ORIGINAL

IN THE SUPREME COURT OF OHIO

PAUL CHEATHAM IRA, Plaintiff-Appellee, vs. THE HUNTINGTON NATIONAL BANK, Defendant-Appellant.	:	CASE NO. 2018-0184 On Appeal from The Court of Appeals of Ohio, 6th Appellate District, Lucas County Court of Appeals Case No. L-16-1292 Court of Common Pleas, Lucas County, Ohio Case No. CI0201502696

BRIEF OF AMICI CURIAE – COMMERCIAL LAW PROFESSORS SUBMITTED ON BEHALF OF DEFENDANT-APPELLANT THE HUNTINGTON NATIONAL BANK

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INTEREST OF THE AMICUS CURIAE

This brief is filed in support of the appellant in this matter. It is filed on behalf of commercial law professors who urge this Court to overturn the Court of Appeals and hold that R.C. 1308.16(A) does not provide for the automatic assignment of present or future choses in action from the transferor of a security to the transferee.

This brief is filed on behalf of the following:

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The signers represent a cross-section of prominent commercial law scholars from a range of law schools. They all hold or have held named professorships at their law schools. They have written or co-written important treatises in such areas as contracts, commercial law theory, international and domestic sales law, damages under the Uniform Commercial Code, corporate reorganization, and bankruptcy. They have written leading casebooks in all areas of commercial law, as well as contracts, bankruptcy, and consumer law. Their articles and essays have frequently appeared in high-ranked law journals across the nation, including the flagship law reviews at Yale, Virginia, Cornell, Michigan, UCLA, Texas, Ohio State, Illinois, Minnesota, Iowa, and William & Mary. Among them are five members of the American Law Institute and

two Uniform Law Commissioners (including one member of the Uniform Commercial Code Committee and one Division Chair). They include the editor of *Business Law Today,* a widely circulated journal published by the American Bar Association. They have headed all the sections of the Association of American Law Schools related to contracts and commercial law.

The principal drafter of this brief, Professor Larry Garvin, is Lawrence D. Stanley Professor of Law at the Michael E. Moritz College of Law at The Ohio State University. He has been a member of that faculty since 2003. Before that he was a tenured member of the faculty at the Florida State University College of Law, where he served as Associate Dean for Academic Affairs, and as a visiting professor at the law schools of Washington University in St. Louis and the University of Texas. His law degree is from Yale Law School, where he was Managing Editor of *The Yale Law Journal* and Article Editor of *The Yale Journal on Regulation*. Between law school and teaching, he clerked for the Honorable Edward N. Cahn, United States District Judge for the Eastern District of Pennsylvania, and practiced law at Shea & Gardner in Washington (now Goodwin Procter).

Professor Garvin teaches and writes in the fields of contracts and commercial law. He has authored or co-authored seven books or editions of books, nine treatise supplements, one book chapter, and eighteen law review articles, all on commercial and contract law. Professor Garvin has been one of Ohio's Uniform Law Commissioners since 2005. Among the committees he sits on is the Uniform Commercial Code Committee. He is also a member of the American Law Institute, where he serves as an advisor to the reporters of the Restatement of Consumer Contracts. Professor Garvin has served as chair of both the Section on Contracts and the Section on Commercial and Related Consumer Law of the Association of American Law Schools.

ARGUMENT

Proposition of Law No. 1: Revised Code Section 1308.16(A) [U.C.C. Section 8-302] Does Not Require that Claims Held by the Transferor of a Security Automatically be Assigned to the Transferee

A. The History of R.C. 1308,16(A) [U.C.C. 8-302(1)] Shows that the Drafters of the U.C.C. Did Not Intend It To Apply To Transfers of Choses in Action

1. Introduction

From the earliest drafts onward, what is now U.C.C. 8-302(1) has codified the common-law principle that, unless the parties agree otherwise, a transferee takes all rights in the thing transferred that the transferor has power to give. In the official text, comment 1 to 8-302(1) makes clear that this subsection is a "statement of the familiar 'shelter' principle": the rule that "the taker receives everything the transferor had to convey." John F. Dolan, *The U.C.C. Framework: Conveyancing Principles and Property Interests,* 59 B.U.L.Rev. 811, 812 (1979).

There has never been any doubt that section 8-302(1) is Article Eight's version of the shelter principle. The issue in this litigation is whether it goes beyond shelter to provide for the automatic assignment of rights beyond the simple passage of title. More precisely, when a security owner transfers title to her security, is she assumed to transfer with it every present or future chose in action that is in some way related?

Much of the dispute between appellant and appellee here, and transferors and transferees generally, turns on whether U.C.C. Section 8-302(1) provides for the transfer of a particular right as part of the transfer of the security. Thus, for example, the parties here differ on the relative relevance of two opinions from Judge Koeltl of the United States District Court for the Southern District of New York in 2004. In *Consolidated Edison, Inc. v. Northeast Utilities*, 318 F.Supp.2d 181 (S.D.N.Y.2004), *rev'd on other grounds*, 426 F.3d 524 (2d Cir.2005), the court looked at some of the history of this section and concluded that "rights in the securities" did not encompass

contract rights against third parties. In contrast, in *R.A. Mackie & Co. v. Petrocorp Inc.*, 329 F.Supp.2d 477 (S.D.N.Y.2004), the same court held that the right to bring claim for breach of a warrant agreement was not transferred with the warrants, distinguishing *Consolidated Edison* on the grounds that the rights purportedly transferred in *Mackie* were for breach of an agreement between the issuer of the warrants and the warrant holders, whereas the transfer in *Consolidated Edison* related to an action for breach against a third-party, not an issuer. *Mackie* at 507-508.

After a thorough study of the drafting history of this section, we have concluded that it does not apply to choses in action at all, but rather merely states the time-honored shelter principle. The drafters of what is now section 8-302(1) did not think it applied to the questions raised in this litigation. As such, it is necessary to look elsewhere to determine whether in a particular transaction the parties have agreed to transfer more than the ownership of the security proper.

The evidence for this proposition comes from two sources. One, of course, is the actual drafting history of the Code, including the successive drafts and the recorded discussions of those drafts in meetings of the American Law Institute and the National Conference of Commissioners on Uniform State Law.[1] The other is the reports and deliberations of the New York Law Revision Commission as it considered both the specific question of automatic assignment raised here and the general question of whether the U.C.C. should become part of

[1] There are two series of books that contain early versions of the Code. Elizabeth Slusser Kelly, *Uniform Commercial Code: Drafts* (1984) (hereinafter *Drafts*); Elizabeth Slusser Kelly and Ann Puckett, *Uniform Commercial Code: Confidential Drafts* (1995) (hereinafter *Confidential Drafts*). These contain no drafts of what is now Article Eight preceding Preliminary Tentative Draft No. 1, dated April 22, 1946. Karl Llewellyn saved many drafts and related materials, which are preserved in his papers at the University of Chicago. Those papers contain some drafts that antedate Tentative Draft No. 1, as well as transcripts of ALI and NCCUSL meetings and the like. It is possible that other sets of archives contain more early material, but it is unlikely that more than one or two drafts are missing; and, in any event, the text and comments for this section had stabilized by the first Tentative Draft.

New York law. After Pennsylvania quickly enacted the Code in 1951, New York conducted hearings that spread over three years, with testimony from the reporters for the Code and ultimately extensive reports about how the Code would change New York law and whether the Code would be an improvement. The significant criticism in these reports caused the drafters of the Code to make extensive revisions, resulting in the text of the Code enacted by essentially all the states in the 1960's. Both historians and courts have found the New York proceedings invaluable and have cited to them often.

While the Code was being drafted, the New York commission addressed some recent cases–in particular, a case decided by the New York Court of Appeals–holding that a sale of bonds did not in and of itself convey to the buyer would take whatever causes of action the seller might have had at the time of sale. It issued its own detailed report and proposed a statute to overturn those cases, which was duly enacted into law in 1951 and is now codified at N.Y.Gen.Oblig. Law Section 13-107. Because this statute addresses the issue raised in this litigation, and because its drafting history is enmeshed with that of the Code itself, its history sheds light on how the Code deals with automatic assignment.

Looking to New York studies, statutes, and opinions is also important because New York was, and is, the center of the American securities industry. Most cases on assignment either arose in New York courts or apply New York law. When the Code was being drafted, the Reporter and most of her advisors were New York lawyers. Ultimately the value of an opinion rests with its reasoning, but changes to New York law have had an outsized effect on the development of the modern law of securities transfer.

There is little doubt that the drafting history of a statute may help explain its scope and meaning. This is particularly true for uniform acts, such as the Uniform Commercial Code.

Ohio's courts, like those in other jurisdictions, seek to maintain the uniformity of uniform state law. *See Casserlie v. Shell Oil Co.,* 121 Ohio St.3d 55, 2009-Ohio-3, 902 N.E.2d 1, ¶ 18, quoting *Edward A. Kemmler Mem. Found. v. 691/733 E. Dublin-Granville Rd. Co.,* 62 Ohio St.3d 494, 499, 584 N.E.2d 695 (1992) ("[I]t is desirable to conform our interpretations of the Uniform Commercial Code to those of our sister states."). The Code requires as much. R.C. 1301.103(A)(3) [U.C.C. 1-103(a)(3)] (the U.C.C. "must be liberally construed and applied to promote [its] underlying purposes and policies, which are * * * (3) To make uniform the law among the various jurisdictions.").

One standard tool employed by the courts is the drafting history of the Code. In the words of one court, "[g]iven 'the legislative intent to make the UCC a uniform code,' we consider prior drafts of the UCC, as drafted by the National Conference of Commissioners on Uniform State Laws (NCCUSL) as part of the legislative history." *Peace River Seed Co-Operative, Ltd. v. Proseeds Marketing, Inc.*, 355 Or. 44, 53, 322 P.3d 531 (2014). This Court has done so on at least one occasion. *G.F.D. Enters., Inc. v. Nye,* 37 Ohio St.3d 205, 214, 525 N.E.2d 10 (1988) (R.C. 1303.42 [U.C.C. Section 3-406]). It is to that history that we shall now turn.

2. The drafting history of this section shows that it was intended only to be a codification of the "shelter principle"

The earliest available versions of this section appeared in 1946. They were rather diffidently labeled "preliminary tentative drafts" or "proposed preliminary tentative drafts"; not until 1947 did the reporter refer to the current version as even a "tentative draft." These embryonic drafts were extensively revised from version to version, so it is not surprising that the language used to state the shelter principle varied.[2] Whatever the precise language used,

[2] *See, e.g.,* U.C.C. Section 17 (Pre-Tentative Draft, 1946?), located in *The Karl Llewellyn Papers,* J.VIII.5.a. ("a person to whom an investment instrument has been negotiated or otherwise transferred acquires to the extent of this transaction of purchase all rights which his

however, the notes and comments to the successive drafts invariably stated that this section did nothing more than restate existing law and that it was drawn from other bodies of commercial law, including what became Articles Two and Three of the Code. Thus, for example, the reporter's note to the March 9, 1946 draft stated that "[t]his section is declaratory of the law and follows the style of language in the corresponding provision of the Revised Uniform Sales Act." Note to U.C.C. Section 16 (Proposed Preliminary Tentative Draft, Mar. 9, 1946), located in *The Karl Llewellyn Papers*, J.VIII.5.c. By March of 1948, the draft comment dealt plainly with the "shelter principle":

> Subsection (2) is declaratory of the present law as to the rights acquired by any purchaser of a security. It includes . . . the shelter provision . . . This definition runs throughout this entire Article so that any reference to the rights of purchasers, including bona fide purchasers, must be read as including the shelter provision * * *

Notes and Comments to Section 13, "Rights Acquired by Purchaser; Title Acquired by Bona Fide Purchaser; 'Bona Fide Purchaser,'" (Tentative Draft No. 3–Article V: Investment Instruments, Mar. 17-20, 1948), *reprinted in* IV *Confidential Drafts* 329, 350.

The identical language appears in Proposed Final Draft No. 1. Notes and Comment to Section 13, "Rights Acquired by Purchaser; Title Acquired by Bona Fide Purchaser; 'Bona Fide Purchaser,'" (Proposed Final Draft No. 1, Apr. 26, 1948), *reprinted in* IV *Drafts* 303, 368. From this history, it seems clear that no one thought this section anything more than a placeholder for the usual shelter principle.

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transferor had or had actual authority to convey * * *"); U.C.C. Section 18 (Preliminary Draft, Feb. 15, 1946), located in *The Karl Llewellyn Papers,* J.VIII.5.b. ("Subject to the terms of the transfer a person to whom an investment instrument has been negotiated or transferred acquires to the extent of his purchase all title and rights to the instrument and the rights represented thereby while his transferor had or had actual authority to convey * * *"); U.C.C. Section 16 (Proposed Preliminary Tentative Draft, Mar. 9, 1946), located in *The Karl Llewellyn Papers*, J.VIII.5.c ("acquires to the extent of his transaction of purchase all rights * * *")

A startling demonstration of this provision's lack of new content came during the discussion of Tentative Draft No. 2 in 1947 at the NCCUSL annual meeting. When this provision came before the committee of the whole, Karl Llewellyn, who led the discussion, said this:

> The [advisory committee], however, had trouble with the language of 17. Partly, it was felt that 17 was totally unnecessary since everybody understood that anybody could turn over whatever it was that he had * * *

Nat'l Conference of Commissioners on Uniform State Laws, Proceedings in the Committee of the Whole at 75 (Sept. 16, 1947), located in *The Karl Llewellyn Papers* J.IX.6.d.

Ultimately, Llewellyn said that the drafters decided to keep it in "because we believe that it greatly simplifies the technical problem of drafting * * *" *Id.* at 76. Nor, indeed, did the reporters think this provision said anything unique to securities law. During a joint session of ALI and NCCUSL in 1948, Soia Mentschikoff, the Reporter, had this to say when the group reached the final draft of this section:

> Subsection 2 deals with the rights that are acquired and contains the shelter principle of the Negotiable Instruments Law, and we would hope that Subsection 2 could someday be moved into the first part of the code, or at least the language could be used identically in the commercial paper article and in the other articles that deal with bona fide purchasers and invoke the question of shelter.

Am. L. Inst., *Proceedings of the Twenty-Fifth Annual Meeting in Joint Session with the National Conference of Commissioners on Uniform State Law* 107 (May 20-22, 1948).

In sum, the drafters of what is now Section 8-302(1) looked at it essentially as boilerplate. From the start, their notes and comments described it as nothing more than a restatement of the time-honored shelter principle. Llewellyn even questioned whether it was needed. Neither did this section lay out a version of the shelter principle unique to securities law; if it had, then the Reporter would hardly have suggested moving it into Article One with the

other general provisions of the Code. Section 8-302(1) does not, and was not intended to, do anything more than lay out the orthodox shelter principle. *See also, e.g., Fraternity Fund Ltd. v. Beacon Hill Asset Mgt., LLC,* 479 F.Supp.2d 349, 373 n.126 (S.D.N.Y.2007) ("Section 8-302(a) [8-302(1)] thus primarily concerns issues of title, such as defenses against enforcement of ownership rights. It does not provide for the automatic transfer of fraud claims against third parties.").

B. The Development of the Law of Automatic Assignment in New York is Inconsistent with the Argument that Section 8-302(1) Applies to the Automatic Assignment of Choses in Action

When Article Eight was being drafted, the New York Court of Appeals had recently issued an opinion regarding automatic assignment of choses in action as part of a sale of bonds, an opinion that proved sufficiently controversial to bring about legislative reversal not long after. The history of this case and the subsequent statute is important because of what it *doesn't* say about Section 8-302(1): It nowhere acknowledges any connection between developments in New York and the drafting of the Code.

The early history of New York law about automatic assignment of choses in action is beyond the scope of this brief.[3] Suffice it to say that New York state courts usually, but not invariably, held that choses in action held by the transferor of a security were not automatically assigned to the transferee. This line of cases culminated in *Smith v. Continental Bank & Trust Co.,* 292 N.Y. 275, 54 N.E.2d 823 (1944). Smith owned coupon bonds secured by an indenture as to which Continental's predecessor served as trustee. Smith sold the bonds at a substantial

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[3] For thorough coverage, see Robert Braucher, *Rights of Purchasers of Bonds to Causes of Action Accruing Before Transfer, in N.Y. L. Revision Comm'n, Act, Recommendation and Study Relating to the Transfer with Bonds of Claims Connected Therewith* 5 (1949), reprinted in *Report of the Law Revision Commission* at 67, 75 (1950) (hereinafter *Braucher Memorandum*); Sol Neil Corbin, Note, *The Subsequent Bondholder and the Delinquent Trustee,* 51 Colum.L.Rev. 813 (1951)

loss and then sued Continental, alleging that gross negligence on the part of Continental caused his bonds to decline in value. Continental argued that Smith's complaint stated no cause of action, because he did not allege that he owned the bonds at the time of suit. This defense succeeded at trial and on appeal, but not before the New York Court of Appeals. That court unanimously reversed, holding that the claims Smith asserted were personal and independent from ownership of the bonds. 292 N.Y. at 278-79.

The so-called "New York rule" attracted comment, little of it favorable. *Smith* clarified the rule in a manner opposed by many in the securities industry. It did not take long for the New York Law Revision Commission to engage Professor Robert Braucher of the Harvard Law School to study automatic assignment, and it did not take long for Professor Braucher to report back. His conclusion–that New York's law should be changed–was welcome to the Law Revision Commission, which adopted his recommendation in 1949 and drafted legislation to overturn *Smith* that passed into law in 1950. N.Y.Gen.Oblig.Law section 13-107. That statute specifically inverts the default rule, so that choses in action are assigned automatically in a sale of bonds unless the parties agree otherwise. *See Bluebird Partners, L.P. v. First Fidelity Bank, N.A.*, 97 N.Y.2d 456, 461, 741 N.Y.S.2d 181, 767 N.E.2d 672 (2002) (under section 13-107, "the buyer of a bond receives exactly the same 'claims or demands' as the seller held before the transfer"; buyer need show no independent injury).

If U.C.C. 8-302(1) applies to automatic assignment, then New York's history would seem to be highly relevant. New York's common law while section 8-302 was drafted was not consistent with the law in most states whose courts had reached the issue, few as those were. Sound commercial lawyers studying the question would have to address this split in authority, particularly because the split put New York in the minority. Similarly, any competent study of

Smith and related cases that proposed a legislative solution would have to take the draft U.C.C. into account. And these projects were not staffed with merely competent lawyers. Soia Mentschikoff, Karl Llewellyn, and Robert Braucher were among the very best contracts and commercial law scholars of their time.

So how did the drafters of the Code deal with *Smith*? By not mentioning it at all. In thousands of pages of drafts of Article Eight, debates at ALI and NCCUSL, and correspondence, I have found not a single reference, even in passing, of *Smith* or the dozen or so cases preceding it. Bear in mind that Mentschikoff and Llewellyn were based at Columbia Law School. They were advised by leading securities and banking lawyers, most of whom practiced in New York. It is inconceivable that the reporters and advisors would be unaware of the leading line of cases in the most important American jurisdiction for the law of securities. If section 8-302(1) either codified or rejected *Smith*, surely that would have been worth mentioning in a comment. After all, draft comments to the Code frequently noted when the blackletter would overturn a line of cases. Article Two even made a specific and disapproving mention of a New York case on investment securities. U.C.C. section 2-105 cmt. 1 (referring to *Agar v. Orda,* 264 N.Y. 248, 190 N.E. 479 (1934)). But in section 8-302? Silence.

The same goes for the New York Law Commission. In its recommendation to the legislature, the Commission observed in passing that:

> the similar problem posed by causes of action arising out of transfers by one bondholder to another has been considered by the Commission but no recommendation is made at this time. A statute covering such causes of action would be more appropriate in the context of a general revision of the Sales Act and the Negotiable Instruments Law. Such a revision is now under consideration by the American Law Institute and the National Conference of Commissioners on Uniform State Laws.

N.Y. Law Revision Commission, *Recommendation of the Law Revision Commission to the*

Legislature Relating to the Transfer with Bonds of Claims Connected Therewith 7 (1950), reprinted in *Report of the Law Revision Comm.* 67, 73 (1950).

The Commission plainly referred to the draft Uniform Commercial Code–but only to what are now Articles Two and Three. Article Eight on investment securities was complete when the Commission issued its recommendations, but one wouldn't know it from the recommendations themselves.

Finally, what about Robert Braucher's thorough report for the New York Law Revision Commission? Just as Mentschikoff and Llewellyn must have known about the New York cases on automatic assignment, Braucher must have known in some detail about the successive drafts of the Code. One would expect no less from a Harvard law professor who later became Reporter for the Restatement (Second) of Contracts and then a Justice on the Massachusetts Supreme Judicial Court. Nor is this a matter of surmise. In his report, Braucher referred to several provisions of the draft Code. *Braucher Memorandum* at 22 fn.58 (three sections of Article Two relating to privity) and fn.59 (one section of Article Three on warranties on negotiation by delivery of a negotiable instrument). So his report on automatic assignment mentioned Article Two and Article Three–but not Article Eight. If U.C.C. section 8-302 codified any of the law on automatic assignment, Professor Braucher would have known about it, and it is impossible to believe that he would not have mentioned it in a report about a proposed state statute dealing with the selfsame topic.

C. The History of the Code after 1950 is Inconsistent with the Argument that Section 8-302(1) Applies to the Automatic Assignment of Choses in Action

Thus far, we have seen that the drafters of the Code apparently did not think the perturbations in the New York law of automatic assignment worth mentioning, and the New York Law Revision Commission, when proposing a statutory correction to that New York law,

apparently did not think the draft U.C.C. worth mentioning. The logical inference to draw is that at the time, even though the problems of automatic assignment were prominent, no one thought that current U.C.C. 8-302(1) said anything about them.

The two bases for this conclusion–the Code and the New York Law Revision Commission–came together in the mid-1950's, when New York considered enacting the Code. The New York Law Revision Commission held extensive hearings over a period of three years, with active participation from the Reporters and from bar associations, industry groups, and leading members of the New York Bar. These proceedings, along with the ultimate report, fill over four thousand pages of the Law Revision Commission's Reports, and the negative report caused ALI and NCCUSL to revise significant parts of the 1951 Official Text. These hearings began in 1953, after New York had enacted its statute reversing *Smith* and making automatic assignment New York's default rule.

This sequence of events raises two questions. First, the comments to the pre-1950 draft Code stated that then-Section 8-301 did nothing more than codify the customary shelter principle–but those comments were drafted before New York's statute upending its law of automatic assignment. If this provision of the Code in fact addressed automatic assignment, then the comment to the Code surely should have changed to reflect New York's *volte face*. Second, in the hundreds of pages of these reports dealing with Article Eight, someone, sometime should have mentioned how the Code meshed with the New York statute, if only to note that they overlapped and that one would take precedence over the other.

Once again, the connection would be glaringly obvious–and once again, no one made it. Nowhere in the five volumes of the New York Law Revision Commission's reports on the Uniform Commercial Code is there any mention of the automatic assignment issue, much less

how New York law and the Code might coexist. Nothing in the 1951 text of the Code made any mention of the New York statute, or any other statute or case authority pertaining to automatic assignment. And nothing in any subsequent draft of the Code, including the draft prepared in response to the New York Law Revision Commission's analysis, mentions automatic assignment.

It is not as though the drafters of the Code had the option to brush off New York's concerns. If New York had rejected the Code, many other jurisdictions would have followed suit; after all, after Pennsylvania in 1951, no state enacted the Code until after the drafters responded to the New York report. It is not as though New York lawyers were unaware of the state of New York law on automatic assignment, given the still-fresh cases and statute that shifted it so radically. And it is not as though the drafters of Article Eight, themselves New York legal academics specializing in commercial law, could have been unacquainted with these legal developments.

D. Conclusion

In sum, as the legal world of automatic assignment changed, the Code did not change with it. Not one of the expert drafters and commentators on Article Eight ever mentioned a connection between section 8-302(1) and automatic assignment–not even in New York, where the law of automatic assignment had lurched back and forth while the Code was being drafted. If we assume that Karl Llewellyn, Soia Mentschikoff, Robert Braucher, and many others were competent and informed commercial lawyers, there is only one inference we can draw: They didn't mention how 8-302(1) applies to automatic assignment because it doesn't apply to automatic assignment at all.[4]

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[4] To the extent that Section 8-302 is germane, it favors the appellant's position. Section 8- 302(1) states that a purchaser "acquires all rights in the security that the transferor had or had power to transfer." The specific term "in the security" has been present in every draft from Tentative Draft No. 1 onward. "Security" is in turn defined as "an obligation of an issuer or a

This result is something like Sherlock Holmes's dog that didn't bark–only here we have not one silent dog, but a whole pack. Even if we can explain away any individual failure to mention how section 8-302(1) affects the law of automatic assignment, there are just too many of them to explain without assuming gross negligence by the reporters, advisors, and law commission members at one or more stages. Wherever the law of assignment of choses in action may be found, section 8-302(1) isn't it.

Proposition of Law No. 2: As a Matter of Both Precedent and Principle, This Court Should Rule That Choses in Action Related to a Security Are Not Automatically Assigned to a Transferee upon Transfer, but May be Transferred by Express Agreement

A basic principle of the Code is that it ordinarily does not oust existing state law. *See* R.C. 1301.103(B) [U.C.C. 1-103(b)] ("Unless displaced by the particular provisions of [the U.C.C.], the principles of law and equity * * * supplement [its] provisions."). The Code is silent about the automatic assignment of choses in action as part of a transfer of securities. There is no evidence that the drafters meant to displace prior state law on the matter, or do anything other than restate the shelter principle with some modest adjustments. There is no Ohio precedent on this specific issue. We are therefore left with the standard tools of common-law analysis to ascertain whether automatic assignment of choses in action is part of Ohio law.

Both precedent and principle favor holding that choses in action related to a security are not automatically assigned upon transfer of the security.[5] For the most part, causes of action

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share, participation, or other interest in an issuer or in property or an enterprise of an issuer" of a type traded in securities markets or specifically labeled as a security. U.C.C. 8-102(a)(15). A chose in action may well be "property . . . of an issuer," but so is any other corporate asset. What makes something a security is that a right of that type is dealt in or traded on securities exchanges or securities markets, which choses in action clearly are not. Nor is a chose of action an "obligation of an issuer," unless one somehow stretches that definition to encompass potential rights that, if realized upon, would help the issuer meet its contractual obligations. Even leaving its provenance aside, a plain reading of section 8-302 does not support the concept of automatic assignment.

[5] The modern law of assignment suggests that the parties should be able to assign them by

similar to the breach of contract action here, and indeed commonly associated with it, are not subject to automatic assignment. This is the case throughout federal securities law, and it is the case for most common-law causes of action as well. *See* Restatement of the Law 2d, Contracts, Section 324 (1981) ("It is essential to an assignment of a right that the obligee manifest an intention to transfer the right to another person * * *"). To choose a default rule on automatic assignment that differs from the rule for allied causes of action can create a trap for the unwary. Even for the wary, the result may be duplicative litigation, liability in excess of the actual harm,[6] and windfalls for buyers who take advantage of this legal uncertainty and the consequent market unpredictability. More generally, the modern law of assignment increasingly favors the ability of contracting parties to assign whatever rights they so choose, and thus not to assign whatever rights they wish to retain. Making automatic assignment the default rule would force action and associated expense upon those who simply want to keep the rights they have.

A. In Related and Analogous Causes of Action, Automatic Assignment is Generally Disfavored

In the absence of Ohio precedent, the next place to look is similar causes of action. Not only do they provide useful analogies, but the possibility of excessive liability and unnecessary litigation weighs in favor of treating assignments identically where causes of action coincide or overlap. There are three sources of law that are especially important: Federal securities law, the Uniform Commercial Code, and the common law. Suits alleging misconduct by an indenture trustee commonly invoke one or more of these; correspondingly, behavior that qualifies as

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agreement, although that is not necessarily the case in all similar settings. *See infra.*

[6] If some, but not all, choses in action pass automatically when a security is transferred, then both the transferor and transferee will have the right to sue the indenture trustee based on essentially identical facts. The result may be overlapping and uncoordinated damage awards. *See* Sarah L. Reid and Robert W. Schumacher, *Automatic Assignability of Claims: The Tension Between Federal and New York State Law,* 125 Banking L.J. 725, 730 (2008).

misconduct may well yield liability in one or more as well.

1. Claims under federal securities laws are not automatically assigned to the transferee upon transfer

a. Claims arising under the Trust Indenture Act of 1939 are not automatically assigned.

Most transactions in bonds are governed by the Trust Indenture Act of 1939, 15 U.S.C. 77aaa to 77bbbb. Municipal bonds are excluded from its coverage. Trust Indenture Act at 304(a)(4), 15 U.S.C. 77ddd.[7] Cases decided under the Trust Indenture Act therefore are not controlling. Nevertheless, they provide strong analogies when determining the law governing municipal bonds. There is no apparent reason to treat municipal bonds differently than non-municipal bonds for the purpose of automatic assignment; certainly none appears in the legislative history of the Trust Indenture Act. S. Rep. No. 76-248 (1939); H.R. Rep. No. 76-1016 (1939).

The Court of Appeals in this case cited to the two leading cases construing the Trust Indenture Act. In the first, *In re Nucorp Energy Securities Litigation,* 772 F.2d 1486 (9th Cir. 1985), the plaintiffs were subsequent purchasers of debentures. They filed suit against the indenture trustee, alleging breach of trust under the Trust Indenture Act and state law claims for breach of fiduciary duty, willful misconduct, fraud, deceit, and negligence. The court held that the Trust Indenture Act did not provide the plaintiffs with a cause of action. Under the Trust Indenture Act, to pursue a private cause of action requires that the purchaser have relied upon misleading statements or omissions. 15 U.S.C. 77www. These subsequent purchasers bought their debentures *after* Nucorp had made a public announcement of its financial difficulties,

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[7] This was meant to parallel the coverage of the Securities Act of 1933, and indeed refers expressly to the coverage of the '33 Act. *Id.* ("The provisions of this subchapter [the Trust Indenture Act] shall not apply to any of the following securities * * * (4) (A) any security exempted from the provisions of the Securities Act of 1933 by paragraphs (2) to (8), (11), or(13) of section 3(a) thereof * * *"). The specific exemption for municipal securities in the '33 Act appears in section 3(a)(2).

however, and could not reasonably have relied upon those earlier misstatements. *Nucorp,* 772 F.2d at 1489-90. More important for our purposes, the plaintiffs argued as well that even if they had no direct cause of action, they acquired a cause of action from their sellers by automatic assignment. The court dispensed quickly with that argument. It observed that the federal cause of action, which depended on misrepresentation, was personal to the party acting in reliance, and thus did not automatically follow the security. Otherwise the remedy under the Trust Indenture Act would move from the defrauded party to the buyer, who by definition was not defrauded. *Id.* at 1490.[8]

Similarly, in *Bluebird Partners, L.P. v. First Fidelity Bank, N.A.,* 85 F.3d 970 (2d Cir.1996), the Second Circuit, after canvassing the caselaw, saw "no persuasive reason to disagree with these cases and impose a rule of automatic assignment here." *Id.* at 974. The court stated that the underlying policy of the Trust Indenture Act is "to protect those who are injured including those who have sold their securities at a reduced price after the Act has been violated, not those who subsequently purchase securities at the reduced price." *Id.* (citations omitted). The market for securities would not be likely to reflect the value of the claim, because the great majority of courts have ruled against automatic assignment. *Id.* The other case authority is not to the contrary. *See English v. Energy Future Holdings Corp.* (*In re* Energy Future Holdings Corp.), D. Del. No. 16-1331-RGA, 2018 WL 1479028, at *5 (Mar. 23, 2018); *Independent Investor Protective League v. Saunders,* 64 F.R.D. 564, 572 (E.D.Pa.1974).

Whether the Trust Indenture Act allows an injured bondholder to assign her claim expressly is not entirely clear. But the courts are clear on this point: The Trust Indenture Act does

[8] The *Nucorp* court also affirmed the dismissal of the state law claims, holding that New York's own law did not provide for automatic assignment of claims upon the transfer of a security. *Nucorp,* 772 F.2d at 1492-93.

not provide for automatic assignment. In the words of Chief Judge Lord's opinion in *Saunders*:

> While a security is of course transferred by its sale, the causes of action belonging to a prior holder do not pass with the transfer of the security. The provisions of the securities acts relied upon here create rights of action on the part of investors who have been harmed by the misconduct of others. Those rights belong to the *persons* who have suffered injury. They do not attach for all eternity to the security itself, to pass forever from the person who has been harmed to be asserted by others who have not.

Saunders, 64 F.R.D. at 572 (emphasis sic).

The logic of *Saunders* and the other decisions construing the Trust Indenture Act applies both to the sale of private-sector bonds and public- sector bonds; uniformity, consistency, and predictability favor its application here.

b. Claims arising under federal securities statutes are not automatically assigned

The great bulk of the cases on the automatic assignment of federal securities law claims as part of a transfer of the securities stem from alleged violations of Rule 10b-5, promulgated pursuant to Section 10(b) of the Securities Act of 1933, 15 U.S.C. Sections 77a et seq. With almost no exceptions, the courts have been reluctant to permit assignment of any type, much less automatic assignment, of these claims.[9] This stems from the United States Supreme Court's decision in *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975). There the Court held that actions under Rule 10b-5 were limited to actual purchasers or sellers of securities. They were thus unavailable to an offeree of stock pursuant to an antitrust decree to which the offeree was not a party and who was dissuaded from purchasing the stock because of the issuer's misrepresentations. In so doing, the Court expressed concern about the likelihood of vexatious litigation brought by those who were not directly injured, but who saw

[9] This appears to be true for other federal securities statutes. *See Soderberg v. Gens,* 652 F.Supp. 560, 564-66 (N.D.Ill.1987) (Section 12(2) of the '33 Act and Section 206 of the Investment Advisers Act of 1940, as well as Section 10(b) of the '33 Act: no automatic assignment)

the possibility of securing excessive settlements because of the costs that litigation would place on the defendant and the difficulty of dismissal or summary judgment. *Blue Chip*, 421 U.S. at 740.

Since *Blue Chip,* the courts have almost unanimously held that a cause of action under Rule 10b-5 is not automatically assigned to a transferee of the security.[10] This is true for both bondholders and stockholders. *In re Natl. Century Fin. Ents., Inc. Litigation*, 755 F.Supp.2d 857, 867 (S.D.Ohio 2010); *see also, e.g., Dobyns v. Trauter*, 552 F.Supp.2d 1150, 1154 (W.D.Wash. 2008) (stocks); *In re Saxon Secs Litigation*, 644 F.Supp. 465, 471-73 (S.D.N.Y.1985) (bonds); *Rose v. Ark. Valley Environmental & Util. Auth.*, 562 F.Supp. 1180, 1188-89 (W.D.Mo.1983) (bonds). *See generally* 3 Thomas Lee Hazen, *The Law of Securities Regulation*, Section 12:42 (7th ed.2014 & Supp.2018) ("The assignment of shares of stock does not automatically assign Rule 10b-5 claims relating to those shares that may have existed in the hands of the seller."); David C. Profilet, Note, *Express Versus Automatic Assignment of Section 10(b) Causes of Action*, 1985 Duke L.J. 813 (against automatic assignment); *but see* William K.S. Wang, *Is a Seller's Rule 10b-5 Cause of Action Automatically Transferred to the Buyer?*, 1988 Colum.Bus.L.Rev. 129 (generally favoring automatic assignment).

2. Causes of action arising under Articles Two and Three of the U.C.C. generally are not automatically assigned to the transferee of the underlying *res*

As already noted, the draft comments to the Code, from the earliest drafts to the latest, analogized the "shelter principle" of Section 8-302(1) to shelter principles found in sales law and negotiable instruments law. Reporter Mentschikoff even expressed a desire that these shelter

[10] It is not even clear that a claim under Rule 10b-5 can be *expressly* assigned. *Compare Farey-Jones,* 132 F.Supp.2d at 100-101 (E.D.N.Y.2001) (assignable); *AmeriFirst Bank v. Bomar,* 757 F.Supp. 1365, 1370-72 (S.D.Fla.1991) (same) *with Aviva Life and Annuity Co. v. Davis*, 20 F.Supp.3d 694, 701-03 (S.D.Iowa 2014) (generally not assignable); *Small v. Sussman*, N.D. Ill. No. 94 C 5200, 1995 WL 153327, at *9-11 (Apr. 5, 1995) (not assignable)

provisions be united and moved into Article One as statements of a general concept. Looking to how those Articles treat automatic assignment may thus be instructive.

a. Causes of action arising under Article Two of the U.C.C. generally are not automatically assigned to the buyer or other transferee of the underlying goods

Section 2-403(1) of the Code, R.C. Section 1302.44(A), is the sales analogue to Section 8-302(1). Under this section, "[a] purchaser of goods acquires all *title* which the transferor had or had power to transfer * * *" (Emphasis added.) The significant word here is *title*. The buyer gets title to the goods; the buyer does not get anything else purely because of the sale of goods. A cause of action for breach of the implied warranty of title, U.C.C. 2-312(1), R.C. 1302.25(A), goes directly to title, and might logically be conveyed as part of a routine sale. Other choses in action, however, go not to title, but to other attributes of the sales transaction, and would not pass to the buyer without an express assignment.

Suppose, for example, that A's automobile crashes, and A plans to sue the manufacturer, the X Motor Corporation, for breach of express and implied warranties and under strict liability for product defect. In the meantime, A sells the charred wreck to B, the owner of a junkyard, as scrap. It would defy common sense to argue that B acquired A's rights against the X Motor Corporation when B bought the junked car. As Professor Braucher put it in his 1950 memorandum to the New York Law Revision Commission, "[i]f property known to be damaged is transferred without mention of a known cause of action for the damage, the inference is likely to be almost inescapable that the transferor intends to reserve the cause of action." *Braucher Memorandum* at 21. Article Two's statement of the shelter principle, U.C.C. Section 2-403(1), did nothing to change the basic law in this area. R.C. 1302.44(A).

Certainly A *could* transfer those rights to B. Section 2-210(2)(a) of the U.C.C. provides

as much: "[A]ll rights of either seller or buyer can be assigned * * *" R.C. 1302.13(B)(1).[11] Saying that they *can* be assigned, however, suggests that they are not assigned automatically. And the substantial abrogation of vertical privity requirements may permit a downstream buyer to assert a warranty claim against the manufacturer. Here the courts commonly distinguish between claims known to the seller and the downstream buyer at the time of their transaction and claims that appeared only afterward. In general, a cause of action belongs to the owner of the goods when the cause of action arose. *See generally* Gregory M. Travalio et al., *Nordstrom on Sales & Leases of Goods*, Section 4.09 (2d ed.2000). But on the whole, prior choses in action for breach of a sales contract do not automatically transfer to the buyer upon the sale of the goods.

b. Causes of action arising under Article Three of the U.C.C. generally are not automatically assigned to the transferee of the negotiable instrument

In Article Three of the U.C.C., the basic shelter principle is codified in U.C.C. 3-203(b): "Transfer of an instrument * * * vests in the transferee any right of the transferor to enforce the instrument, including any right as a holder in due course * * *" R.C. 1303.22(B); *compare* Negotiable Instruments Law 57 & 58 (restating holder-in-due-course doctrine). This provision, however, addresses only the rights to enforce the instrument and the defenses that can be asserted by the obligor. *See also* U.C.C. 3-302 (holder in due course) and 3-305 (defenses to enforcement), codified at R.C. 1303.32 and 1303.35. It does not address claims arising from the relationship of the payor bank and transferees of the negotiable instrument.

An appropriate analogy concerns wrongful dishonor. Suppose A, who has a checking account with Bank B, writes a check on that account and presents it to C as payment for a business obligation. C thereupon tenders the check for payment to Bank B, but the check is wrongly dishonored. As a result, C's own bank account is overdrawn and C suffers substantial

[11] Subject to several exceptions irrelevant for present purposes.

damages. Who has a claim against Bank B: A, C, or both?[12]

This situation is governed by U.C.C. 4-402, R.C. 1304.31. Under this section, which codifies pre-Code common law, "[a] payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item." U.C.C. 4-402(b), R.C. 1304.31(B).[13] So A has a right of action against Bank B–if, say, after dishonor C rightfully declares A in material breach of contract, causing A to lose a major customer.

But as Official Comment 5 to this section states, "the section itself gives no cause of action to other than a 'customer,' however that definition is construed, and thus confers no cause of action on the holder of a dishonored item." This is consistent with Ohio authority on wrongful dishonor. In the words of the Sixth District Court of Appeals, "where funds are deposited to the general account, the depositor-customer * * * and the lending institution * * * are in a debtor-creditor relationship. Under these circumstances * * * the holder of a dishonored check has no cause of action against the lending institution, but rather a cause of action against the maker of the check." *Klorer v. Ohio Citizens Bank,* 6th Dist. Lucas No. L-85-343, 1986 WL 9099, at *4 (Aug. 22, 1986); *see generally Messing v. Bank of Am., N.A.,* 373 Md. 672, 692, 821 A.2d 22 (2003) ("Absent a special relationship, a non-customer has no claim against a bank for refusing to honor a presented check."); Fred H. Miller & Alvin C. Harrell, *The Law of Modern Payment Systems and Notes*, para. 9.02, at 433 (2002) ("[T]he only person entitled to sue a bank for

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[12] This analogy actually favors the cause of automatic assignability. By definition, a check cannot be dishonored, wrongfully or otherwise, until it has been presented by a subsequent holder. The transfer of the check therefore takes place before the parties to the transfer know that there may be a cause of action associated with it. In contrast, in this case and others of its type the buyer of securities knows about the cause of action associated with the securities.

[13] The term "customer" is defined elsewhere in Article Four as "a person having an account with a bank or for whom a bank has agreed to collect items * * *" U.C.C. 4-104(a)(5), R.C. 1304.01(A)(5).

wrongful dishonor under § 4-402 is the person who has a deposit or other contract with the payor bank.").

So as the law of wrongful dishonor shows, a claim held by the drawer of a check–the original holder–against the payor bank does not pass automatically to a subsequent holder. The aggrieved holder may have a cause of action against its transferor, but not against the payor. *See generally Nautilus Leasing Servs., Inc. v. Crocker Natl. Bank,* 147 Cal.App.3d 1023, 1028, 195 Cal.Rptr.478 (1983) ("Generally, a drawee bank is not liable to a holder for failure to pay a check, because the check is not an assignment of the funds in the drawer's bank account * * * The payee's remedy is against the maker of the check, not against the payor bank."). Here too automatic assignment is not the law.

3. Existing common-law causes of action in general are not automatically assigned by a transferor to the transferee of the underlying res

The final place to look for guidance is the common law of automatic assignment as applied to tort, property, and contract claims. With a few modest exceptions, the courts consistently make two clear distinctions. First, they draw a line between claims manifested before the transfer and those manifested after; only the latter are assigned as part of the transfer of the underlying *res.* Second, they distinguish between claims necessary to give effect to the transfer, which are automatically assigned, and those less integral, which are not. Both of these distinctions disfavor the automatic assignment of claims like those the appellee seeks to assert.

Our starting point comes from Corbin's magisterial treatise:

> Contract rights are rights *in personam,* as opposed to rights *in rem*; they are rights to conduct by specified individuals and not manifold rights to conduct by all other persons (rights against 'all the world').

4 Arthur Linton Corbin, *Corbin on Contracts* Section 860, at 420 (1951).

We will cover *in rem* rights–those based on property–first, with contract and tort to follow.

Automatic assignment as part of the law of property transactions follows a straightforward pattern. The courts ask whether a particular cause of action exists at the time of the transaction. If it does, then it remains with the seller, subject to contrary agreement; if it does not, then it belongs to the buyer, again as a default rule. As the Sixth Circuit recently put it, "[c]hoses in action to enforce property rights do not, as a general matter, automatically transfer when the underlying property changes hands." *Herr v. U.S. Forest Serv.,* 803 F.3d 809, 821 (6th Cir.2015) (right to challenge boating restriction); *see also Ginsberg v. Austin,* 968 F.2d 1198, 1201 (Fed.Cir.1992) (federal common law, but following *National Reserve,* 17 Cal.2d 827, 112 P.2d 598 (1941); assignment of reversionary interest in lease does not automatically include assignment of claims for rent due and owing), *followed in 17 Mile, L.L.C. v. Kruzel,* 8th Dist. Cuyahoga No. 99358, 2013-Ohio- 3005, ¶¶ 13-17; *Schmidgall v. Jones Boatyard, Inc.,* 526 So.2d 1042, 1044 (Fla.Dist.Ct.App.1988) ("[I]f the loss or damage to the bailed property occurs *before* the purchaser acquired title thereto, the original bailor retains the exclusive right to sue the bailee for any loss or damage to the bailed property.") (emphasis in original).

Tort and contract are somewhat more complicated. We have already seen that federal securities law, much of it analogous to tort law, disfavors automatic assignment. The same, broadly speaking, is true in tort or contract, though with some qualification.

Traditionally, tort claims were regarded as fundamentally personal and thus not assignable, even if the tort claimant sought to do so. That rule retains some force in Ohio. *See In re Natl. Century Fin. Enters., Inc. Invest. Litigation,* 755 F.Supp.2d 857, 867 (S.D.Ohio 2010) (fraud claims are "personal to the plaintiffs" and are not automatically assigned; claims for rescission "generally are not assignable" at all). In contrast, contract claims have long been expressly assignable, with a few notable exceptions. *See Fitness Experience, Inc. v. TFC Fitness*

Equip., Inc., 355 F.Supp.2d 877, 887-88 (N.D. Ohio 2004) (Ohio courts will not presume the assignability of a non-compete agreement, and will find an agreement assignable "only under certain prescribed circumstances"). Here as well, Ohio has been fairly cautious about increasing the assignability of a potential claim. *See W. Broad Chiropractic v. Am. Family Ins.*, 122 Ohio St.3d 497, 2009-Ohio-3506, 912 N.E.2d 1093, ¶¶ 15-16 (no assignment of cause of action where there is no present right to settlement funds).

Even jurisdictions readier than Ohio to validate assignment generally hold that the sale or assignment of a *res* does not automatically carry with it the assignment of a cause of action related to that *res*. *See, e.g., Banque Arabe et Internationale D'Investissement v. Md. Natl. Bank,* 850 F.Supp. 1199, 1209 (S.D.N.Y.1994) (New York law: "[T]he assignment of a contract does not automatically transfer related tort claims."); *Sanders Oil & Gas, Ltd. v. Bike Lake Kay Constr., Inc.*, Tx.App. No. 08-00156-CV, 2018 WL 1082248 at *7 (Feb. 28, 2018) (assignment of receivables to factor did not constitute assignment of cause of cause of action against debtor).

In making this determination, the courts commonly refer to a classic Roger Traynor opinion, *National Reserve Company of America v. Metropolitan Trust Company,* 17 Cal.2d 827, 112 P.2d 598 (1941). That case, like this, arose from allegations that an indenture trustee had failed to comply with the terms of the trust agreement by inadequately protecting the security. The question was whether a pre-existing claim for breach of the trust agreement was assigned to the buyer as part of his purchase of a security. Justice Traynor began by observing that ordinarily an unqualified assignment vests in the assignee "ancillary causes of action" that are "incidental thereto." *Id.* at 833. But Traynor went on to state this test: aside from explicit or implicit designations, accrued causes of action arising out of an assigned contract, whether ex contractu or ex delicto, do not pass under the assignment as incidental to the contract if they can be

asserted by the assignor independently of his continued ownership of the contract and are not essential to a continued enforcement of the contract. *Id.*

Thus, for example, an accrued right for rescission passed with the assignment of a partnership interest, because dissolution of a partnership is one of the fundamental remedies given a partner faced with fraud committed by another partner. *Chatten v. Martell,* 166 Cal.App.2d 545, 551-52, 333 P.2d 364 (1958). In contrast, a claim based on pre-existing fraud was not automatically assigned with the transfer of a promissory note, because an action for fraud has no material relation to an action to collect on the note. *Heritage Pac. Fin., LLC v. Monroy,* 215 Cal.App.4th 972, 990-91, 156 Cal.Rptr.3d 26, 40 (2013). The facts in *Heritage Pacific Finance* parallel those here, and the result should logically be the same.

Both the willingness to consider automatic assignment and the unwillingness to consider it for claims antedating the transfer are present in the Restatement of the Law 2d, Contracts (1981). Section 340(2) states that "[w]here an assignor holds collateral as security for the assigned right and does not effectively transfer the collateral to the assignee, the assignor is a constructive trustee of the collateral for the assignee * * *" Along with the collateral comes a warranty that these rights exist. *Id.*, section 333(b). If those rights are impaired, then the assignor has breached its implied warranty, and "a constructive trust for the assignee is imposed on the collateral." *Id.*, section 340, Comment b.

Putting the facts of this case into the Restatement framework, Cheatham, the assignee, is arguing that his rights in the collateral have been impaired by the indenture trustee, and therefore seeks to have a constructive trust put on any rights against the trustee still held by the assignor. But the assignee's right is subject to any limitations "stated or apparent at the time of the assignment." *Id.*, section 333(b). How this curtailment works is shown in illustration 3 to

Section 340–which uncannily anticipates the facts in this case:

> A holds a bond issued by B, secured by collateral held by X as trustee for the benefit of the bondholders. X wrongfully fails to preserve the collateral. Later A sells the bond to C, *who does not know of the wrong*. When the wrong is discovered, B is insolvent. C is entitled to A's claim against X. (Emphasis added.)

So, applying the Restatement, Cheatham's problem is that he knew of the purported wrong when he bought the bonds. Indeed, that seems to have been one of the most important reasons that he bought the bonds. Accordingly, the assignor gave him no warranty regarding rights in the collateral, and Cheatham cannot claim the assignor's cause of action against the indenture trustee.

In sum, the argument that automatic assignment is consistent with the general law of assignment does not hold water. Indeed, New York, which enacted a statute that made automatic assignment the default rule, has recognized as much. The report of the New York Law Revision Commission stated that the *Smith* decision rejecting automatic assignment was a minority rule and in part for that reason recommended that it be overturned legislatively. N.Y. Law Revision Comm., *Recommendation of the Law Revision Commission to the Legislature Relating to the Transfer with Bonds of Claims Connected Therewith*, 5 (1950), reprinted in *Report of the Law Revision Commission* 67, 71 (1950) ("The New York rule is at variance with the law of other states."). But in 2002, the New York Court of Appeals, after surveying the case authority, had this to say:

> Federal courts in the last 50 years have declined to apply [the] automatic assignment of claims rule outside the context of "ensuring the integrity of a court-appointed receiver * * *" Those courts no longer treat claims as automatically assigned to buyers of bonds. Thus, New York's attempt to bring its rule into conformity with other jurisdictions has ironically achieved the opposite result.

Bluebird Partners, 97 N.Y.2d 456 at 461 fn.1 (citations omitted).

B. A Default Rule that Separates Securities from Choses in Action is Consistent with Existing Legal Principles and Favors Freedom of Contract and the Effective Vindication of Rights

The appellant's position–that the transfer of a security does not automatically mean the transfer of any choses of action relating to it–is not only consistent with the history of the Code and the law governing similar causes of action; it is the position that does most to uphold the reasonable expectations of the parties and support an efficient securities market.

1. The arguments favoring automatic assignment are weak at best

The courts and commentators favoring automatic assignment of breach of contract actions with the sale of the underlying security make three main arguments in support of their position. None of them is sound.

First, they frequently state that without automatic assignment, the transferor, who has already sold the bond, will be less likely to pursue a breach of contract action, and the indenture trustee will therefore profit from its misdeeds. *See, e.g., Lowry v. Baltimore & Ohio RR. Co.*, 707 F.2d 721, 741-42 (3d Cir.1983) (Gibbons, J., dissenting). This argument makes little sense. Suppose an indenture trustee or other responsible entity by its misdeeds caused the value of a $1,000 bond to drop to $600. The owner of the bond would stand to gain $400 by pursuing her claim. If she sells the bond, but not the choses in action, for $600, then she would still stand to gain $400 by pursuing her claim–except that now she has an additional $600 in cash to bankroll her litigation. Whether one owns or sells a bond or other security should not reduce one's likelihood of pursuing related claims.

In fact, the likelihood of vindicating claims not only would not increase were breach of contract claims automatically assigned–it would decline. This would be the result of some claims remaining with the transferor and others being automatically assigned to the transferee. First, if the claims are split, so will be the recovery, so neither the transferor nor the transferee will have

the same incentive to seek redress. Moreover, because these claims arise from the same basic facts, it costs very little extra for a tort plaintiff to add a count or two for breach of contract and to litigate those counts to their conclusion. But if the transferor owns some choses in action and the transferee owns others, then pursuing those claims requires two lawsuits with all the attendant expenses. Splitting the claims, which is an inevitable consequence of the appellee's position, means greater cost for less reward, and would therefore yield fewer vindicated claims and more reward to the wrongdoer.

To argue that automatic assignment is necessary to provide the right incentives to litigate also ignores class actions. It is common for these claims to be pursued collectively. This litigation is a prime example. Even if the appellees were somehow correct that the buyer of a bond would be more likely to pursue an individual action than its seller, that observation amounts to little if there would be no individual actions in any event.[14] A variation of this argument is likewise unsound. Advocates for automatic assignment contend that it will seldom be possible for a buyer to bargain for an express assignment from its seller, because "[t]he vast majority of securities transactions takes place in a faceless market"; consequently, buyers, who are more likely to know that a cause of action exists, will be more likely to pursue it and maximize the efficacy of the cause of action. *See Lowry,* 707 F.2d at 746 (Seitz, C.J., dissenting); *see also id.* at 741-42 (Gibbons, J., dissenting). That argument is based on an assertion–that buyers are more likely than sellers to pursue their rights–with no empirical support. It also assumes that tracing prior ownership is virtually impossible, which is an overstatement–especially in markets for thinly-traded securities, like municipal bonds. *See* Wang, *supra* p. 21, at 135. And it again ignores class actions. Once the class members have

[14] Presumably a major bondholder would have enough at stake to sue individually, but that would be true whether the suit was brought by a major current owner or a major past owner.

been identified, potential buyers of these choses in action can identify potential sellers easily. It would not be necessary to match up a particular buyer and a particular seller.

Those who support automatic assignment also argue that the sellers of these securities would get a windfall if they received both payment for the security and a cause of action against a third party, such as an indenture trustee. Payment, the argument goes, includes the value of that cause of action; automatic assignment means only that the buyer gets what she paid for. *See, e.g.,* Corbin, Note, *supra* note 3, at 830.

That may well be true for causes of action that arise after the sale or transfer of the securities, but it is not true for existing causes of action. The windfall argument assumes that the price of the securities includes both their value as they are and the value of any claims the owner may have against others. But the opposite assumption is at least as plausible: The heavily discounted price of the security reflects its diminished value, so the buyer is not paying for any existing choses in action. This has long been a concern for the courts. *See In re Nucorp,* 772 F.2d at 1490 (no automatic assignment, because allowing it "would remove the remedy from those to whom the statute provides it * * * by gratuitously giving it to those who were not defrauded and have suffered no injury under the securities law"); *In re Natl. Smelting of N.J., Inc. Bondholders' Litigation,* 722 F.Supp.152, 176 (D.N.J. 1989) (courts are unwilling to grant standing under §10(b) to a subsequent purchaser who paid less because of public revelation of fraud, because "this would deprive the true victim, i.e., the purchaser who suffered the loss because of the fraud, of her cause of action and unduly benefit someone who had not been harmed.") In principle, it would be possible to determine this for any particular securities transaction, but in practice that would be unwieldy, expensive, and uncertain. There are many reasons that a security might trade as a discount, so teasing out one particular reason would be a

tricky exercise in statistical analysis. The result: More expensive litigation and yet another hurdle for an aggrieved owner to surmount.

2. Larger considerations of judicial economy, efficiency, and fundamental rights favor a default rule in which choses in action are assigned only by express agreement

This court should reaffirm the traditional view of assignment and hold that, absent express agreement, choses in action related to a security are not transferred when that security is transferred. One who owns a chose in action should be free to assign it to the transferee of the security–or to someone else, or to no one, just like other property rights. Earlier sections of this brief discussed some of the reasons behind this conclusion. In this section, we gather and extend that analysis.

a. A default rule that does not provide for automatic assignment is consistent with the default rules that apply to many related causes of action

Breach of contract seldom appears alone in suits alleging wrongdoing in this setting. In the usual multi-count complaint, it is accompanied by other sources of liability, most importantly causes of action in tort and for breach of the federal securities laws. These causes of action are rooted in the same operative facts and require overlapping proof. Indeed, this case is a good example. The plaintiff's complaint here asserted both tort claims (for example, negligence and breach of fiduciary duty) and contract claims for essentially the same conduct.

Simple efficiency strongly favors treating these causes of action the same for the purposes of automatic assignment. Were contract claims to be assigned automatically and tort claims and federal securities claims not, then the indenture trustee could face liability for breach of contract to the transferee and liability under federal securities law and tort to the transferor, with the very real possibility of two actions brought in two different states in two different types of courts and yielding two different and perhaps duplicative remedies. As one judge phrased it,

"[w]hile a security such as a bond is transferred by its sale, generally any cause of action belonging to its previous holder remains with its previous holder, so that one purchasing a bond may not sue because of alleged actions by the corporate debtor reducing the value of the bond before purchase * * * Otherwise, defendants would be subject to double liability." *Mfrs. & Traders Trust Co. v. Wachovia Capital Mkts., LLC,* W.D.Pa. Misc. No. 09-162, 2010 WL 1541683, at *3 (Apr. 16, 2010). The center of gravity for these causes of action does not fall within automatic assignment.

b. Automatic assignment is inconsistent with modern concepts of assignment and freedom of contract

Over the last two or three hundred years, the law of assignments has moved steadily toward allowing those who hold legal rights to transfer those rights to others. *See* 3 E. Allan Farnsworth, *Farnsworth on Contracts*, Section 11.2 (3d ed. 2004). The courts have generally concluded that choses in action should be treated like other property rights and, barring some countervailing public policy, should be transferrable just as they are. This reflects our common law's preference for freedom of contract. It also reflects our common law's preference for the divisibility of property rights. It has become possible to convey all manner of fractional or incomplete or contingent interests in property, personal or real. That entails both having the freedom to convey what one wants to convey–and the freedom not to convey what one wishes to keep.

Automatic assignment impedes freedom of contract and of alienability, because it requires one who holds a property right to take some action or else lose that right. Under that rule, the owner of a security can keep it, or can sell it with any related choses of action, without any extra costs. But if the owner wishes to convey some of his rights, but not others, he has to contract around the default rule in a market setting, where this sort of side deal is frequently

difficult and slow–for all practical purposes, impossible for publicly-traded securities. This rather sticky default rule would thus impede the owner of a security from conveying only that part of his rights that he wishes to.

This is particularly troublesome because very few securities are bought and sold with choses of action in mind. Just as the great majority of contracts are performed, the great majority of securities transactions take place on the tacit assumption that there are no particularly important causes of action in the shadows. Consequently, the most efficient default rule is the one with the lowest costs–in essence, the one that leaves everyone where they were before the transaction. The few buyers and sellers who care about choses in action are always free to seek one another out.

C. Conclusion

In short, the holding of the Sixth District Court of Appeals is inconsistent with the history of the Uniform Commercial Code, inconsistent with the plain meaning of the Code, inconsistent with the policies behind the Code, and inconsistent with the general treatment of related causes of action. This Court should reaffirm the traditional law of assignment and hold that R.C. 1308.16(A) does not provide that a transferor of a security automatically assigns all her present or future causes of action to her transferee. Consistent with freedom of contract, the transferor should have the right to assign those causes of action–but also the right not to do so, without having to engage in costly and perhaps futile attempts to avoid automatic assignment. The owner of a security should have the same freedom of action allowed the owner of practically any other type of property. To do this would be consistent with the approach taken for the causes of action most closely related to breach of contract, and it would provide the best incentives for those injured by bad actors to seek redress. This Court should reverse the ruling below.

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CERTIFICATE OF SERVICE

I hereby certify that on August 27, 2018, I electronically filed the foregoing Merits Brief of Amicus Curiae Commercial Law Professor Larry Garvin and served a copy by regular U.S. mail, with a courtesy copy by electronic mail, on the following:

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