted the debtor to reach the assets in the safe deposit box upon payment of a fee for drilling out the lock if the debtor remained the authorized signatory and the bank had not been notified of the security interest granted to the creditor.\textsuperscript{118} The court held that under these circumstances the creditor's interest was unperfected.\textsuperscript{119}

Specifically, the court noted that if the purpose of filing to perfect is to give notice, "[c]ertainly an open and obvious possession by a secured party must put others on guard that the possessor may have some interest in the property so possessed."\textsuperscript{120} The court then concluded that mere possession of the keys by the creditor would not put third parties on notice, especially when the depositor can still gain access to the box.\textsuperscript{121} It is important to emphasize that the evidentiary purpose of possession, in the context of perfection, is different from the purpose served when seeking to establish attachment.\textsuperscript{122} With respect to the use of the bailee-with-notice as evidence of perfection, prior section 9-305 states that if the collateral is "held by a bailee," then the secured party is deemed to have possession as soon as the bailee is notified of the security interest.\textsuperscript{123} The language of this section therefore conforms to prior common law to the extent that it seems to require that the bailee already have possession before any attempt is made to grant the security interest.\textsuperscript{124} This was

\textsuperscript{116} Id. at 520.
\textsuperscript{117} Id. at 520-21.
\textsuperscript{118} Id. at 521.
\textsuperscript{119} Id. at 525. Professor Coogan warns against reading Bialk too broadly, emphasizing that retention by the debtor of shared control with the creditor should not always prove fatal to attachment. See 1B U.C.C. Serv. (MB) § 14.03[2][c], at 14-23 to -24 (1988). The issue relating to attachment, as Coogan points out, is whether the secured party's control evidences the debtor's intent to grant a security interest. Id. Attachment, however, was not the issue in Bialk since there was a signed agreement; rather, the court focused on perfection. See 16 U.C.C. Rep. Serv. (Callaghan) at 525.
\textsuperscript{120} Bialk, 16 U.C.C. Rep. Serv. (Callaghan) at 524.
\textsuperscript{121} Id. at 524-25.
\textsuperscript{122} See supra text accompanying note 114.
\textsuperscript{123} 1972 Official Text, supra note 1, § 9-305.
\textsuperscript{124} See supra text accompanying notes 46-47.
the precise factual context in *Bialk*. The *Bialk* court specifically noted that the bank was not notified of the secured party's interest, thereby seeming to imply that, while the creditor was not in possession of the box because his receipt of the keys did not constitute section 9-305 possession, the bank would have been a section 9-305 bailee-with-notice if it had in fact received notice. In that case, the security interest which attached due to the signing of the security agreement would have been perfected, and the secured party would have prevailed over the bankruptcy trustee.

However, in its discussion of the possibility that the bank would have been a bailee-with-notice if it had been notified of the creditor's interest in the collateral, neither the *Bialk* court nor Professor Coo- gan mentioned the timing of the bailee's receipt of the collateral. The fact that the bank had held the collateral prior to the attachment of the security agreement therefore seems not to have been considered a critical factor. Indeed, courts focus first on whether notice has in fact been given to the bailee, so that the technical requirements of section 9-305 have been met. Once the bailee-with-notice provision is satisfied, prospective creditors of the debtor are deemed to be adequately notified (by the bailee's possession of the collateral) “that [the debtor] no longer has unfettered use” of the collateral. For example, in *Ingersoll-Rand Financial Corp. v. Nunley*, the use of mining equipment owned by a debtor whose principal place of business was in Virginia on the West Virginia property of a third party (the putative bailee) was found by the Fourth Circuit to be sufficient notice to third parties that the debtor was not in sole control of the asset.

Therefore, under prior section 9-305, because the courts' only focus when analyzing a bailment-with-notice is whether the bailment provided adequate third-party notice, the courts no longer emphasize the distinction between the classic second pledge, where the first pledgee is already in possession when he becomes bailee-with-notice,

125. *See supra* text accompanying notes 115-18.
126. *See Bialk*, 16 U.C.C. Rep. Serv. (Callaghan) at 520.
127. *See id.*
128. *See, e.g., Ingersoll-Rand Fin. Corp. v. Nunley, 671 F.2d 842, 845 (4th Cir. 1982)* (noting that the court must decide whether the third party was acting as a bailee, and if so, whether it knew of Ingersoll-Rand's security interest, in order to find perfection of the security interest).
129. *Id.*
130. 671 F.2d 842 (4th Cir. 1982).
131. *Id.* at 845.
and the escrow, where the escrowee typically receives the collateral simultaneously with the attempt to create the security interest. Furthermore, when deciding whether a security interest had been perfected, courts no longer feel constrained to find proof of the actual underlying arrangement between the debtor and the creditor. Such proof is required to evidence only attachment under prior section 9-203, which requires that there must have been a written security agreement or evidence of the type of possession which indicated a relatively higher level of pledgee involvement than is necessary to evidence perfection.\(^3\) This result differs from that required under common law where the security agreement option for attachment was not available and, therefore, where possession necessarily constituted both attachment and perfection.\(^3\) And, as the next section demonstrates, it permitted a more favorable judicial attitude toward escrows in the context of security interests.

4. Escrows under the pre-1977 Uniform Commercial Code.—As a general matter, two characteristics typify escrows: the mutual distrust between the debtor and creditor and the neutrality of the escrowee. Since escrows are created for the purpose of receiving property which neither party trusts the other to hold, the transfer is effected simultaneously with the establishment of the unsteady relationship between the parties, and the escrowee is selected because of his neutrality.\(^3\) At common law, this very neutrality made escrows and pledges mutually exclusive.\(^3\)

As demonstrated, however, the pre-1977 Uniform Commercial Code brought significant changes in the area. First, by permitting attachment to be effected by a writing, not just by transfer of possession, the prior Code in many factual cases limited the evidentiary purpose of the transfer of possession to proving perfection rather than creation of the security interest.\(^3\) Secondly, the prior Code re-

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132. See supra text accompanying notes 76-109 (discussing attachment under the pre-1977 code).
133. See supra text accompanying notes 18-35 (discussing common law pledges). While an additional historical basis for the higher level of dominion and control required of the pledgee under the common law exemplifies the respect then given to Benedict v. Ratner, 268 U.S. 353 (1925), discussed supra note 39, it should be remembered that Benedict was repealed by pre-1977 § 9-205 in part because the security agreement was expected to supercede possession as the preferred method of effecting attachment.
136. See supra text accompanying notes 76-133 (discussing attachment versus perfection).
pealed Benedict v. Ratner, thereby removing a historical precedent for substantial transfer of dominion and control to the creditor before a security interest could be created.137

There are two preeminent cases relating to escrows under the prior Code. The first, In re Dolly Madison Industries, Inc.,138 is a 1973 Third Circuit case in which the seller of stock entered into a purchase agreement with the buyer and transferred to the buyer stock certificates registered in the buyer’s name.139 Pursuant to the purchase agreement, the buyer delivered a promissory note to the seller and, as required by an escrow agreement executed simultaneously with the purchase agreement, placed the stock certificates, indorsed in blank, with a lawyer as escrow holder.140

The buyer’s trustee in bankruptcy argued that the seller’s interest was merely an unperfected security interest and, therefore, that the seller did not take precedence over the trustee.141 The trustee conceded that the purchase agreement was a valid security agreement under the Uniform Commercial Code, but insisted that the language of the purchase agreement, which was incorporated by reference in the escrow agreement, evidenced the parties’ intent that actual attachment of the security interest would not occur until and unless the buyer defaulted on the note.142

The district court adopted the trustee’s position that the purchase agreement was a valid security agreement,143 and held that there was no perfected security interest in favor of the seller since attachment of the interest had been postponed by the terms of that security agreement.144 The court, however, did not base its decision

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137. See supra text accompanying notes 95-101 (discussing the repeal of Benedict by prior § 9-205).
139. 351 F. Supp. at 1040.
140. Id. There is no discussion as to whether the lawyer-escrowee was, in another capacity, representing either the buyer or the seller.
141. Id. at 1041.
142. Id. Dolly Madison refers to a security agreement pursuant to § 9-204(1), not § 9-203(1), since the case was decided under the 1958 predecessor to the 1972 U.C.C. See American Law Inst. & National Conf. of Comm’rs on Uniform State Laws, Uniform Commercial Code: 1958 Official Text with Comments and Appendices (1958) [hereinafter 1958 Official Text]. Section 9-204(1) of the 1958 official text stated that a “security interest cannot attach until there is an agreement . . . that it attach and value is given and the debtor has rights in the collateral.” Id. § 9-204(1).
143. 351 F. Supp. at 1041 (construing 1958 Official Text, supra note 142, § 9-204(1)).
144. Id. at 1042.
directly on the textual analysis proposed by the trustee. Rather, the
court concluded that when the seller allowed the buyer to place the
certificates in escrow, thereby relinquishing dominion and control
over those certificates, she evidenced her agreement that the security
interest would not attach until an event of default occurred, which
pursuant to the terms of the executed agreements would then compel
the escrowee to deliver the stock certificates to her.\textsuperscript{145} In other
words, the seller could not have the security interest attach in her
favor until she had sufficient dominion and control over the stock
certificates, and the escrow agreement would not give her that mea-
sure of dominion and control unless the certificates were delivered to
her out of escrow. The court cited pre-Code cases and referred back
to the old common law rule that pledges and escrows are mutually
exclusive.\textsuperscript{146}

Perhaps the court focused on transfer of possession as a means
of effecting attachment precisely because the valid security agree-
ment was written in such a way that the seller’s security interest
would not attach until a later date.\textsuperscript{147} Consequently, the only way
that the seller could still hope to prevail was if, despite that agree-
ment, the buyer’s transfer to the escrowee of the certificates indorsed
in blank constituted a transfer of possession to the pledgee-seller or
her agent pursuant to prior section 9-203(1)(a).\textsuperscript{148} The opinion
seems to stretch when it emphatically maintains that an item in the
possession of an escrowee could not have been intended by the par-
ties to be the object of an attached security interest in favor of one of
those parties.\textsuperscript{149} Surely, if the purchase agreement had called for au-
tomatic attachment, that document, recognized as a valid security
agreement, would have been respected despite the escrow.\textsuperscript{150} After

\textsuperscript{145} Id.
\textsuperscript{146} Id. (citing Qualley v. Snoqualmie Valley Bank, 136 Wash. 42, 238 P. 915 (1925));
\textit{see supra} text accompanying notes 46-49 (discussing \textit{Qualley} and the mutual exclusivity of an
escrow transaction and a pledge).

\textsuperscript{147} \textit{See} 351 F. Supp. at 1041.

\textsuperscript{148} \textit{See} 1958 \textit{OFFICIAL TEXT}, \textit{supra} note 142, § 9-203(1)(a) (providing that a security
is not enforceable against the debtor or third parties unless “the collateral is in the possession
of the secured party . . . ”).

\textsuperscript{149} \textit{See} 351 F. Supp. at 1042 (referring to 1958 \textit{OFFICIAL TEXT}, \textit{supra} note 142, § 9-
305 official comment 2); \textit{supra} text accompanying notes 123-33 (discussing the impact of § 9-
305). The court’s reliance on § 9-305, which governs perfection and not attachment, may have
been inadvertent, since the court in its final paragraph grounds its decision on lack of attach-
ment, not lack of perfection. \textit{See} 351 F. Supp. at 1042.

\textsuperscript{150} \textit{See} 351 F. Supp. at 1042 (noting that the escrow agreement did not indicate any
time of attachment, and with no evidence of the parties’ intent, the court construed that intent
to be that attachment would not occur until default).
all, attachment by security agreement would have been possible even if the debtor had retained complete control over the share certificates.\textsuperscript{151}

The \textit{Dolly Madison} decision has received some criticism.\textsuperscript{152} To put it in perspective, however, it is necessary to examine \textit{In re Copeland},\textsuperscript{153} a subsequent Third Circuit decision often considered to be the leading case in the area.\textsuperscript{154}

In \textit{Copeland}, the debtor and the creditor entered into a pledge agreement, whereby the debtor ostensibly pledged certain shares to the creditor.\textsuperscript{155} The parties entered into an escrow agreement pursuant to which the debtor, after having indorsed the certificates in blank,\textsuperscript{156} placed those shares with a third-party escrow holder.\textsuperscript{157}

At the outset, the Third Circuit noted that attachment of the security agreement had been effected by the execution of the pledge and escrow agreements together.\textsuperscript{158} The court specifically rejected the debtor's claim that the pledge agreement evidenced the parties' intention to postpone attachment until default had occurred, finding that the relevant paragraph in the pledge agreement merely described the mechanics of how the escrow holder was to dispose of the stock in the event of default.\textsuperscript{159} Although the court found that its earlier decision in \textit{Dolly Madison} involved a purchase agreement that was a security agreement, the court further noted that the purchase agreement had, by its terms, postponed the effective date of the attachment.\textsuperscript{160} In that manner, the court distinguished \textit{Dolly Madison} with respect to attachment.\textsuperscript{161} Therefore, in the context of

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\bibitem{151} See supra text accompanying notes 82-85.
\bibitem{152} See, e.g., 1B U.C.C. Serv. (MB) § 14.04[2][e], at 14-53 to -54 (1988).
\bibitem{154} See, e.g., 1B U.C.C. Serv. (MB) § 14.04[2][e], at 14-52 (1988).
\bibitem{155} 531 F.2d at 1199.
\bibitem{156} \textit{Id}. at 1205.
\bibitem{157} \textit{Id}. at 1199.
\bibitem{158} \textit{Id}. at 1200 n.3.
\bibitem{159} \textit{Id}. at 1201.
\bibitem{160} \textit{Id}. at 1201-02.
\bibitem{161} See \textit{id}. It appears that the Third Circuit focused only on the trustee's argument in \textit{Dolly Madison} that the text of the valid security agreement postponed attachment. \textit{See supra} text accompanying notes 141-42 (setting forth the trustee's argument in \textit{Dolly Madison}). The court did not consider the basis of the district court's decision in \textit{Dolly Madison} which found that the creditor would not acquire possession of the alleged collateral for attachment purposes unless and until the appropriate contingency occurred. \textit{See In re Dolly Madison Indus., Inc.}, 351 F. Supp. 1038, 1042 (E.D. Pa. 1972), aff'd, 480 F.2d 917 (3d Cir. 1973); \textit{see supra} text accompanying notes 145-46 (discussing the basis of the district court's decision). Such a con-
attachment, the Third Circuit made no reference to the escrow agreement or to any potential impact the escrow agreement might have on the attachment of the security interest.\textsuperscript{162}

It is with respect to perfection that the Third Circuit discussed the escrow arrangement.\textsuperscript{163} The court first noted that pledges and escrows were mutually exclusive under common law, and then recognized that the Uniform Commercial Code "does not wholly displace the common law."\textsuperscript{164} The opinion further stated that historical distinctions will be respected only to the extent that they influence whether the security interest was in fact perfected, and that they will have such influence only if they help to respect the notice function of perfection.\textsuperscript{165}

While analyzing whether the historical incompatibility of pledges and escrows should still be applicable, the court emphasized that the notice function of section 9-305, the perfection section of the Code, would be satisfied even if the creditor did not have "sole dominion and control" over the collateral.\textsuperscript{166} The purpose of perfection, the court noted, is to put third parties on notice that "the debtor's property is encumbered."\textsuperscript{167}

After a review of perfection under prior section 9-305,\textsuperscript{168} one cannot take exception to the court's description of the purpose for perfecting a security interest. One can, however, question the court's analysis on two points. First, the historical issue of dominion and control, and therefore, of the alleged incompatibility of pledges and

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\item[162] It is interesting to note that the district court's opinion in \textit{Copeland} not only found that the text of the \textit{Dolly Madison} purchase agreement had by its terms postponed the time for attachment, unlike the pledge and escrow agreements in \textit{Copeland}, but concluded that "[i]n \textit{Dolly Madison} there was not present any purported pledge agreement." \textit{Copeland}, 391 F. Supp. at 145. However, the district court in \textit{Dolly Madison} had held that the purchase agreement was a security agreement for purposes of the U.C.C. \textit{See supra} text accompanying notes 143-46 (discussing the \textit{Dolly Madison} court's holding). Given the conclusion by the \textit{Dolly Madison} district court that the security interest did not attach immediately due to the language in the purchase agreement, the title attached to the document by the court should be of no consequence to a subsequent decision also considering agreements deemed to constitute a valid security agreement. The Third Circuit in \textit{Copeland}, therefore, was correct not to consider the title of the \textit{Dolly Madison} agreement when analyzing the \textit{Dolly Madison} case.

\item[163] \textit{See Copeland}, 531 F.2d at 1202-05.
\item[164] \textit{Id.} at 1203.
\item[165] \textit{See id.} at 1203-04.
\item[166] \textit{Id.} at 1204.
\item[167] \textit{Id.}
\item[168] \textit{See supra} text accompanying notes 123-33.
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\end{footnotesize}
escrows, is more appropriately an attachment issue which need not be discussed in the context of perfection. The Copeland court therefore correctly concluded that dominion and control are not critical because the issue is one of perfection and not of attachment and thus the court’s conclusion as to the first point will not necessarily be applicable to a future fact pattern where transfer of possession is to evidence attachment as well as perfection.

Second, the court’s conclusions concerning the applicability of section 9-305 to the escrow context should not be accepted without further study. The Third Circuit in Copeland concluded that the escrowee is a bailee-with-notice within the meaning of prior section 9-305. Further, the court recognized that under prior section 9-305 possession by the secured party is the only method of perfecting a security interest in the stock, unless possession is in the hands of a bailee-with-notice. The Copeland debtor who argued against perfection first stated that the escrowee was not the secured party’s agent for purposes of perfection; the court appears to have accepted this argument since it focused on the bailee-with-notice exception.

However, in discussing the bailee-with-notice exception, the court neglected to consider the evolution at common law of the bailee-with-notice concept. Specifically, the court failed to recognize that the bailee exception was established to enable the creation of a second pledge, even after the first pledgee had taken possession of the collateral. Therefore, the common law bailee situation always had the bailee already in physical possession of the collateral before the second pledge transaction was commenced.

While this may seem to be precisely the kind of historical argu-

169. See supra text accompanying notes 76-109 (discussing attachment under the pre-1977 Code); see also 1972 OFFICIAL TEXT, supra note 1, § 9-205(1)(a) (indicating that possession, which was traditionally considered the requirement for dominion and control, was no longer required for attachment as long as there was a written security agreement)

170. See Copeland, 531 F.2d at 1204.
171. Id. at 1205.
172. Id. at 1202.
173. Id. at 1202-03.
174. See id. at 1203. The court is correct in agreeing that the escrowee is not the agent of the secured party, at least until a contingency, described in the escrow agreement as requiring delivery of the collateral to the secured party, occurs. See RESTATEMENT (SECOND) OF AGENCY § 14D (1958), discussed supra text accompanying note 40.
175. See supra text accompanying notes 44-45 (noting that a security interest is only created in favor of the second creditor if the first creditor is notified that he holds the collateral for his own benefit as well as the benefit of the second creditor).
176. See supra text accompanying note 47.
ment that the court refused to indulge in with respect to pledgee-escrowee incompatibility, and while the court's ignoring of the timing of the transfer of the property to the bailee had been foreshadowed in earlier pure pledge cases decided under the prior Uniform Commercial Code, the precise text of section 9-305 suggests that the bailee-with-notice exception was intended to cover only the classic second pledgee situation. The second sentence of section 9-305 specifies that if the "collateral . . . is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest." The reference to the timing of the notification would be superfluous in the escrow situation, since the escrowee, as a signatory to the escrow agreement, will consequently have notice of the escrow from the moment it is created.

Further, an argument can be made that the statutory bailee-with-notice exception contained in section 9-305 is one which should not be extended beyond those situations historically within the exception. In the context of perfection, the holding of collateral by a first pledgee as bailee provides no notice to third parties of the existence of a second pledge. It provides notice only of the first pledge, or notice "that the debtor's property is encumbered," without indicating how or in whose favor it is encumbered. A potential creditor, investigating the extent to which the collateral is in fact encumbered, would have to rely on the good faith (and aversion to liability) of the first pledgee, acting as bailee, in order to learn of the existence of the second pledge. The applicability of this potentially unsatisfactory exception should not be lightly extended.

Leaving aside the textual and evolutionary argument for restricting the types of persons who can be bailees-with-notice, a properly neutral escrowee may provide relatively more notice than would the first pledgee as bailee. In other words, an escrowee not tied too closely to the pledgor could satisfy the notice function of perfection better than the first pledgee as bailee, since the independent escrowee would not only be putting the world on notice that the item is

177. See supra text accompanying notes 128-31 (noting that courts were not focusing on whether the collateral in question was in the bailee's possession prior to attachment, but on whether notice had been given to the bailee).
178. See 1972 OFFICIAL TEXT, supra note 1, § 9-305.
179. Id.
being held for the benefit of someone other than the pledgor, but that it is being so held in connection with a transaction separate from any other. The risk of the first pledgee not effectively communicating the existence of the second pledge is thereby eliminated.\(^{182}\)

Part II(B)(2)(b) of this Article considers whether the analysis of section 9-305 should provide an additional reason for requiring truly independent escrowees in the event escrow arrangements are finally considered compatible with pledges of certificated shares.\(^{188}\)

Since \textit{Copeland}, escrow agreements have been found to be approved mechanisms for the creation of perfected security agreements under prior Article 9.\(^{184}\) The escrow agreement can be a section 9-203(1) security agreement, and the escrowee can be a section 9-305 bailee-with-notice.\(^{186}\) Professor Coogan has applauded the result in

\(^{182}\) That is, the risk is eliminated at least until a second security interest attaches on the collateral already held by the escrowee under § 9-203(1) of the 1972 Code.

\(^{183}\) \textit{See infra} text accompanying notes 268-91. In \textit{In re North Broadway Funding Corp.}, 20 Collier Bankr. Cas. (MB) 354 (Bankr. E.D.N.Y. 1979), the bankruptcy court spoke in terms of perfection and found that there was no perfected security agreement despite the existence of escrow agreements. \textit{Id.} at 357-58. \textit{North Broadway} has been criticized as inconsistent with \textit{Copeland}. \textit{See, e.g.}, Schimberg, \textit{Secured Transactions}, 35 BUS. LAW. 1165, 1177 (1980) (criticizing the \textit{North Broadway} holding that an escrowee cannot serve as agent or bailee under § 9-305 so as to enable a secured party to perfect by possession by the escrowee and stating that the court should have followed \textit{Copeland}). The result in \textit{North Broadway}, however, may be based on issues of attachment, rather than on issues of perfection. The court did not find that the escrow agreements, which were the only relevant writings, amounted to a perfected security agreement under the Uniform Commercial Code. \textit{See id.} at 357. The court also noted that, to the extent that the escrow agreements evidenced an intent to create a security interest, they also evidenced the intent that it not attach unless there exists an uncured default by the debtor. \textit{Id.} at 358. There also is discussion in the opinion as to whether "any asset" was in fact transferred into escrow. \textit{See id.} at 359. Finally, the court sharply questioned the neutrality of the escrowee by concluding that the conduct of the escrowee may be subject to class action by those creditors who stand in a position similar to the plaintiff. \textit{See id.}

\(^{184}\) \textit{See, e.g.}, Ingersoll-Rand Fin. Corp. v. Nunley, 671 F.2d 842, 844-45 (4th Cir. 1982) (following \textit{Copeland} in holding that the plaintiff had perfected its security interest by satisfying the "bailee-with-notice" provision of § 9-305); \textit{In re O.P.M. Leasing Servs., Inc.}, 46 Bankr. 661 (Bankr. S.D.N.Y. 1985) (holding that the escrow agreement was a perfected security agreement since the escrowee was a § 9-305 bailee-with-notice).

\(^{185}\) \textit{See In re Roulain}, 823 F.2d 198, 200 (8th Cir. 1987) (finding debtor's attorney, for purposes of § 9-305, to be at least an escrowee and possibly even the creditor's agent); \textit{Ingersoll-Rand}, 671 F.2d at 845 (finding that a neutral third party was a § 9-305 bailee-with-notice); \textit{see also} Kruse, Kruse & Miklosko, Inc. v. Beedy, 170 Ind. App. 373, 412-14, 353 N.E.2d 514, 538-39 (1976) (analogizing to the § 9-305 meaning of "possession" in construing § 9-505(2)). \textit{But see} Stein v. Rand Constr. Co., 400 F. Supp. 944 (S.D.N.Y. 1975) (agreeing with \textit{Dolly Madison} that the escrowee did not provide the secured party with the control necessary to perfect). In \textit{Stein}, the escrowee was the attorney for both the debtor and the creditor, and, during the escrow, interest on the escrowed certificate of deposit was paid to the debtor. \textit{Id.} at 948. The \textit{Stein} court, however, erred by placing its focus on the control function, rather than on the notice function. \textit{See supra} text accompanying notes 123-31 (discussing.
Dickerson: New Article 8 of the Uniform Commercial Code: Are Certificated Sh

Copeland, stating that:

[the Section 9-305 bailee-with-notice technique is particularly appropriate in the escrow context because the debtor has lost unrestricted control over the collateral and the escrow holder is accountable to the secured party. The reliability of notice as a general matter in such cases is quite high, so that commercial expediency and the demands of Section 9-305 are in accord.]

Evidence of Copeland’s influence exists in the 1985 bankruptcy court decision in In re O.P.M. Leasing Services, Inc., in which the escrowee was the law firm of the debtor. The only document evidencing the creation of any security for the underlying obligation was the escrow agreement itself. Nevertheless, the court found that the escrow agreement was in effect a security agreement, and, as to perfection, held that the escrowee was a section 9-305 bailee-with-notice. Following the Copeland decision, the court found that the “notice” function of the perfection requirements of the Code was “fully satisfied,” since the escrowee was informed of the escrow (as a signatory to the escrow agreement) and since subsequent creditors of the debtor would be put on notice by the existence of the escrow that the debtor no longer had unencumbered use of the collateral in escrow.

II. ANALYSIS OF THE UTILITY OF ESCROWS AS A MEANS OF CREATING A PERFECTED SECURITY INTEREST IN CERTIFICATED SECURITIES UNDER NEW ARTICLE 8

Having reviewed how escrows were viewed at common law and under the prior text of the Uniform Commercial Code, this Article
now turns to the impact which the 1977 revisions had on the use of escrows in the creation of perfected security interests in certificated shares.

A. General Purpose and Structure of New Article 8

1. Focus: Uncertificated Shares, but Applicable to Certificated Shares as Well.—The stated purpose for the revisions to Article 8 proposed in 1977 was to provide a system which would take into account the expectation of an increased use of non-paper transfers of shares.\textsuperscript{193} It is for this reason that new Article 8 introduces the concept of “uncertificated” shares, which are defined, in part, as shares “not represented by an instrument . . . .”\textsuperscript{194} Once the Uniform Commercial Code defined “uncertificated shares,” however, it had to define “certificated shares” as well. This definition appears in new section 8-102(1)(a).\textsuperscript{195} As is clear from the text of the new section, the definitional issues concerning certificated shares remain the same as those concerning shares under the prior section.\textsuperscript{196} For purposes of this Article, therefore, it can be assumed that any share within the definition of prior section 8-102(1)(a) is a certificated share under new section 8-102(1)(a).

Given that the stated reason for the 1977 revisions was to recog-
nize the existence of uncertificated shares and to provide for transfers of such shares or of interests in them, it is important to understand that Article 8 also expressly applies to certificated shares. Further, when considering the impact of new Article 8 on certificated shares, it is useful to remember that the changes made to accommodate uncertificated shares, but which necessarily impact certificated shares as well, may have been enacted prematurely. In other words, the impact of Article 8 on certificated shares may, at least to some extent, be both inadvertent and unnecessary. Nevertheless, the impact is real.

2. The Twinning of Attachment and Perfection.—With respect to security interests in certificated shares, the most important fact to recognize is that new Article 8 governs all aspects of the attachment and perfection of such interests; Article 9 no longer controls this type of collateral. Another related change is that, under new Article 8, it is no longer possible to create a security interest in a certificated share which has attached but has not been perfected. Indeed, with respect to certificated shares, a security interest is perfected as soon as it has attached, and cannot attach until it has been perfected.

Specifically, and to the extent that the distinction can still be

197. The intent of the drafters was to change Article 8 as little as possible as it applies to certificated shares. See 1978 Official Text, supra note 7, reporter's introductory comments, app. I at 780. Only one section applicable to certificated shares, and relevant to this Article, was changed, see id. § 8-313, and only one section was added, see id. § 8-321.

198. See generally 1B U.C.C. Serv. (MB) chs. 14A-14B (1988) (stressing that the new Article 8 may have gone too far, and that slight alterations to Article 9 may have been preferable). Specifically, Professor Coogan points out that "[t]here does not seem to be a great deal of hue and cry for uncertificated securities at the present time." Id. § 14A.08(7), at 14A-89. But see Aronstein, Haydock & Scott, Article 8 is Ready, 93 Harv. L. Rev. 889, 913-14 (1980) (stating that the changes made to accommodate uncertificated shares were necessary for their development). It should be noted that Aronstein, Haydock, and Scott were intimately involved in the preparation of new Article 8. See id. at 890 n.4.


200. Section 9-203(1) is expressly made subject to § 8-321, see id. § 9-203(1), and § 9-305 is expressly inapplicable to certificated securities, see id. § 9-305.

201. It is still possible, however, to have an attached but unperfected security interest in certificated shares, but only if it was once both attached and perfected. See infra note 285. Transfer of a security interest under new § 8-313(1)(i) occurs where the security interest is transferred pursuant to a signed security agreement and the secured party gives new value, see 1978 Official Text, supra note 7, § 8-313(1)(i), but the security interest may become unperfected under new § 8-321(2) if within the 21-day period, perfection under another subsection of new § 8-313 is not effected, see id. § 8-321(2). Nevertheless, no security interest in certificated shares can be created unless it is perfected at the moment of creation. See id. reasons for 1977 change, app. I at 843, 844.

made, new section 8-321 concerns attachment. For example, subsection (1) reads, "A security interest in a security is enforceable and can attach only if it is transferred to the secured party or a person designated by him pursuant to a provision of Section 8-313(1)." Further, subsection (2) of new section 8-321 requires, as an additional condition, that the debtor have rights in the shares and that the secured party have given value.

The official reason provided for the addition of section 8-321 expressly states that section 9-203(1) is subject to section 8-321 if the collateral in which the security interest is to attach is a security, certificated or not, and new section 9-203(1) has been amended to make that section "subject to the provisions of . . . Section 8-321 on security interests in securities." The official reason provided for the change to section 9-203(1), in turn, specifies that while subsection 9-203(1)(a), unchanged from the prior text, permits attachment either by possession by the secured party or by a security agreement signed by the debtor, a perfected security interest in certificated shares can be effected only by rigorous compliance with the terms of new section 8-313.

If a subsection of new section 8-313 calls for possession and not a security agreement, such an agreement existing parallel to the poss-

203. Id. The California variation to § 8-321(1) imposes the additional requirement that the certificated share "is in the possession of the secured party pursuant to agreement" before a security interest is enforceable and can attach. CAL. COM. CODE § 8321(1)(a) (West Supp. 1988). Section 8321(1)(a) of the California Code offers an alternate method of creating a security interest if "the debtor has signed a security agreement which contains a description of the collateral." Id. It would thus appear that California has provided a method for creating a security interest by means of an escrow. However, in addition to satisfying one of the alternative methods under § 8-321(1)(a), a security interest can attach only if subsection (b) is also satisfied, which requires that the share be "transferred to the secured party or a person designated by him or her pursuant to a provision of subdivision (1) of Section 8-313." Id. § 8321(1)(b). This raises doubts as to whether any escrow arrangement is permissible under the California Uniform Commercial Code. See infra text accompanying notes 268-74 (questioning whether an escrowee could ever be a "person designated by" the creditor within the meaning of § 8-313(1)(a)).

204. 1978 OFFICIAL TEXT, supra note 7, § 8-321(2). Subsections (1) and (2) of § 8-321, when read together, require that the debtor have rights in the collateral and that the secured party give value. See id. § 8-321(1)-(2). Consequently, the requirements are identical to those found in subsections (b) and (c) of § 9-203(1). See id. § 9-203(1)(b)-(c). The issue of transfer of possession, or of signing a security agreement, found in § 9-203(1)(a), is incorporated into § 8-321(1) by its reference to § 8-313(1). See id. § 8-321(1).

205. Id. § 8-321 reasons for 1977 change at 843, 844.

206. Id. § 9-203(1).


208. 1978 OFFICIAL TEXT, supra note 7, § 9-203 reasons for 1977 change at 862.
session may nevertheless be respected, since there is authority that the security agreement will provide evidence of the debtor's intent to create the security interest in such a circumstance. Of course, in those subsections of section 8-313(1) where possession is required but a security agreement is not, the possession will have to satisfy the evidentiary requirements for attachment, as well as perfection, if no security agreement was in fact executed. This result is the same as under sections 9-203(1) and 9-305.

Therefore, new section 8-313(1) is the analogue, at least in part of its role, of the Article 9 perfection sections. This is also evident from the fact that new section 8-321(1) refers to new section 8-313(1), and from new section 8-321(2), which states that a security interest transferred as contemplated by new section 8-321(1) will be a perfected security interest.

New section 8-313(1) specifies that a "[t]ransfer of a security or a limited interest (including a security interest) therein to a purchaser occurs only" in those cases specifically enumerated in subsections (a) through (j). Therefore, the list in new section 8-313(1)

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209. The language in new § 8-321(3)(b) to the effect that "no written security agreement . . . is necessary . . . except as provided in paragraph (h), (i), or (j) of [new] Section 8-313," id. § 8-321(3)(b) (emphasis added), may limit the reach of the language provided by the drafters to explain the reasons for the 1977 change to new § 9-203. See supra text accompanying note 208. The word "necessary" would then mean that attachment can be effected without a security agreement except where expressly required by a subsection of new § 8-313(1), not that such an agreement would be ignored if not statutorily required.

Professor Coogan implicitly agrees with this interpretation—when analyzing further amendments to new § 8-313(1) which he believes to be advisable, Professor Coogan suggests that security agreements should be required under Article 8 at least for uncertificated shares. See 1B U.C.C. Serv. (MB) § 14A.07[3][d], at 14A-76 (1988). In this context, he reads new § 8-321(3)(b) as making security agreements non-mandatory except under subsections (h) through (j) of § 8-313(1), but he does not read it as making security agreements ineffectual in all other circumstances. See id.; see also Aronstein, Haydock & Scott, supra note 198, at 902-05 (interpreting § 8-313(1) to require mere notice, even without acknowledgment, to achieve perfection under subsections (h) through (j)). The general consensus is that the function of possession required by new § 8-313(1) focuses on perfection, leaving room for proof of the debtor's intent by means of a writing. Nevertheless, if this is to be the result, it would be wise to revise the reasons provided for the 1977 change to new § 9-203 to eliminate any ambiguity and perhaps to clarify new § 8-321(3) as well.

210. See text accompanying notes 76-133 (discussing attachment and perfection under Article 9 of the 1972 Code).


212. See 1978 OFFICIAL TEXT, supra note 7, § 8-321(1).

213. Id. § 8-321(2).

214. Id. § 8-313(1) (emphasis added). New § 8-313(1) speaks of transfer to a "purchaser," which is defined under § 1-201(32) as a transferee who takes by a "voluntary transaction creating an interest in property." Id. § 1-201(32). Therefore, "[t]ransfers by operation of law are excepted because they are not transfers to a 'purchaser.' " Id. § 8-313 reasons for 1977
describes the exclusive means of creating a perfected security interest in certificated shares.218

B. The Purpose for Attachment and Perfection and the Applicability of New Section 8-313(1) to Escrows

In order to understand how a perfected security interest in certificated shares can be created, assuming that the debtor has rights in the shares and that the creditor has given value, this Article now focuses on a textual analysis of new section 8-313(1). Specifically, this Article seeks to ascertain under what circumstances new section 8-313, when read together with new section 8-321, will permit attachment of a security interest in certificated securities in a structure similar to an escrow agreement. Only then will it be possible to determine the extent to which the Copeland line of cases remains relevant under new sections 8-313 and 8-321.216

The first part of this analysis involves an overview of the concepts of attachment and perfection, as retained in new Article 8, in order to determine their compatibility with the neutral escrow structure.217 Second, this section will review each relevant subsection of new section 8-313(1) in detail in the context of an escrow agreement.218

1. Overview of Attachment versus Perfection as Applied to Escrows.— When the draftsmen of new Article 8 moved the principal provisions relating to the creation and perfection of security interests in certificated shares out of Article 9 and into Article 8, they reintroduced an essential aspect of the common law of security in effect prior to the adoption of the Uniform Commercial Code. Specifically, they reinstated the symbiotic relationship of attachment and perfection. Not unlike the common law,219 new Article 8 renders it impossible to have a security interest attach in a certificated security

change at 830. More importantly, the general definition of “purchaser” as being one involved in a voluntary transaction, and the express reference to a purchaser in new § 8-313(1), makes it unambiguous that “purchaser” includes a person acquiring only a security interest.


216. See infra text accompanying notes 303-45 (analyzing the applicability of the Copeland line of cases to escrows in the modern context of new Article 8).

217. See infra text accompanying notes 219-39.

218. See infra text accompanying notes 240-91.

219. See supra text accompanying notes 19-20 (discussing the automatic perfection of a security interest as soon as it was created under the common law).

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unless it is also perfected.\textsuperscript{220}

Assuming that the debtor has rights in the certificated share and that the secured party has given value as required under new section 8-321(2),\textsuperscript{221} a perfected security interest can be created only if one or more of the transactions described in new section 8-313(1) are effected. Therefore, these transactions must satisfy the notice requirements for both attachment and perfection.

Interestingly, the drafters give no specific reason for this return to the common law rule.\textsuperscript{222} Professor Martin J. Aronstein, one of the members of the Permanent Editorial Board for the Uniform Commercial Code at the time of the 1977 revisions, indicated that some members of the Board were “not persuaded that the unperfected security interest in securities [was] an institution worth preserving.”\textsuperscript{223} Aronstein did acknowledge, however, that the holder of an unperfected security interest does have certain rights and remedies under part 5 of Article 9 not generally available to unsecured creditors.\textsuperscript{224} To the extent that Aronstein’s view is representative of the views of all the draftsmen, this explanation tends to indicate that they did not intend to make it easier for a perfected security interest to be created under the new rules as compared with the old; rather, all security interests in certificated shares would have to meet both the standard attachment and the standard perfection requirements, as modified, if at all, by the statute. Whatever the reason, it is clear that each of the transactions listed in new section 8-313(1) must evidence the debtor’s intention that a security interest attach in the certificated share,\textsuperscript{225} and must give notice to potential third-party creditors that the debtor’s interest in the certificated share is encumbered.\textsuperscript{226}

\textsuperscript{220} See supra text accompanying notes 199-202 (describing the circular process in which a security interest is perfected as soon as it has attached, and cannot attach until it has been perfected).

\textsuperscript{221} See 1978 Official Text, supra note 7, § 8-321(2).

\textsuperscript{222} See id. § 8-313 reasons for 1977 change at 831.

\textsuperscript{223} See Aronstein, Haydock & Scott, supra note 198, at 912 n.108.

\textsuperscript{224} Id. (admitting that a holder of an unperfected security interest may have some leverage against the debtor under § 9-503).

\textsuperscript{225} See supra text accompanying notes 76-109 (discussing the necessary evidence of attachment in pre-1977 Article 9).

\textsuperscript{226} See supra text accompanying notes 110-33 (discussing the notice function of perfection). Professor Coogan maintains that new Article 8 abandons the principle that public notice is essential to perfection. See 1B U.C.C. Serv. (MB) § 14A.07[2][b][iv], at 14A-69 (1988). Professor Coogan’s examples, however, all relate to uncertificated shares. See id. § 14A.07[3][d], at 14A-76.
There are major differences, however, with regard to evidencing attachment and perfection between the common law pledge and the new Article 8 transactions. First, *Benedict v. Ratner*, which at common law was read to require a transfer by the debtor of a high degree of dominion and control over the collateral, remains repealed by new section 9-205. Thus, in order to satisfy the evidentiary aspects of attachment in particular, and of perfection as well, there is no longer a historically imposed prerequisite that the debtor have transferred dominion and control. Rather, the transaction must both evidence the debtor’s intent to create the interest and give reasonable notice to third parties that the collateral is encumbered. This, of course, is generally favorable to the continued viability of escrows and of the *Copeland* line of cases.

The second major difference between the common law pledge and at least some of the transactions listed in section 8-313(1) of new Article 8 is that, in specified cases, the security agreement is a prerequisite to a perfected security interest in certificated shares.

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228. *See supra note 39.*
229. *See 1978 OFFICIAL TEXT, supra note 7, § 9-205 official comment 1; see also supra text accompanying notes 95-101 (discussing the repeal of Benedict).*
230. *Benedict* is more properly considered as applying to attachment rather than perfection. *See supra text accompanying notes 95-101.*
231. Evidencing the debtor’s intent to create the interest and giving reasonable notice to third parties that the collateral is encumbered are the functions of attachment and perfection, respectively. For a discussion of these functions, *see supra text accompanying notes 76-133.*
232. *See supra text accompanying notes 134-92 (discussing escrows under pre-1977 Article 9).*
233. *See supra text accompanying notes 153-67 (discussing Copeland’s conclusion that historical distinctions will only have influence to the extent to which they help to respect the notice function of perfection).*
234. *See 1978 OFFICIAL TEXT, supra note 7, § 8-313(1)(h)-(j). Under new Article 8, if the security agreement has effect, i.e. if it is required by new § 8-313(1), then the statutory definition of security agreement found in new § 9-105(1)(l) will control. The applicability of new § 9-105 is not restricted by new § 8-321(3)(b), which states that “[a] security interest in a security is subject to the provisions of Article 9, but . . . no written security agreement signed by the debtor is necessary to make the security interest enforceable, except as provided in paragraph (h), (i), or (j) of Section 8-313(1).” Id. § 8-321(3)(b). This is evident from the fact that the new § 9-105 definition of “security agreement” is included in a definitional cross-reference table after the official comments to new § 8-313. See id. § 8-313 definitional cross references; *see also supra text accompanying note 83 (discussing the definition of “security agreement”). It should be noted that the definition of “security agreement” in new § 9-105(1)(l) is identical to the language in prior 9-105(1)(l). Compare 1978 OFFICIAL TEXT, supra note 7, § 9-105(1)(l) with 1972 OFFICIAL TEXT, supra note 1, § 9-105(1)(l). The definition, initially, appears to mean that if there is an authorized security agreement, there is a valid security interest, because a security agreement is required and by definition creates or provides for a security interest. This circular result is incorrect. Each of the new § 8-313(1)
Under common law, no writing was required.\textsuperscript{236} If a writing existed, however, it could provide evidence of the debtor's intent to create the security interest in favor of the putative secured party.\textsuperscript{236} A review of the impact of this change from the common law rule is part of the analysis which immediately follows the detailed textual analysis.\textsuperscript{237}

The changes in new Article 8 also mark differences from prior Article 9.\textsuperscript{238} The inseparability of attachment and perfection under new Article 8, which casts us back to the pre-Uniform Commercial Code pledges, and section 8-313(1)'s exclusive listing of transactions, which is also relevant in comparing new Article 8 to pre-Code common law, will also be considered immediately after the detailed review of the new section 8-313(1) subsections.\textsuperscript{239}

2. Textual Analysis of New Section 8-313(1): Attachment and Perfection of a Security Interest in the Escrow Context.— Prior to analyzing the drafters' intent regarding attachment and perfection in the escrow context, it is important to ascertain which of the subsections of new section 8-313(1) can potentially apply to the escrow situation. This analysis is essential because the list in section 8-313(1) is exclusive, and if the escrow does not fit under one or more of the categories of that list, no security interest is possible in the certificated shares. This Article first ascertains which subsections of new section 8-313(1) are applicable to certificated shares, and then reviews, specifically in the context of the escrow situation, the subsections of new section 8-313(1) primarily applicable to publicly traded certificated shares and closely held certificated shares.

transactions calling for the use of a security agreement, except for subsection (i) which permits only temporary perfection, also requires other actions to be taken or factors to be present. See infra text accompanying notes 259-63, 284-91. Therefore, with the exception of the creation of a temporarily, but automatically, perfected security interest under subsection (i), no security interest can be created until all of the companion actions are taken or factors are present.

\textsuperscript{235}. See supra text accompanying note 34.

\textsuperscript{236}. See, e.g., supra note 50 (noting the evidentiary function of a writing in the bailee-with-notice scenario).

\textsuperscript{237}. See infra text accompanying notes 294-354.

\textsuperscript{238}. See supra text accompanying notes 54-75 (discussing the creation and perfection of security interests under prior Article 9).

\textsuperscript{239}. See infra text accompanying notes 294-354. In this connection, it should be noted that where delivery of possession was necessary for perfection, as was the case in Copeland, prior § 8-313(1) already contained subsections substantially similar to new subsections (a), (c), (d), (e), and (g); however, it did not contain an analogue to new subsections (h) through (j). See supra text accompanying notes 74-75 (discussing delivery under prior Article 8). Nevertheless, prior section 8-313(1) did not contain an exclusive listing of the categories available for transfers of interests in certificated shares. See 1978 OFFICIAL TEXT, supra note 7, § 8-313 reasons for 1977 change at 830.
New section 8-313(1) contains ten subsections, (a) through (j).240 Of these, only the following eight apply in whole or in part to certificated shares: subsections (a), (c), (d), (e), (g), (h)(i)-(ii), (i), and (j).241 Subsections (b), (f), and (h)(iii)-(iv) apply only to uncertificated shares.242 To further categorize section 8-313(1), of the eight subsections applicable to certificated shares, subsections (c), (d), (g), (h)(i), and (j) apply to publicly traded securities and involve relatively sophisticated financial institutions.243 Only subsections (a), (e), (h)(ii), and (i) permit the creation of a perfected security interest in any type of certificated share, and permit such perfection without the use of any sophisticated financial mechanism or institution.244

a. Illustrations of New Subsections 8-313(1)(c), (d), (g), (h)(i), and (j) Applicable to Publicly Traded Securities.— Subsections (c), (d), (g), (h)(i) and (j) apply only when a so-called “financial intermediary” is used.245 New section 8-313(4) defines a “financial inter-

240. See 1978 OffiCial Text, supra note 7, § 8-313(1).
241. See id. § 8-313(1)(a), (c), (d), (e), (g), (h)(i)-(ii), (i), (j).
242. See id. § 8-313(1)(b), (f), (h)(iii)-(iv).
243. See id. § 8-313(1)(c), (d), (g), (h)(i), (j) (stating that these sections apply to either financial intermediaries or clearing houses).
244. See id. § 8-313(1)(a), (e), (h)(ii), (i).
245. Section 8-313(1)(c), (d), (g), (h)(i), and (j) provide, to the extent applicable to certificated shares, as follows:

Transfer of a security or a limited interest (including a security interest) therein to a purchaser occurs only:

    (c) at the time his financial intermediary acquires possession of a certificated security specially indorsed to or issued in the name of the purchaser;
    (d) at the time a financial intermediary, not a clearing corporation, sends him confirmation of the purchase and also by book entry or otherwise identifies as belonging to the purchaser
        (i) a specific certificated security in the financial intermediary’s possession;
        (ii) a quantity of securities that constitute or are part of a fungible bulk of certificated securities in the financial intermediary’s possession . . . ;
        (iii) a quantity of securities that constitute or are part of a fungible bulk of securities shown on the account of the financial intermediary on the books of another financial intermediary;
    . . .
    (g) at the time appropriate entries to the account of the purchaser or a person designated by him on the books of a clearing corporation are made under Section 8-320;
    (h) with respect to the transfer of a security interest where the debtor has signed a security agreement containing a description of the security, at the time a written notification, which, in the case of the creation of the security interest, is signed by the debtor (which may be a copy of the security agreement) . . . is re-
mediary" as "a bank, broker, clearing corporation, or other person... which in the ordinary course of its business maintains security accounts for its customers and is acting in that capacity." It should be noted that a person who is otherwise a financial intermediary is not to be considered a financial intermediary if he is holding for his own account, rather than for a customer. Thus, a bank or a broker who lends to a shareholder and takes back a security interest in certificated shares will not be receiving physical possession of those pledged shares as a financial intermediary, and therefore not be creating a security interest under new section 8-313(1)(c) or (d).

As a practical matter, a consequence of the definition of "financial intermediary" as one who "maintains security accounts for its customers" and "control[s] the disposition of securities pursuant to its customers' orders" is that the certificated shares discussed in this section will be publicly traded securities.

The first subsection of new section 8-313(1) which is applicable...
to publicly traded certificated shares is subsection (c). While a security interest could be created in favor of a creditor under this subsection, if the debtor-owner indorses the certificated share to the name of the creditor and then places that share with the creditor’s broker, this structure would not amount to a normal escrow agreement. Generally, the debtor insists on the escrow situation to insure that he will automatically receive back the collateral, without further steps by the creditor, if the contingencies set out in the escrow agreement do not occur within a specified time. Accordingly, the certificated share would normally be indorsed in blank, not to the name of the creditor.

Subsection (d) also appears, on its face, inapplicable to escrows. Professor Coogan has indicated that section 8-313(1)(d)(i) requires “almost by definition [that the financial intermediary] already [have] possession” of the certificate. An escrow, however, typically contemplates transfer of the collateral to the neutral escrowee at the time when the security interest is created.

Nevertheless, the official reasons provided for the change to new section 8-313(1) imply that subsection (d) is a descendent of prior section 9-305. Consequently, an argument can be made that subsection (d) of new section 8-313(1) can apply where the bailee does not have preexisting possession of the certificated share, since this is consistent with prior section 9-305. For example, the debtor and creditor could agree with the debtor’s broker that the share certificates, whether or not previously held by the broker, would then be held by that broker in escrow. On the debtor’s instructions, the broker would then make a book entry of the creditor’s security interest and send him notification thereof. Subsection (d) does not require that the certificate be indorsed by the creditor. As long as the debtor’s broker is considered sufficiently neutral by the creditor, subsection (d) could then create a security interest with the collateral held in escrow.

Subsection (g) contemplates that the collateral is held by a special type of financial intermediary, the regulated clearing corpora-

252. 1978 Official Text, supra note 7, § 8-313(1)(c).
254. See 1978 Official Text, supra note 7, § 8-313 reasons for 1977 change, app. I at 830, 831 (stating that “[u]nlike a transfer under subparagraph (d) . . . of subsection (1), Section 9-305 does not require confirmation or acknowledgment by the controlling party, but only the receipt of notice.”); see also supra text accompanying notes 123-33 (discussing prior § 9-305).
255. See supra text accompanying notes 128-32.
While the clearing corporation will certainly not be the escrowee, a federal district court in New York concluded in 1977 that a certificated share held by a “clearing agent” was “in the broker’s possession” for purposes of prior section 8-313(1) when the other aspects of the subsection had been respected. Therefore, it is conceivable that subsection (g) would apply if the broker agreed to act as escrow agent as discussed in the context of subsection (d), even if the clearing corporation actually held the relevant certificate. In this case, the certificate in question would presumably be in “street name.”

Although it seems to be common practice to leave certificated shares with a clearing corporation for long periods of time, one would expect that a creditor would prefer that the broker-escrowee pull the shares back from the clearing corporation in order not to give any impression that the shares were capable of unencumbered transfer. Consequently, as a practical matter, it is unlikely that an escrow arrangement would arise under subsection (g).

The next subsection to consider is (h)(i). Not only must the debtor enter into a security agreement, but, assuming that the financial intermediary is the debtor’s broker, the debtor must also sign and submit to the broker notification of the creditor’s interest. The broker, however, will automatically receive notification because, if he agrees to act as escrowee, he will have executed an escrow agreement with both the debtor and the creditor. The broker must then also reflect the creditor’s interest on the broker’s books. Again, it is not clear under what circumstances a broker would agree to hold

256. See 1978 OFFICIAL TEXT, supra note 7, § 8-313(1)(g); see also id. § 8-102(3) (defining clearing corporation).

257. See Matthysse v. Securities Processing Servs., Inc., 444 F. Supp. 1009, 1018 (S.D.N.Y. 1977). In Matthysse, the Code provision in question was prior § 8-313(1)(c), see id. at 1017, the predecessor to new § 8-313(1)(d)(i). The court found that the clearing agent was not a clearing corporation within the meaning of § 8-102(3). Id. Nevertheless, the court’s reasoning should apply even if the person in possession is a clearing corporation because the clearing agent in Matthysse, like a clearing corporation, held the relevant securities “on behalf of [the broker] . . . and subject to [the broker’s] directions.” Id. at 1018.

258. “Street name” has been defined as:
[a] phrase describing securities held in the name of a broker or another nominee instead of a customer. Since the securities are in the broker’s custody, transfer of the shares at the time of sale is easier than if the stock were registered in the customer’s name and physical certificates had to be transferred.

J. FRIEDMAN, supra note 2, at 554.

259. 1978 OFFICIAL TEXT, supra note 7, § 8-313(1)(h)(i). Subsection (h) is the first to require a security agreement. See id. § 8-313.

260. Id. § 8-313(1)(h)(i).
shares indorsed in blank, but, conceptually, even that aspect of the typical escrow arrangement could be respected.

Finally, subsection (j) cannot give rise to an escrow situation.\textsuperscript{261} Under this subsection, the financial intermediary must have prior possession of the certificated share.\textsuperscript{262} As previously shown, this is not fatal to the escrow situation, although it is atypical.\textsuperscript{263} However, the financial intermediary holding the shares becomes the secured party and continues to hold the shares. By logic, the secured party is not neutral, and thus is not an escrowee.

It is interesting that the two subsections which are not applicable to the creation of escrows in publicly traded shares are those which would give the most unambiguous evidence to third parties of the encumbrance by the debtor—under subsection (c) the certificate is indorsed to the secured party,\textsuperscript{264} and under subsection (j) the holder is the secured party.\textsuperscript{265}

b. Illustrations of New Subsections 8-313(1)(a), (e), (h)(ii), and (i) Applicable to all Certificated Securities.—New subsections 8-313(1)(a), (e), (h)(ii), and (i) could apply to publicly traded securities since nothing in the text prevents that result.\textsuperscript{266} However, since

\begin{itemize}
\item Transfer of a security or a limited interest (including a security interest) therein to a purchaser occurs only:
\item (a) at the time he or a person designated by him acquires possession of a certificated security;
\item (c) with respect to an identified certificated security to be delivered while still in the possession of a third person, not a financial intermediary, at the time that person acknowledges that he holds for the purchaser;
\item (h) with respect to the transfer of a security interest where the debtor has signed a security agreement containing a description of the security, at the time a written notification, which, in the case of the creation of the security interest, is signed by the debtor (which may be a copy of the security agreement) is received by
\item (i) a third person, not a financial intermediary, in possession of the security, if it is certificated;
\item (i) with respect to the transfer of a security interest where the transferor has signed a security agreement containing a description of the security, at the time new value is given by
\end{itemize}
these subsections do not require the use of a financial intermediary, they are particularly interesting as the subsections which will most likely apply to certificated shares of closely held corporations.\textsuperscript{267} The importance of these subsections can be illustrated in the leveraged buyout situation.

The first subsection applicable to closely held certificated shares is subsection (a) of new section 8-313(1).\textsuperscript{268} Clearly, a certificate delivered to the creditor himself will not be held in escrow. An issue exists, however, as to whether an escrowee could be a "person designated by" the creditor within the meaning of subsection (a). It is certain that subsection (a) was designed to "describe the most basic forms of transfer,"\textsuperscript{269} and that these include the transfer to a creditor or his agent.\textsuperscript{270} It also is certain, as we have seen, that an escrowee is not the secured party's agent.\textsuperscript{271} The language in new subsection (a) referring to the creditor's designee is identical to the language in prior section 8-313(1)(a),\textsuperscript{272} and that prior section was interpreted to require intent by the transferor to effect a change of ownership (or, in the case of a security interest, to grant a more limited interest).\textsuperscript{273} In a context other than the creation of a security interest, however, subsection (a) has also been determined to cover a physical transfer to an escrowee where the court was satisfied that the debtor intended a transfer.\textsuperscript{274} It is therefore unclear whether subsection (a) can apply to the escrow situation.

Subsection (e) of new section 8-313(1) is another descendent of section 9-305.\textsuperscript{275} Indeed, it is the subsection which most closely ap-
proximates the bailee-with-notice provision under section 9-305. It does appear to require that the certificated share be in the hands of the bailee before the attempt is made to create the security interest, since the text refers to a “certificated security to be delivered while still in the possession” of the bailee. However, as with subsection (d), another descendent of section 9-305, it is arguable that subsection (e) is intended to apply not only to the classic first pledgee, but also to an escrowee.

The major change from section 9-305 to new section 8-313(1)(e) is that it no longer is sufficient for the bailee to receive notification of the creditor’s interest from either the debtor or the creditor—under the new subsection, the bailee must acknowledge “that he holds for” the creditor. The acknowledgment will inherently exist in an escrow situation since the escrowee will have executed the escrow agreement, although a prudent creditor would ask the escrowee to acknowledge it expressly. The purpose of the acknowledgment requirement is to force the transferee to be explicit as to the role of the bailee. The issue still remains, however, as to whether an escrowee can acknowledge that he holds for the creditor, given that the escrowee is by definition not the creditor’s agent unless and until the event specified in the escrow agreement occurs.

Two other subsections of section 8-313, subsections (h)(ii) and (i), are applicable to certificated shares, and both require the execution of a security agreement. The applicability of subsection (i) is of limited practical import, since another section of new Article 8

276. See supra text accompanying notes 113-33 (discussing the bailee-with-notice provision of § 9-305).
277. 1978 OFFICIAL TEXT, supra note 7, § 8-313(1)(e) (emphasis added). In this case, a security interest in the certificated share is to be delivered, but the share must have already been in the possession of the bailee. See id. This conforms to the historical, pre-Code analysis of the bailee-with-notice, but query whether it conforms to the bailee-with-notice provision under prior § 9-305, which referred only to perfection. See supra text accompanying notes 113-33 (discussing perfection by possession and the bailee-with-notice alternative).
278. See supra text accompanying note 254.
279. See supra text accompanying note 255.
280. See 1978 OFFICIAL TEXT, supra note 7, § 8-313 official comment 3 (stating that “[a]cknowledgement by that [third] person that he holds for the purchaser is the only condition to the transfer.”); id. § 8-313 reasons for 1977 change, app. 1 at 830 (stating that “[i]n both (e) and (f), acknowledgment by the third person is the critical event.”). Query what the drafters’ intent was as to whether the bailee must previously be in possession of the collateral.
281. Id. § 8-313(1)(e).
282. Id. § 8-313 official comment 3.
283. See supra text accompanying note 40.
284. See 1978 OFFICIAL TEXT, supra note 7, § 8-313(h)(ii), (i).
must be satisfied within twenty-one days after creation of the security interest if that interest is to remain perfected. Subsection (h)(ii), however, requires that if the security agreement has been executed, the bailee must receive written notification, signed by the debtor, of the creditor's interest. The bailee, in this case, could be a law firm, since there is no financial intermediary requirement. Furthermore, the notification to the bailee could be a separate document signed by the debtor, or could be contained in the escrow agreement executed by the debtor, the creditor and the escrowee.

The problem with this interpretation is that subsection (h)(ii) seems to be another descendent of section 9-305, and, therefore, it is unclear whether it was intended to cover the escrow situation. The list in new section 8-313(1) is the exclusive description of circumstances under which a security interest in certificate shares can be created. In this context, it is useful to note that subsection (h)(ii) states that the notification from the debtor is to be received by a "third person...in possession of the security..." Typically, the escrowee receives the item to be held in escrow simultaneously with execution of the escrow agreement, and the escrow agreement contains the debtor's notice to the escrowee. Since there is no case law on point and it is not clear that subsection (h)(ii) was intended to govern escrows, a prudent creditor would at minimum request that the debtor provide separate written notice to the escrowee.

285. See id. § 8-313 official comment 3 (recognizing the need to read § 8-313(1)(i) in conjunction with § 8-321). A security interest created under new § 8-313(1)(i) is automatically perfected as long as the debtor has an interest in the collateral, since § 8-313(1)(i) already requires that the secured party give value. See id. (providing that the perfection will last for 21 days after new value is given to a security interest that already exists pursuant to a security agreement). Therefore, the first phrase of new § 8-321(2) also will have been satisfied. See supra note 201 (discussing the interplay between new § 8-313(1)(i) and new § 8-321(2)). The remainder of § 8-321(2), however, addresses § 8-313(1)(i) specifically. It states that, unless within 21 days after perfection under § 8-313(1)(i) has been achieved, a transfer is effected under a subsection of § 8-313(1) other than subsection (i), the security interest will become unperfected. 1978 OFFICIAL TEXT, supra note 7, § 8-321(2). This is the only circumstance where there can be an unperfected security interest in a certificated share.

286. See 1978 OFFICIAL TEXT, supra note 7, § 8-313(1)(h)(ii). Alternatively, if the creditor's interest is either released or assigned, then notification must be given to the bailee by the secured creditor. Id.

287. See id.

288. See 1978 OFFICIAL TEXT, supra note 7, § 8-313 official comment 3.

289. See supra text accompanying notes 123-92 (discussing § 9-305 and its applicability in the escrow context).

290. 1978 OFFICIAL TEXT, supra note 7, § 8-313 official comment 1.

291. Id. § 8-313(1)(h)(ii) (emphasis added).
immediately after the escrowee has taken possession of the certificates.

This Article has reviewed the technical requirements of the relevant subsections of new section 8-313(1) under classic escrow scenarios, and has separated those subsections providing for attachment by transfer of possession from those requiring the execution of a security agreement. The two major structural differences between prior Article 9 and new Article 8 as they apply to the creation of perfected security interests in certificated shares have been identified as being the inseparability of attachment and perfection under new Article 8 and the exclusive listing in new section 8-313(1) of all circumstances under which a perfected security interest can arise. This textual analysis has revealed a series of precise categories, none of which expressly cover escrows.

C. Analysis of the Four Fact Patterns in which Escrows can Arise under New Section 8-313(1)

There are four fact patterns under which escrows can arise under new section 8-313(1): (1) where a security agreement is required under the new statute and one is in fact executed; (2) where a security agreement is not required, but one is executed; (3) where a security agreement is neither required nor executed; and (4) where a security agreement is required but is not executed.

1. Escrows When a Security Agreement is Required and is Executed.—As expressed earlier, the critical difference between classic pledges and the escrow arrangement is the amount of control transferred by the pledgor-debtor to the third-party recipient of possession. Of the subsections described as having potential applicability to escrows, only subsections (h)(i) and (h)(ii) of section 8-313(1) require the execution of a security agreement. Both subsections also require that the third party be in possession of the collateral and receive notification, signed by the debtor, of the creditor's interest. Therefore, some form of possession by, and notification to, the bailee is mandatory. The critical issue, however, is how much transfer by the debtor must be evidenced by these acts of transfer or notification.

292. See supra text accompanying notes 252-58, 268-83.
293. See supra text accompanying notes 259-63, 284-91.
294. See supra text accompanying notes 134-92 (discussing escrows under the pre-1977 Code).
295. See 1978 Official Text, supra note 7, § 8-313(1)(h)(i), (ii).
296. See id.
In seeking the answer to this question, it is necessary to focus on the drafters' intent in requiring such transfer or notification.

As the official reasons provided by the drafters for the 1977 change to Article 8 emphasize, subsection (h) "deals with the situation where a security interest, pursuant to a written agreement, is perfected by notice to a bailee under Section 9-305." The commentary subsequently notes that section 9-305 requires only receipt of notice by the bailee, but not his confirmation or acknowledgment. In this sense, new section 8-313(1)(h) is identical. However, unlike section 9-305, which does not specify whether it is the debtor or the secured party who must give the notice, new section 8-313(1)(h) requires that the debtor sign the notice. The purpose for this change is to eliminate the risk that a creditor would falsely give notice to a bailee that a security interest has been granted.

The comments to new section 8-313 specify that section 9-305 does not apply to certificated shares. Moreover, the references to new section 9-305 underscore the history of new section 8-313(1)(h) without causing new section 9-305 to be the controlling provision. Therefore, as compared with the rules under prior Article 9, new subsection (h) of section 8-313(1) requires that a security agreement be executed rather than permitting attachment by transfer of possession, and mandates that it is the debtor who must give the notice to the bailee.

The requirement of a security agreement, and the fact that reference is made to perfection analogous to that provided by section 9-305, imply that the possession by and the notice to the bailee are for the purpose of perfection only. The requirement that it be the debtor who gives the notice, on the other hand, appears to relate more to attachment, and to the evidence that the debtor intended to grant a security interest. It could be argued, however, that since attachment is covered by the security agreement, the insistence on notice from the debtor is merely to give the bailee greater confidence that he is holding on behalf of the creditor. Since another potential creditor

297. Id. § 8-313 reasons for 1977 change, app. I at 831.
298. See id.
299. Compare id. § 8-313(1)(h) (requiring the debtor to sign the written notification) with 1972 OFFICIAL TEXT, supra note 1, § 9-305 (failing to specify whether the debtor or secured party must sign the written notification).
301. Id. at 832, 865.
302. Id. at 831-32.
could in practice learn only from the debtor or the bailee that there is a prior security interest in the collateral, the assurance of the bailee in this regard may be useful. Such an analysis would indicate that the drafters were focusing on perfection, not attachment, when they mandated that it be the debtor who gives the notice.

If the purpose for the debtor giving notice is related to perfection, then the application of new section 8-313(1)(h) is substantially similar to the application of prior sections 9-203(1)(a) and 9-305, assuming that a security agreement has been executed. As previously shown, a security agreement perforce has been executed if one refers to new section 8-313(1)(h).\(^303\) In that case, it would be appropriate to apply the Copeland line of cases\(^304\) to a new section 8-313(1)(h) fact pattern. This is especially proper if the facts include the classic escrow of closely held shares, as in Copeland itself,\(^305\) in which case new subsection (h)(ii) would appear to apply. The Copeland line of cases should also be applied if the shares are publicly traded and are held by the broker as escrowee, particularly if the broker accepts holding shares indorsed in blank.\(^306\) In that case, subsection (h)(i) would seem to apply.

If the Copeland line does apply, then for all the reasons described in the discussion of prior section 9-305,\(^307\) the escrow will not impede the creation of a valid, perfected security interest, provided that the possession by the bailee is sufficient to constitute notice to third parties.\(^308\) In analyzing whether the escrowee has sufficient possession for purposes of subsection (h), which does not expressly refer to escrows,\(^309\) application of pre-1977 Code considerations is defensible. An argument can, of course, be advanced that new section 8-313(1) is an exclusive list,\(^310\) and thus, if the given facts do not fit

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303. See supra text accompanying note 295.
304. See supra text accompanying notes 153-92 (discussing the Copeland line of cases in the context of escrows under pre-1977 Article 9).
305. See supra text accompanying notes 155-57 (discussing the facts in Copeland).
306. See supra text accompanying notes 259-60 (discussing the holding of shares indorsed in blank).
307. See supra text accompanying notes 113-33 (discussing perfection under prior § 9-305); supra text accompanying notes 134-92 (discussing escrows under pre-1977 Article 9).
308. See In re Copeland, 391 F. Supp. 134, 151 (D. Del. 1975) (finding that possession by a bailee is sufficient to constitute notice to third parties), aff'd in part, vacated without prejudice in part, 531 F.2d 1195 (3d Cir. 1976).
309. See 1978 OFFICIAL TEXT, supra note 7, § 8-313(1)(h) (referring to transfers involving third persons or a financial intermediary).
310. See id. § 8-313 official comment 1 (stating that "[t]he word 'only' in the first sentence is intended to provide that the methods of transfer listed are exclusive and that compliance with one of them is essential to a valid transfer.").
the precise subsection, that subsection cannot be applied. However, it seems more consistent with the drafters' avowed effort to follow prior section 9-305 if facts similar to those in *Copeland* are henceforth treated under new section 8-313(h)(ii) as they were under prior section 9-305.

Under this analysis, therefore, if the transfer to the escrowee is sufficient to put third parties on notice, a valid, perfected security interest should be created under new section 8-313(1)(h)(ii). This argument can be advanced to cover subsection (i) as well, provided that the escrow would have been permissible at the time of *Copeland*. These ideas, of course, are posited on the execution of a valid security agreement, which could theoretically be contained in the escrow agreement among the debtor, the creditor, and the escrowee.311

What if the courts, however, conclude that the drafters were addressing the problem of attachment, not of perfection, when they required that it be the debtor who gives the subsection (h) notice to the bailee? In other words, what if the drafters had been satisfied that, regardless of the identity of the bailee's notifier, the bailee would have sufficient incentive to fulfill the perfection function of confirming to prospective creditors that the collateral may be encumbered in favor of another, thereby obligating those prospective creditors to investigate further? In that situation, the new requirement that it be the debtor who gives the notice would be evidence supplementary to the security agreement to the effect that the debtor truly intended to create the interest.

Given this scenario, the possession by the bailee may take on a new significance. Not only does possession give notice to third parties, but, especially in the classic second pledge scenario where the bailee has prior possession of the collateral, the notice from the debtor coupled with that possession also satisfies at least some part of the attachment function. Although the proper analysis may be that only the notice touches on attachment and that the possession is purely for perfection, this cannot be proven given the inseparability of attachment and perfection under new Article 8.312

Consequently, if new section 8-313(1)(h) applies to a fact pattern, it is not clear that possession by the classic neutral escrowee will be sufficient to create a perfected security interest, despite the

311. *Cf. supra* text accompanying notes 158-62 (comparing *In re* Copeland, 531 F.2d 1195 (3d Cir. 1976), with *In re* Dolly Madison, 480 F.2d 917 (3d Cir. 1973)).

312. *See supra* text accompanying notes 199-215 (discussing the twinning of attachment and perfection under new Article 8).
Copeland heritage. At minimum, a prudent creditor should not push to the outer limits of the Copeland line. Although the escrowee in Copeland appeared truly neutral,\textsuperscript{313} and the escrow which was upheld under prior Article 9 in In re O.P.M. Leasing Services, Inc. involved the debtor's law firm as escrowee,\textsuperscript{314} such an aggressive position may be unwise under new Article 8. For example, the use of the creditor's broker under subsection (h)(i), or the creditor's law firm under subsection (h)(ii), should be a safer choice as escrowee.\textsuperscript{315} The cautious creditor, moreover, should be particularly wary of permitting the debtor to insist on his own broker or law firm.

What if a security agreement has been executed, but the cautious creditor, aware that new section 8-313(1) provides the exclusive list of circumstances in which a security interest can be created in certificated securities,\textsuperscript{316} is concerned that the notice to the bailee or the neutrality of the bailee is insufficient to satisfy the attachment function of notice and possession under subsection (h)? The creditor, then, should seek to structure the transaction in a manner that satisfies more than one of the subsections of new section 8-313(1).

2. Escrows When a Security Agreement is Not Required but is Executed.—No security agreement is required under subsections (d) or (g) of new section 8-313(1), which are applicable to publicly traded shares,\textsuperscript{317} or under subsections (a) or (e), which are primarily applicable to closely held shares.\textsuperscript{318} Like subsection (h), subsection (d) of new section 8-313(1) is a descendent of section 9-305,\textsuperscript{319} as is subsection (e).\textsuperscript{320} As descendents of the perfection provision of Article 9, it is logical to focus on possession by the third party, and to assume that the confirmation by the financial intermediary under subsection (d), or the acknowledgment by the bailee under subsection (e), are purely for the purpose of perfection. In other words, it

\textsuperscript{313} See supra text accompanying notes 155-57 (discussing the facts in Copeland).
\textsuperscript{314} See supra text accompanying notes 187-92 (discussing the O.P.M. decision).
\textsuperscript{315} The creditor's law firm is a safer choice than the debtor's law firm because of the appearance that the debtor has relinquished greater control over the shares.
\textsuperscript{316} See 1978 OFFICIAL TEXT, supra note 7, § 8-313 official comment 1.
\textsuperscript{317} See supra text accompanying notes 253-58 (discussing subsections (d) and (g) of new § 8-313(1)).
\textsuperscript{318} See supra text accompanying notes 268-83 (discussing subsections (a) and (e) of new § 8-313(1)).
\textsuperscript{319} See supra text accompanying note 254.
\textsuperscript{320} See supra text accompanying note 275. The discussion of the applicability of subsection (e) to the escrow situation should be specifically noted, given that subsection (e) requires the bailee to acknowledge that "he holds for" the creditor. See supra text accompanying notes 281-83.
makes sense to assume that the sole function of these acts is to put prospective creditors on notice that the certificated share has been encumbered.

However, one should be careful before adopting this conclusion. First, the analysis applied to subsection (h) is also relevant in connection with subsections (d) and (e), and thus the inquiry becomes whether the confirmation or acknowledgment by the bailee constitutes an attachment or perfection function. It appears that the acknowledgment is for the purpose of perfection, since an act by the bailee would not be evidence of the intent of the debtor. The act would indicate that the bailee recognizes that the item held has been encumbered and is, therefore, in a position to inform prospective creditors.

Furthermore, a significant question has already been raised as to whether an escrowee would be considered the creditor's designee for purposes of subsection (a), applicable chiefly to closely held shares. If an escrowee could be such a designee, it is clear that at least part of the purpose of the escrowee's holding of the certificates would be to satisfy the perfection function of providing notice to third parties.

Finally, subsection (g), which discusses publicly traded shares being held by a clearing corporation on behalf of the broker-escrowee, must also be considered. Although it is highly unlikely that a subsection (g) structure would, as a practical matter, be used to create a security interest in publicly traded shares, here too the possession by the broker through the physical possession by the clearing corporation should serve, in part, to give notice to potential creditors that the shares are encumbered.

As demonstrated during the review of Article 9, the type of possession or transfer required to satisfy the perfection function is relatively less than what is required to evidence the debtor's intent that the security interest attach. If possession focuses solely on the perfection function, then the Copeland line of cases should apply, and a neutral escrowee under at least subsections (d) or (e), combined with the statutorily-required confirmation or acknowledgment

321. See supra text accompanying notes 269-74.
322. See supra text accompanying notes 256-58.
323. See supra text accompanying notes 258-59.
324. Compare supra text accompanying notes 76-109 (discussing attachment under pre-1977 Article 9) with supra text accompanying notes 110-33 (discussing perfection under pre-1977 Article 9).
by the bailee, should give rise to a valid, perfected security interest.\textsuperscript{325} Under these subsections, a creditor should feel reasonably comfortable in allowing the debtor to insist on his own broker or law firm as escrowee unless, of course, the creditor hopes to back up his position as secured party by applying subsection (a) as well.\textsuperscript{326} After all, in \textit{In re O.P.M. Leasing Services, Inc.},\textsuperscript{327} the court had approved such a structure where that escrowee did not in fact act as the agent of the debtor.\textsuperscript{328}

The \textit{sine qua non} of the creditor’s comfort is, of course, the assumption that the bailee’s possession addresses only the perfection function. The premise of the creditor must be, therefore, that the security agreement, although not required by the applicable subsection, is fully effective to cause the security interest to attach. Indeed, this premise is not unreasonable since a security agreement must evidence the debtor’s intent to create the security interest.\textsuperscript{329}

This was certainly the result under prior section 9-203, which permitted, but did not require, the use of security agreements.\textsuperscript{330} Further, as previously noted, prominent authorities have implicity agreed that security agreements continue to be effective even if they are not required by the particular subsection of new section 8-313(1).\textsuperscript{331} One could argue, however, that a careful reading of new section 8-321 and of the official comments to new section 9-203 do not mandate the conclusion that subsections such as (a), (d), (e), and (g), which do not require the use of security agreements, will permit the attachment function to be satisfied by such agreements.

Specifically, the only 1977 amendment to prior section 9-203 was to make the provision’s applicability subject to “Section 8-321 on security interests in securities.”\textsuperscript{332} The official reasons provided for this change first note that new section 8-321(1) provides that “an enforceable security interest in a security can be created only by a transfer which complies with Section 8-313(1).”\textsuperscript{333} The drafters sub-

\textsuperscript{325} See supra text accompanying notes 253-55 (analyzing subsection (d)); supra text accompanying notes 275-83 (analyzing subsection (e)).
\textsuperscript{326} See supra text accompanying notes 268-74 (analyzing subsection (a)).
\textsuperscript{327} 46 Bankr. 661 (Bankr. S.D.N.Y. 1985).
\textsuperscript{328} See supra text accompanying notes 187-92 (discussing \textit{O.P.M.}).
\textsuperscript{329} See 1978 OFFICIAL TEXT, supra note 7, § 9-203 official comments 3-5 (discussing the evidentiary purpose of the formal requisites).
\textsuperscript{330} See supra text accompanying notes 76-109 (discussing attachment under prior § 9-203).
\textsuperscript{331} See supra note 209 (discussing the interpretations of Coogan and Aronstein).
\textsuperscript{332} 1978 OFFICIAL TEXT, supra note 7, § 9-203(1).
\textsuperscript{333} Id. § 9-203 reasons for 1977 change, app. I at 862.
sequently note that, while subsection (1)(a) of new section 9-203 continues to permit attachment either by possession or by security agreement, "[o]f the various provisions of Section 8-313(1), some require possession by the secured party, some require a signed security agreement and the rest require procedures which are functionally equivalent to possession." Thus, the official reasons provided for the change to section 9-203 can be interpreted to indicate that, in the context of attachment, where a security agreement is not expressly required by the relevant subsection of new section 8-313(1), it is possession which will be necessary to attachment.

New section 8-321(3)(b) is also important to this analysis since it provides that "no written security agreement signed by the debtor is necessary to make the security interest enforceable, except as provided in" subsections 8-313(1)(h), (i), or (j). The scholarly authorities seem to interpret the word "necessary" in this context as meaning that the security agreement is a prerequisite not only under subsections (h) through (j), but it is permitted and given effect under the other subsections as well. It is arguable that the elimination of the effectiveness of security agreements outside of subsections (h) through (j) would be such a drastic change that the drafters could not have intended this result without expressly stating as much.

Subsection (a) of new section 8-321(3) also states that "no filing is required to perfect the security interest . . ." However, no filing was effective with respect to certificated securities under prior law, and filing remains ineffective under new Article 8. This use of the word "required" has not been interpreted to make filing a permitted alternative to possession under new section 8-313(1). Therefore, when the word "necessary" in new section 8-321(3)(b) is read together with the explanations for the change to section 9-203 and with the use of "required" in subsection (a) of new section 8-

334. Id. The reference to methods "functionally equivalent to possession" appears to refer to those subsections of new § 8-313(1) which are applicable to uncertificated shares, such as registration under subsection (b).
335. See id.
336. Id. § 8-321(3)(b).
337. See supra note 209 (discussing the interpretations of Coogan and Aronstein).
339. See 1972 OFFICIAL TEXT, supra note 1, § 9-304(1) (stating that instruments can be perfected only by possession).
340. Filing is not listed in any subsection of new § 8-313(1). See 1978 OFFICIAL TEXT, supra note 7, § 8-313(1); cf. 1B U.C.C. Serv. (MB) § 14A.02[1][f], at 14A-19 to -22 (1988) (suggesting that perfection by filing should be an alternative to requiring the borrower to obtain and pledge the share certificate).
it is no longer certain that a security agreement was intended to effect attachment under a subsection of new section 8-313(1) other than (h) through (j).

If a security agreement is executed but is of no effect, subsections (a), (d), (e), and (g) mandate that possession by the third party will have to satisfy not only the perfection function of notice to prospective creditors, but also the attachment function of evidencing the debtor's intent to grant a security interest. At this point, it is necessary to return to In re Dolly Madison Industries, Inc., and the court's finding of a valid security agreement which was not immediately effective. The result would arguably be no worse for the secured party if there had been no security agreement at all. The Dolly Madison court concluded that in the absence of an immediately effective security agreement, the creation of the escrow did not create a valid security interest. Thus, at a minimum, the court found that possession by the escrowee did not amount to a sufficient transfer by the debtor to evidence the debtor's intent to create the security interest and, therefore, to effect attachment by possession.

Consequently, there is, at a minimum, unpredictability about the effect of a security agreement, and, therefore, the usefulness of an escrow arrangement, if the creditor is to derive comfort from any subsection other than (h).

3. Escrows When a Security Agreement is Not Required and None is Executed.—Thus far, this Article has analyzed the subsections of new section 8-313(1) under a fact pattern which has suggested that the creditor is seeking to comply with those subsections. Indeed, the creditor has insisted on a signed security agreement whether or not it was expressly required. However, what if the creditor has not planned well, and no security agreement has been executed, yet the creditor nonetheless claims that he was granted a security interest in certain certificated shares held by a third party? Can there be a security interest in his favor?

It is clear that subsection (h) has not been complied with, be-

342. See supra text accompanying notes 138-51 (discussing Dolly Madison and escrows under prior Article 9).
343. Dolly Madison, 351 F. Supp. at 1042; see supra text accompanying notes 143-46.
344. See supra text accompanying notes 143-46.
345. Technically, this applies to any subsection other than (h) through (j), but, as previously demonstrated, subsections (i) and (j) are of little value in the escrow context. See supra text accompanying notes 261-63 (discussing subsection (j)); supra text accompanying notes 284-85 (discussing subsection (i)).
cause no security agreement has been entered into. However, it is also necessary to consider subsections (a) and (e) with respect to closely held shares, and subsections (d) and (g) with respect to publicly traded shares. The analysis is identical to the one applicable under those subsections governing the situation where a security agreement is entered into but deemed invalid. First, the creditor would have to show, for example, confirmation by the financial intermediary under subsection (d),346 or acknowledgment by the bailee under subsection (e).347 Further, subsection (a) would still be of doubtful application based on the meaning of “person designated by” the creditor.348 Subsection (g) might be applicable but would probably be of little practical use.349 Finally, the possession acquired by the bailee, assuming that there really was an escrowee, would have to be sufficient to satisfy both the attachment and perfection functions, which, as previously shown, will be difficult where the purported collateral is held by an escrowee.350 Consequently, it seems unlikely that the escrow arrangement would allow creation of a security interest where no security agreement has been entered into.

4. Escrows When a Security Agreement is Required but is Not Executed.—What would happen if the creditor has planned so poorly that the fact pattern is one that fits only under subsection (h) of new section 8-313(1), and although expressly required, no security agreement has been executed? Can a security interest be created?

This is the only circumstance where the answer is simple and unequivocal. Assume, for example, that the shares are publicly traded, that no clearing corporation is involved, and that, although the debtor notified his broker, the broker did not send the confirmation required under subsection (d) of new section 8-313(1). Assume also that the escrowee is not clearly a designee of the creditor for purposes of subsection (a) of new section 8-313(1), and that the bailee did not acknowledge that he was holding for the creditor as required by subsection (e). Thus, a perfected security interest can be

346. See 1978 Official Text, supra note 7, § 8-313(1)(d), discussed supra text accompanying notes 253-55.
347. See 1978 Official Text, supra note 7, § 8-313(1)(e), discussed supra text accompanying notes 275-83.
348. See supra text accompanying notes 269-74 (discussing whether or not an escrowee could be considered a “person designated by” the creditor for purposes of applying new § 8-313(1)(a)).
349. See supra text accompanying notes 256-58 (discussing new § 8-313(1)(g) and its limited utility in the escrow context).
350. See supra text accompanying notes 320-21.
created only under subsection (h). Assume further that no security agreement was executed.

Under prior Article 9, if the requirements inherited from the common law were satisfied, i.e. that there were sufficient evidence of the debtor’s intent and sufficient notice to third parties, possession alone could create a perfected security interest. The only statutory requirement was that the bailee receive notice of the creditor’s interest.

Such is not the case today. As previously noted, new section 8-313(1) contains the exclusive list of circumstances which can give rise to a security interest in certificated shares. If no subsection other than (h) could apply, then subsection (h) must be satisfied if the creditor is to have a security interest in those shares. Even if the debtor gives notice to the bailee under that subsection and the bailee is in fact far less neutral than the escrowee, there can be no subsection (h) security interest without a security agreement.

This example emphasizes the risk to creditors inherent in new section 8-313(1). If the parties seek to create a security interest by an arrangement not permitted by that section, the creditor will have no security interest whatsoever. The risk for the creditor is that a form, such as the escrow, not expressly and unambiguously included in a subsection of new section 8-313(1), will be deemed wholly outside new section 8-313(1), and therefore, incompatible with the creation of a valid, perfected security interest in certificated shares.

CONCLUSION

Escrow arrangements have often been used when the parties seek to create a security interest in favor of a creditor, but the debtor does not trust the creditor to hold the shares. While such an arrangement has typically been used for security interests in closely held shares, it can also be applied when publicly traded shares constitute the collateral.

The use of the escrow gained recognition under the pre-1977 version of Article 9 of the Uniform Commercial Code. Especially where attachment of the security interest in the certificated shares is effected by a security agreement, the escrow has been accepted as a...
method of perfecting that interest. The 1977 revisions to the Code
remove the creation and perfection of security interests in certifi-
cated shares from Article 9 and place them in new Article 8.

New Article 8 blurs the distinction between attachment and
perfection, contains ambiguities about the effectiveness of a security
agreement in certain circumstances, and includes the exclusive list of
circumstances under which a security interest in certificated shares
can be created. This confluence of changes creates more uncertainty
about whether, under new Article 8, the escrow form remains com-
patible with the creation of security interests in certificated securi-
ties. This additional uncertainty exists not only in the absence of an
executed security agreement, but also where a security agreement
has been entered into.

Since the escrow mechanism does, however, respond to a com-
mmercial need, steps should be taken to return to the state of the law
defined by the Copeland line of cases decided under prior Article 9.
Although there are numerous methods of achieving this result, the
solution requiring the least changes to new Article 8 would be to
make explicit in new section 8-313(1) that financial intermediaries
and bailees include escrowees who receive possession of the collateral
simultaneous with the attempt to create the security interest.355
There are, of course, recognizable dangers of tinkering with the stat-
ute at this level, but until the drafters are ready to reconsider the
uncertainty presented by new Article 8, the individual states could
introduce this refinement into section 8-313(1).

355. A threshold question, often raised by Professor Coogan, is whether the change
should be to reinstate in Article 9 the creation and perfection of security interests in all securi-
ties, both certificated and uncertificated. See 1B U.C.C. Serv. (MB) § 14A.08[5], at 14A-86
to -88 (1988).