

DON GRANDE LAW

Attorneys at Law

820 34th Avenue East, Ste. 200

West Fargo, ND 58078

Tel: 701-365-8088

Fax: 877-678-5051

Writer's Email: don@dongrandelaw.com

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State of North Dakota
North Dakota Legislature
Senate Judiciary Committee

Re: SB 2364 – A BILL for an Act to amend and reenact sections of Article 8 of the Uniform Commercial Code.

Chairman Larson, Vice-Chairman Paulson, and Members of the Committee:

My name is Don Grande, and I am an attorney in private practice. I have worked on issues related to the Uniform Commercial Code (UCC) for many years and specifically on Article 8 of the UCC for over a year. Thank you for allowing me to testify in support of SB 2364.

Certain provisions in North Dakota's UCC put investor (individuals, entities, and institutions) assets at risk of loss in a financial crisis. As an investor under the current law if your broker, custodian, or higher-level securities intermediary becomes insolvent your investment assets are at risk - without your knowledge or consent. I address the specific statutory language below, but I want to provide some background and foundation.

The Uniform Law Commission (ULC) formed a Drafting Committee to revise UCC Article 8 which deals with investment securities (Code Section 41-08). The ULC adopted a model amendment in 1994, and it was provided to the states for ratification. It was passed into law in North Dakota in the 1997 session.

The current statute provides the appearance of normalcy, investors are not even aware that their property rights have been subverted. But, in the event of a financial collapse the statute protects the biggest banks at the expense of the investor.

This revision made a fundamental change to the concept of property rights. The Committee conjured a new ownership concept – a 'security entitlement'. When an investor initiates an order to buy a stock what the investor receives is a security

entitlement related to the stock the investor intended to purchase. The Drafting Committee defines a security entitlement as *'a bundle of personal rights one holds against their broker'*, essentially a contract.

The investor is no longer a stockholder or bondholder under your current law, but an entitlement holder. In addition, your broker or custodian is referred to as a 'securities intermediary'. These definitions are important to understand when evaluating SB 2364.

Code Section 41-08-51 (8-511) provides certain secured creditors of your broker and/or custodian priority to your investment assets in the event of *insolvency of your broker or custodian*.

Specifically, Sections 8-511(2) and (3) state:

(2) A claim of a creditor of a securities intermediary who has a security interest in a financial asset held by a securities intermediary has priority over claims of the securities intermediary's entitlement holders who have security entitlements with respect to that financial asset if the creditor has control over the financial asset. (emphasis added)

(3) If a clearing corporation does not have sufficient financial assets to satisfy both its obligations to entitlement holders who have security entitlements with respect to a financial asset and its obligation to a creditor of the clearing corporation who has a security interest in that financial asset, the claim of the creditor has priority over the claims of entitlement holders. (emphasis added)

The Official Comment to this Code Section makes clear the risk to investors. SB 2364 removes these two exceptions from your UCC Article 8 and ensures the investor will always have priority to his or her investment assets.

Opposition

Opponents of this Bill make two primary arguments. They testify that the exception in 8-511(2) only applies to a margin account. This is false. A margin account is used by an investor who wants to borrow money from his broker and use securities in his account as collateral. Each margin account requires a separate written agreement between the investor and the broker. This separate written agreement supersedes UCC Article 8 and grants a full security interest in the collateral to the broker.

Section 8-511(2) does not mention ‘margin account’ because there is no competing claim requiring this priority provision. It is not that Section 8-511(2) does not apply to margin accounts – it cannot apply to margin accounts by law.

Opponents may also point to Section 41-08-44 (8-504) stating that this section protects investors. This argument also fails upon analysis.

41-08-44 Duty of Securities Intermediary to Maintain Financial Asset. –

(1) *A securities intermediary shall promptly obtain and thereafter maintain a financial asset in a quantity corresponding to the aggregate of all security entitlements it has established in favor of its entitlement holders with respect to that financial asset. The securities intermediary may maintain those financial assets directly or through one or more other securities intermediaries.* (emphasis added)

(2) Except to the extent otherwise agreed by its entitlement holder, a securities intermediary may not grant any security interests in a financial asset it is obligated to maintain pursuant to subsection (a).

(3) A securities intermediary satisfies the duty in subsection (a) if:

(a) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(b) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset.

(4) *This section does not apply to a clearing corporation that is itself the obligor of an option or similar obligation to which its entitlement holders have security entitlements.* (emphasis added)

Subsection (1) provides that a broker can satisfy this requirement directly or indirectly through another securities intermediary. The investor remains at risk.

For example, an investor maintains an investment account with broker-dealer. Broker-dealer complies with UCC 8-504 through a higher-level custodian.

If that custodian fails, the custodian’s secured creditor will have priority over the broker-dealer’s financial assets. *The investor’s assets can be lost even though the broker-dealer is in compliance with 8-504.*

Conclusion

Opponents will say unforeseen consequences will harm the state if your UCC is not uniform with the other states. But they cannot point to a specific unintended negative consequence from this bill.

February 11, 2025

Page 4 of 4

More certain are the **intended consequences** in your current statute. Uniformity cuts both ways. It will be little consolation and comfort to investors in North Dakota knowing that people in the other 49 states lost their securities too thanks to the need for uniformity.

Protecting property rights is a priority of government, a priority this body takes seriously. This is not a red vs. blue issue – it is the people vs. too big to fail banks issue. The UCC can seem complex and unfamiliar, but the intent and impact of SB 2364 is simple – the protection of property rights.

Sincerely,

/s/ Don R. Grande

Additional Information and Resources:

The Oklahoma House held an interim study hearing on Article 8 of the Uniform Commercial Code. [Click here to view that Hearing.](#)

This [Too Big To Fail article](#) provides additional background and analysis of the 1994 UCC Article 8 Amendment.

[Stop It - The Great Taking](#) film documents the legislative efforts in South Dakota and Tennessee in the 2024 legislative sessions and provides additional information relative to SB 2364.

There is also a short [13-minute video](#) summarizing this issue by Taylor Kenny with ITM Trading, Inc..