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## Investment Securities under the Uniform Commercial Code

### Erratum

The third sentence of footnote 17a on page 19 which read: It is submitted that the effect of making such negotiability possible is not just the creation of a negotiable chose in action, such as the share in the company, by means of the transfer of the share certificate, a situation already recognized in the N.I.L.

should have read:

It is submitted that the effect of making such negotiability possible is not just the creation of a negotiable share certificate, but the creation of a negotiable chose in action, such as the share in the company, by means of the transfer of the share certificate, a situation already recognized in the N.I.L.

In footnote 70 on page 14 the word "test" should read: "text."

In footnote 76 on page 15 the term "English court" should read: "English corporation."

# INVESTMENT SECURITIES UNDER THE UNIFORM COMMERCIAL CODE

EGON GUTTMAN\*

COMMERCIAL necessity has long been chafing under the restrictions which the formal requirements of the Uniform Negotiable Instruments Act<sup>1</sup> have placed upon the negotiability of investment securities.<sup>2</sup> These formal requirements have excluded from negotiability many forms of financing; whilst uncertainty remains to shroud others.<sup>3</sup> Attempted amelioration of the situation has been piecemeal and has covered only restricted fields of corporate financing.<sup>4</sup> Article 8 of the Uniform Commercial Code seeks to fill in these lacunae and to introduce "a negotiable instrument law dealing with securities."<sup>5</sup>

Recognizing that the formal requirements adopted by the N.I.L.<sup>6</sup> may be apposite to short term credit devices<sup>7</sup> but not to instruments evidencing long term investments,<sup>8</sup> the Code gives effect to the fundamental commercial approach which would differentiate between a payment device and an investment security. Thus, although an instrument may comply with the formal requirements of the law relating to Commercial Paper (Article 3 of the Uniform Commercial Code), instruments falling within the functional and formal definition of Article 8 are excluded from that part of the Uniform Commercial Code.<sup>9</sup>

The definition adopted by Article 8 to describe an "investment security" is mainly a functional one. It requires that a security shall be "commonly dealt in upon securities exchanges or markets or commonly recognized in any

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1. 5 Uniform Laws Annotated, hereinafter in the text referred to as N.I.L.

2. E.g., stock certificates, script certificates, bonds payable to registered holders and other certificates evidencing long term financing referred to as "securities generally." See also *Robotham v. Prudential Insurance Company of America*, 64 N.J. Eq. 673, 53 Atl. 842, 847 (Ct. Ch. 1903) (*Stevenson, V.C.*) and *Una v. Dodd*, 39 N.J. Eq. 173, 186 (Ct. Ch. 1884) (*Van Fleet, V.C.*).

3. E.g., the position of "interim certificates" is not settled in New Jersey. New York, until the passing of the Hofstadter Act (Personal Property Law § 260 et seq. and § 186 et seq.) was bound by the decision in *Manhattan Co. v. Morgan*, 242 N.Y. 38, 150 N.E. 594 (1926), while Ohio followed *Hoppel v. Cleveland Discount Co.*, 25 Ohio App. 138, 157 N.E. 414 (1927). Also consider the market upset caused by the unpublished opinion in *Pulaski County v. Ben Hur Life Association of Crawfordsville*, reconsidered 286 Ky. 119, 149 S.W.2d 738 (1941).

4. E.g., Uniform Stock Transfer Act, 6 U.L.A. Also many Government and Municipal Bonds have been declared negotiable by the statutes authorizing their issue, e.g., N.J.S.A. 40: 1-29, L. 1957 c. 10 § 1.

5. Official Comments to Section 8-101 Uniform Commercial Code. Section 8-105 reiterates this intention in a formal enactment of negotiability, setting out presumptions regarding signatures, required to establish negotiability.

6. 5 U.L.A. § 1.

7. These short term credit devices are in effect payment devices.

8. See supra note 2.

9. Section 8-102(1)(b).

area in which it is issued or dealt in as a medium for investment."<sup>10</sup> By adopting such a functional definition, this Article avoids the pitfalls of the N.I.L. and follows the policy embodied in the English Bills of Exchange Act, 1882,<sup>11</sup> which enables the custom of merchants to develop new negotiable instruments as commercial necessity arises, *i.e.*, common law negotiability.<sup>12</sup>

A difficulty is raised by this functional definition in that it may result in an instrument originally non-negotiable achieving the status of negotiability as a result of being "dealt in" as such in "any area." This is, however, rarely the case, since most laws will let the place of issue govern negotiability,<sup>13</sup> while Section 8-106 refers to the place of organization of the issuer as governing the validity of the security and the rights and duties of the issuer. Although these two places are not necessarily the same, a reference to these laws should prevent negotiability being imposed on instruments not intended to have such status.

It is to be regretted, however, that in addition to the functional requirements contained in the definition of an investment security, certain formalistic requirements should also have been found desirable. Thus the security must be "issued in bearer or registered form." This would exclude the order but non-registerable bond, which would have to seek to qualify for negotiability under Article 3 (Commercial Paper) which requires that it contain "no other promise."<sup>14</sup>

Whether an instrument is in bearer form depends not on any indorsement, but on the form in which it has been issued.<sup>15</sup> Similarly, the fact that the security is in registered form will have to be apparent from the face thereof.<sup>16</sup> The difficulty caused by these formal requirements is that it may negate the lead shown by the functional definition. Thus, despite practice which may result in certain instruments being dealt with as "media of investments," Article 8 may not become applicable merely because an instrument runs to order rather than to a bearer or to a registered holder. The exclusion of these instruments is a policy decision, the reasons for which are not apparent.

The Uniform Commercial Code does not attempt to cover all the law relating to investment securities. It is not concerned with the fundamental validity of a security, except to recognize the invalidity of an overissue.<sup>17</sup> Questions of validity are left to be determined, *inter alia*, by the relevant

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10. Section 8-102(1)(a)(ii) note—"a medium of investment" is not necessarily a "secure investment." See *Una v. Dodd*, *supra* note 2. Its purpose is that it "may produce a revenue."

11. 45 & 46 Vict. c. 61.

12. *Edelstein v. Schuler & Co.*, [1902] 2 K.B. 144, 154-156 (Bigham, J.).

13. Restatement, Conflict of Laws § 348.

14. Uniform Commercial Code § 3-104.

15. Section 8-102(1)(a)(i) and (d). *I.e.*, it is not possible by an indorsement in blank to change an instrument payable to order into an investment security payable to bearer.

16. *Id.* and (c).

17. Section 8-104.

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Corporation Laws<sup>18</sup> and Blue Sky Laws.<sup>19</sup> The Code is intended to make provisions for the ready and easy transfer of investment securities dispensing with excessive investigation of questions of title. In this respect many states have already taken steps to ease the difficulties introduced by the unfortunate dictum of Chief Justice Taney in *Lowery v. Commercial & Farmers Trust Company*.<sup>20</sup> The provisions of the Code are wider than any steps taken so far and are not confined to those situations where the existence of fiduciaries has been the cause of complications.

In connection with the transfer of registered securities,<sup>21</sup> two important questions arise. The first concerns the validity of the transfer, *i.e.*, an attack claiming the transfer to be void, *e.g.*, due to signatures being unauthorized or forged. The form of protection afforded in this case by signature guarantees,<sup>22</sup> satisfactory evidence of appointment of a person attempting to effectuate a transfer on behalf of an estate or settlement,<sup>23</sup> etc., is adhered to without great objection by the participating parties. Another story surrounds the problem of transfers where there is a fiduciary duty imposed by a testator or settlor. Here English law indicates that a corporation is under no duty to inquire as to the rightfulness of a particular transfer.<sup>24</sup> This rule, which became established in the English Common Law at an early stage,<sup>25</sup> was later embodied in the statute laws of England<sup>26</sup> and was, at first, also adopted in the United States.<sup>27</sup> An issuer could thus transfer to a fiduciary and could thereafter transfer on the instructions of such fiduciary, without inquiring as to the rightfulness of the transfer. If asked to transfer by one named as a fiduciary, the only requirement was for the issuer to satisfy himself that the request came from a fiduciary duly constituted as such and not whether the transfer itself was rightful.

In 1848, however, a dictum of Chief Justice Taney<sup>28</sup> set off a chain reaction which made the transfer of securities a most hazardous and, as a result, most expensive adventure. Referring to the corporate issuer of investment securities, Taney, C.J., stated that it was ". . . the custodian of the shares of stock, and clothed with power sufficient to protect the rights of everyone interested, from unauthorized transfers; it is a trust placed in the hands of

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18. *E.g.*, N.J.S.A. 14: 8-1 et seq.

19. *E.g.*, N.J.S.A. 49: 1-1 et seq. and 49: 2-1 et seq.

20. 15 Fed. Cas. 1040 (1848).

21. *I.e.*, securities the transfer of which involves an entry in the books of the issuer. Thus there is here a contact with the issuer, which is absent in the case of a security transferable by mere delivery, *i.e.*, a bearer security.

22. Section 8-312(1).

23. Section 8-402.

24. Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 117.

25. *Hartga v. Bank of England*, 3 Ves. Jun. 56, 30 Eng. Rep. 891 (Ch. 1796).

26. Companies Clauses Consolidation Act, 1845, 8 & 9 Vict. c. 16, § 20. See now Companies Act, 1948, *supra* note 24.

27. *Bank of Virginia v. Craig*, 50 Va. (6 Leigh) 399 (1835); *Hutchins v. State Bank*, 47 Mass. (12 Metc.) 421 (1847).

28. *Lowry v. Commercial & Farmers Trust Co.*, 15 Fed. Cas. 1040 (1848).

the corporation for the protection of individual interests, and like every other trustee, it is bound to execute the trust with proper diligence and care, and is responsible for any injury sustained by its negligence or misconduct."<sup>29</sup> Holding that wills are registered public documents, the learned Chief Justice came to the conclusion that a corporation transferring a security contrary to a will would be liable in breach of trust.

Much litigation followed the adoption of this rule. Finally a procedure was devised which, it was felt, would give the necessary amount of protection to transfer agents. But the price paid for this procedure is a high one and is paid by the estate trying to transfer the security.<sup>30</sup>

Instead of placing the responsibility and any subsequent loss where it should lie, *i.e.*, the property of testators or settlors who have placed a trust in their respective executors or trustees, the law places a duty to police such fiduciaries on the transfer agents and on the corporation. These in turn have passed on the risk, in the form of high transfer charges, which in many instances border on the exorbitant.<sup>31</sup> A change of this approach can only come about by the Supreme Court overruling the *Taney* doctrine<sup>32</sup> or by statutory intervention. The Uniform Law Commissioner, when recommending statutory intervention, felt the English approach to be too broad and imprecise. As a result various statutes were drafted which attempted to exonerate the transfer agent by indicating the precise steps he would have to follow to avoid liability for a transfer in breach of a fiduciary duty.

Of the various statutes which have been drafted on this subject, the most important were the Uniform Fiduciary Act,<sup>33</sup> the Model Fiduciaries Securities Transfer Act,<sup>34</sup> and the Uniform Act for Simplification of Fiduciary Security Transfers.<sup>35</sup> All these enactments suffer from one major defect. They have not been adopted generally, so that in many cases it is still incumbent upon a transfer agent to demand additional items of proof. In addition, the Uniform Fiduciary Act is limited to securities registered in the name of the fiduciary

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29. *Id.* at 1047.

30. In the typical case of a deceased shareholder, the executor signs the power of attorney printed on the back of the share certificate, gets a bank or broker to guarantee the signature, obtains a waiver signed by the appropriate inheritance tax official, and gets the clerk of the probate court to issue a certificate that the executor has qualified and has not been removed. With these documents, under the *Taney* doctrine, the executor is ordinarily required by the transfer agent to supply a certified copy of the will; many transfer agents will demand a court order in addition to or instead of the will. When the documents are received by the transfer agent, they are carefully examined and often additional documents, such as affidavits from the heirs, are then demanded.

Braucher, *Security Transfers by Fiduciaries*, 48 *Minn. L. Rev.* 193, 194 (1958).

31. It has been estimated that a transfer costs an estate or trust a minimum of approximately \$30. Conard, *Simplifying Securities Transfers*, 30 *Rocky Mt. L. Rev.* 33, 34 (1957).

32. Since in most commercial cases there is no Federal question involved, such overruling is most unlikely to occur.

33. 9B *U.L.A.* adopted in New Jersey, *N.J.S.A.* 3A: 41-1 et seq.

34. Adopted in Connecticut, Delaware and Illinois.

35. Adopted in New Jersey, *N.J.S.A.* 14:18-1 et seq.

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and thus is inapplicable to those cases where protection is really needed, *i.e.*, where the security is registered in the name of a decedent, or where the security, to the knowledge of the transfer agent, is registered in the name of a nominee.<sup>36</sup>

Great uncertainty surrounds the question of "knowledge" of facts that the transfer is in breach of a fiduciary duty. At present, transfer agents require an indemnity to protect themselves.<sup>37</sup> The fact that both the transfer agent and the corporation have to be satisfied with the indemnity makes it extremely rare that such an indemnity would be accepted from a private executor or trustee.

The latest attempt in this direction, The Uniform Act for Simplification of Fiduciary Security Transfers in amending the Uniform Fiduciary Act, is not as comprehensive as the Uniform Commercial Code.<sup>38</sup> Although not completely clearing the trust from the record of the corporation,<sup>39</sup> Article 8 limits the proof which can be demanded by a transfer agent and protects him on compliance with its provisions.<sup>40</sup> The primary advantage of Article 8 lies in the fact that it is integrated in the comprehensive coverage of Commercial Law provided by the Uniform Commercial Code and not just another bit of piecemeal legislation. It is to be hoped that the provisions of the Uniform Commercial Code will be adopted in all jurisdictions of the United States, so as to eliminate the difficulty a variety of laws causes. It is also to be hoped that transfer agents will rely on the provisions of the Code and will not insist on further proofs so as to make the provisions of the Code a mere dead letter. Writing in 1959, the Temporary Commission to Study and Report upon the Uniform Commercial Code for the State of Connecticut stated that the 1952 draft of the Code adopted in Pennsylvania "achieved considerable success in reducing demands for documentation in Philadelphia and little or none in

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36. To deal with this problem N.J.S.A. 3A: 15-7 permits a corporate fiduciary to keep securities in the name of a nominee without disclosing the fiduciary position; see further Bogert, *Trust Investment: Earmarking or Nominee?*, 24 *Texas L. Rev.* 417 (1946).

37. The standard form of such indemnity is as follows:

The undersigned Bank requests that this transfer be made without its furnishing supporting documents, and warrants the propriety of such transfer and agrees, in any case where the uniform fiduciaries act does not or may not afford full protection for such transfer, fully to indemnify and hold harmless the corporation and its transfer agent for any loss or cost, including counsel fees, which either may suffer by reason thereof.

See Christy, *The Transfer of Stock* § 225 (3d ed. 1958).

38. For example, the Act is confined to "fiduciaries," [§ 1(d)] who are only one of the group of "appropriate persons," [§ 8-308] who can indorse a security to transfer it. See also the definition of "security" in Section 8-102 as opposed to that in Section 1(f) of the Act. The essential similarity between the two has, however, been recognized. Thus, the New York Transfer Association Rules, Rules I, II, and IV, prepared by F. T. Christy, recognize conformity with either of these provisions as conformity with its own stringent rules for transfers outside the State of New York.

39. See the English Companies Act, 1948, § 117:

No notice of any trust, express, implied or constructive, shall be entered on the register or be receivable by the registrar, in the case of companies, registered in England.

40. Section 8-402 and 8-404.

Pittsburgh. A revised version of Article 8 in the Code which went into effect in Massachusetts in 1958 is reported to have met with some success.<sup>41</sup> Some inducement to make transfer agents cease their reactionary approach to the simplification of transfers is indicated in Section 8-402, and a further inducement would be a compulsory insurance in addition to the voluntary one taken out by most transfer agents. Such compulsory insurance has existed in England since 1891,<sup>42</sup> and has proved a boon to transfer agents.

It is the purpose of this paper to consider some of the provisions of the Uniform Commercial Code, Article 8, and to criticize those features of the Article which, to the writer, appear to be in need of further consideration at some future stage in the development of Commercial Law. Article 8 is divided into four parts. Part 1 deals with general matters, definitions, etc.; Part 2 with the rights, duties and defences of the issuer of securities in relation to the holder thereof; Part 3 sets out the provisions governing the purchase of securities; and Part 4 regulates the registration of transfers.

## II

It is of interest to note that the Code tackles a problem which has too often been ignored in commercial statutes. It is the question of the choice of law rule applicable in those situations which involve a conflict of laws. The possibility of foreign securities being traded in Code states is realized and an attempt is made by the Code to indicate a solution to the vexing problem of applicable law.

Here the Code departs from the rigidity of absolute rules by conferring upon the parties a freedom of choice of law, provided that the law chosen has some contact with the transaction.<sup>1</sup> Beyond this freedom of choice, no real interference with existing choice of law rules is attempted, for Section 1-105(1) states: "Failing such agreement this Act applies to transactions bearing an appropriate relation to this state." There is no definition of what would be such "appropriate relation," leaving this to be determined by the usual conflict of laws of each state. A court confronted with this provision should bear in mind, however, that the purpose of the Code is to make the law uniform.<sup>2</sup>

In Article 8, the general choice of law rule of the Code is fitted to the situations dealt with in that Article.<sup>3</sup> Three problems have to be considered here: (a) the validity of the security, (b) the rights and duties of the issuer with respect to registration of transfers and (c) the transfer of the security by negotiation. As to the first there can be no doubt that the law of the

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41. Report of the Temporary Commission at page 48.

42. Forged Transfer Act, 1891, 54 & 55 Vict. c. 43.

1. Section 1-105(1).  
2. Section 1-102(2).  
3. Section 8-106.



place of the organization of the issuer will have to govern this question. It is that law which will give legal status to the issuer and as such will govern his ability to issue securities.<sup>4</sup> When we come to examine the second problem, this choice of law rule will once more appear appropriate. Two approaches exist in the United States. The first considers the law of the place of transfer to be effective; whereas, the second requires conformity with the place of organization to effect a transfer. But whichever rule may be applied, the law of the place of incorporation of the issuer will indicate the choice of law rule applicable to the registration of transfers.<sup>5</sup>

Though this appears clear in relation to stock, a different rule may well be required in relation to bonds, which evidence the indebtedness of a corporation. The law of incorporation may here have to compete with that governing the indebtedness, *i.e.*, contract, and that governing the transfer of the debt. The various rules which have been applied in these situations vary from the *lex loci contractus*, the *lex loci solutionis* and the law having the closest contact as the proper law of the contract to the *lex actus* as governing the transfer of the obligations. Authority can be found in favour of all these laws. The Code solves this problem by providing one uniform choice of law rule applicable to all investment securities,<sup>6</sup> while preserving the right of the *lex actus* to govern the negotiation of the securities.<sup>7</sup>

It should be noted that the reference is not just to the law of the jurisdiction of organization of the issuer, but "including its conflict of laws rule." This is a clear reference to the admission of a *renvoi*. Thus, if that law were to refer back to, or on to, the law of the place of the transaction, such law will be applied.<sup>8</sup> The general approach in the United States has been to ignore the conflict of laws of the law to which the court had been referred by its choice of law rule.<sup>9</sup> But certain cases, such as rights in land situated in a foreign legal system, rights of shareholders to participate in a corporation, etc., seem to require the application of a *renvoi* theory, so as to enable the holder to realize his expectations. It is submitted that this reasoning is equally applicable to securities governed by Article 8. Only by looking to the totality

4. See E. R. Latty, Pseudo-Foreign Corporations, 65 Yale L.J. 137 (1955).

5. Restatement, Conflict of Laws § 182 (1934); Uniform Act for Simplification of Fiduciary Security Transfers § 8; *Seymore v. National Biscuit Co.*, 107 F.2d 58 (3d Cir. 1939).

6. A. F. Conard, A New Deal for Fiduciaries Stock Transfers, 56 Mich. L. Rev. 843, 869 (1958).

7. Section 8-401. It is clear that within a Code-state, the transfer, if complying with the provisions of Article 8, would be mandatory. The fact that the security is made negotiable by the Code indicates that the place of transfer governs. It will then be for the seller to assist the buyer to obtain registration of the transfer in accordance with the law of the place of organization of the issuer. Section 8-316.

8. The various *renvoi* theories have received considerable criticism. E.g., Lorenzen, The Renvoi Doctrine, 27 Yale L.J. 509 (1918), but see Cowan, Renvoi Does Not Involve a Logical Fallacy, 87 U. Pa. L. Rev. 34 (1938). For a full discussion of the problem, see Dicey, Conflict of Laws (7th ed. Morris) 1958.

9. Restatement, Conflict of Laws § 7 (1934); *In re Tallmadge*, 109 Misc. 696, 181 N.Y. Supp. 336 (Surr. Ct. 1919).

of the foreign law will it be possible to determine the rights of the holder of a security. To enforce such security it may be necessary ultimately to proceed against the assets of the issuer himself and these would normally be in the place of original organization of the issuer.<sup>10</sup> A full determination of rights will prevent the unnecessary expenditure involved in an attempt to enforce rights not recognized by the relevant foreign forum.

In the realm of negotiable instruments, the terms "maker," "drawer," "acceptor," "accommodation party" are familiar to us. However, the U.C.C. in Article 8 introduces a new term, the "issuer."<sup>11</sup> Defining an "issuer" as including a person who places or permits the placing of his name on a security to evidence that it represents a share in his property or an obligation on him as represented by the security, Section 8-201 indicates the person who would be subject to the obligations imposed by the Article on the issuer and who would be able to avail himself of the defences granted therein to the issuer. The section specifically includes a guarantor in the definition of issuer,<sup>12</sup> and for the purpose of the transfer of securities widens the definition further to include all those persons on whose behalf transfer books are being kept.<sup>13</sup>

The Article does not indicate when a security is issued. A difficulty exists here in view of the fact that corporate stock certificates need not be issued for corporate liability to arise thereon. They are mere evidence of ownership and are not necessary to vest in the owner thereof the rights of a stockholder.<sup>14</sup> Issue and allotment are thus not the important moments in relation to the transfer and registration of securities under Article 8 which they are in relation to the creation of corporate liability. However, the purpose of Article 8 being to create "a negotiable instrument law dealing with

10. Cf. E. R. Latty, *supra* note 4.

11. Section 8-201.

12. Section 8-201(2). This subsection gives rise to numerous questions. Must the guarantor sign the security? Is it immaterial whether or not his "obligation" as a guarantor appears thereon? Is a guarantor liable irrespective of having signed? I.e., is extrinsic evidence admissible to show the existence of a guarantor, and the extent of his guaranty? If a signature appears on the security, will extrinsic evidence be admissible to show it is that of a guarantor? For, unless otherwise agreed, an indorser is not a guarantor. Section 8-308(4). Though in commercial practice, these problems will not prove insurmountable, they should not have been left in a Code which attempts to clear up difficulties. The better view appears to be that a guarantor need not sign. It will be possible to adduce extrinsic evidence to indicate the limits of the guarantee, except against a "purchaser for value who has taken without notice of the particular defence." Section 8-202(4). Where the guarantor signs, the extent of his guaranty will generally appear on the face of the instrument. But where the relationship of guarantor arises subsequent to the instrument being issued, no such indication exists and the admissibility of extrinsic evidence becomes important. *First Bank & Trust Co. v. Siegel*, 36 N.J. Super. 207, 115 A.2d 152 (1955). Courts are however reluctant to admit parol evidence: *Norman v. Beling*, 57 N.J. Super. 575, 157 A.2d 17 (App. Div. 1959), *rev'd*, 33 N.J. 237, 163 A.2d 129 (1960).

13. Section 8-201(3). Placing one's name on the security as "authenticating Trustee, registrar, transfer agent, or the like," will not result in such signatory becoming an "issuer." The rights, duties and warranties of such persons are set out in Section 8-205 and 8-406.

14. *Richardson v. Shaw*, 209 U.S. 365 (1908); *Lask v. Bedell, Inc.*, 91 N.J. Eq. 341, 109 Atl. 849 (1920), *aff'd*, 91 N.J. Eq. 341, 111 Atl. 936 (1920).

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securities,"<sup>15</sup> an issue of allotment, at least in the corporation law sense of these terms, must be taken for granted. The question arises in connection with transfers. Thus, when the Article refers to "issue" it really makes use of a term already found in Article 3, Commercial Paper, "first delivery of an instrument to a holder or remitter."<sup>16</sup> Yet non-delivery is not a defence which an issuer can raise against the purchaser for value without notice.<sup>17</sup> A presumption of delivery thus exists, which becomes irrebuttable where a purchaser for value without notice is concerned.<sup>18</sup>

We have already noted that it is usual for investment securities to incorporate provisions of other documents and that such incorporation has often resulted in such securities containing "other promises" so as to take them out of the provisions of the N.I.L.<sup>19</sup> In part, it was to overcome this difficulty that the Uniform Stock Transfer Act was introduced,<sup>20</sup> so as to make shares of stock negotiable by a transfer of the certificate.<sup>21</sup> The general test under the N.I.L.<sup>22</sup> is to test negotiability by looking at the document for which negotiability is claimed and to construe it in order to ascertain whether it is negotiable on its face.<sup>23</sup> There is no reference to the document which it might have been intended to incorporate.<sup>23a</sup> Section 8-202(1) recognizes the existence generally of incorporated provisions and that those dealing with securities are aware that securities are issued subject to such incorporated provisions. The subsection therefore considers the incorporated provisions to be binding, even on a purchaser for value without notice, provided that the incorporated terms are not in "conflict with the stated terms."<sup>24</sup> This provision is, however, severely restricted. Thus, subject to the provisions of Section 8-202(4), a purchaser for value without notice is not given notice of any defect going to the validity of the security unless notice of the particular defect exists, *i.e.*, incorporation by reference "of itself" will not suffice. This restriction applies even though the security carries a term that the person accepting the security admits having such notice.

This leads to a consideration of the term "notice." The term notice is defined in Section 1-201(25). This definition effects a change from the meaning

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15. Official Comment to Section 8-101.

16. Section 3-102(1)(a).

17. The burden of proof lies on the person alleging that the defence is inapplicable to him. Section 8-105(2).

18. Section 8-202(4).

19. N.I.L.; 5 U.L.A. §§ 1, 2.

20. 6 Uniform Laws Annotated.

21. Uniform Stock Transfer Act § 1.

22. *Supra* note 19.

23. *Perth Amboy Trust Co. v. Modern School Ass'n of North America*, 9 N.J. Misc. 368, 154 Atl. 418 (1931).

23a. See, however, Illinois, where the courts have generally permitted incorporation by reference, *Sturgis Nat'l Bank v. Horn's Trust & Saving Bank*, 351 Ill. 465, 184 N.E. 589 (1933), provided such reference does not qualify or make uncertain or conditional the promise to pay. *Biegler v. Merchant's Loan & Trust Co.*, 164 Ill. 197, 45 N.E. 512 (1896).

24. Section 8-202(1). A "term" is defined in Section 1-201(42) as "that portion of an agreement which relates to a particular matter."

of that term under the N.I.L.<sup>25</sup> and under the Uniform Stock Transfer Act. Under these enactments the general approach is that of "the white heart and empty head,"<sup>26</sup> requiring actual knowledge of facts, a denial of which would amount to a fraud, mere knowledge of such facts as would put a prudent man on his inquiry being insufficient.<sup>27</sup> This new definition of notice would include not only "actual knowledge," but also the receiving of "notice or notification of it; or (c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists."<sup>28</sup> This is of particular importance to the corporate "issuer."<sup>28a</sup>

In connection with notices of defects or of restrictions, Section 8-103 requires that a lien retained by an issuer has to be "noted conspicuously on the security."<sup>29</sup> At common law, a secret lien would not be recognized. Thus, against a transferee, a corporation could not claim to have a lien on stock when such lien was not indicated on the face of the stock certificate.<sup>30</sup> Clearly, therefore, where no certificate had been issued, an assignee would not have notice of the existence of a lien otherwise than by virtue of the rules of equity.<sup>31</sup> Section 8-103, however, merely demands that the lien be "noted" on the security. Some difficulty had been caused by the use of the term "stated," as it gave rise to a controversy whether or not the whole content of the lien would have to be set out. "Noted" indicates that, subject to any provision of the relevant corporate law of the state, it is only necessary to indicate that a lien does exist. Such indication must be "conspicuous," *i.e.*, "so written that a reasonable person against whom it is to operate ought to have noticed it."<sup>32</sup>

Restrictions in relation to transfer are often imposed. The issuer<sup>33</sup> or the relevant state law<sup>34</sup> may impose restrictions on the transfer of securities, a situation especially common in close corporations. Here too, the restriction must be "conspicuously" noted on the security in order to be effective, al-

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25. N.I.L.; 5 U.L.A. § 56.

26. See Hawkland, *Bills & Notes* 194-197.

27. *Graham v. White-Phillips*, 296 U.S. 27 (1935); *Driscoll v. Burlington-Bristol Bridge Co.*, 8 N.J. 433, 86 A.2d 201 (1952); *Joseph v. Lesnevich*, 56 N.J. Super. 340, 153 A.2d 349 (1959).

28. Section 1-201(25).

28a. Sections 1-201(26) and (27) indicate when a corporate issuer will have received notice and demand due diligence in the transmission of such notification from the person receiving the notice to the person in charge of the particular transaction involved. See further Section 3-304.

29. This section re-enacts the Uniform Stock Transfer Act § 15 extending the scope of its provision to a wider group of securities.

30. *Drexel v. Long Branch Gas Light Co.*, 3 N.J.L.J. 250 (1880).

31. *Lask v. Bedell, Inc.*, *supra* note 14.

32. Section 1-201(10).

33. *Rosenfeld v. Einstein*, 46 N.J.L. 479 (1884); *Morris v. Hussong Dying Machine Co.*, 81 N.J. Eq. 256, 86 Atl. 1026 (1913). *I.e.*, the restriction must be imposed by the issuer. The Section does not refer to any restrictions which shareholders may have agreed to inter se.

34. *E.g.*, Blue Sky Laws.

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though knowledge obtained in some other form will be binding as well.<sup>35</sup> If there should be a refusal to transfer in circumstances where such restriction is neither conspicuously noted on the security nor known to the person applying for the transfer, such refusal would amount to a conversion of the security by the corporation,<sup>36</sup> and such transfer could be compelled under Part 4 of Article 8.

Further defences of the issuer are set out in Section 8-202. Of these the most important is the allegation that the security is lacking "in genuineness."<sup>37</sup> This defence is available against a transferee or holder of a security, though he be a purchaser for value without notice, *i.e.*, it is a real defence.<sup>38</sup> In this connection two situations have to be considered: (a) where there is an unauthorized signature<sup>39</sup> and (b) where there has been alteration or completion of a security.<sup>40</sup>

(a) Under the N.I.L. a forgery makes the instrument totally inoperative.<sup>41</sup> The U.C.C. continues this approach to a forgery.<sup>42</sup> But the defence of "forgery" cannot be raised where the "party, against whom it is sought to enforce such right, is precluded from setting up the forgery or want of authority";<sup>43</sup> *i.e.*, generally, where an estoppel can be raised. The circumstance here envisaged is where the previous conduct of the maker of a negotiable instrument is such as to preclude him from denying the authority of a person to sign his name, *i.e.*, an apparent authority.<sup>44</sup>

The mere fact that an agency exists will not be enough to raise such apparent authority.<sup>45</sup> There must be an actual "holding out" resulting in a reliance by a third party in his dealings with the agent.<sup>46</sup> In many cases, standing by and allowing a person to give the appearance of such authority

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35. Section 8-204. Note *Baumohl v. Goldstein*, 95 N.J. Eq. 597, 124 Atl. 118 (1924) where the transferor was a director of the company and thus had notice of a restriction which was not noted on the security. The restriction must, of course, be a legal one.

36. *Siegel v. Riverside Box & Lumber Co.*, 89 N.J.L. 595, 99 Atl. 407 (1916).

37. *I.e.*, not "free from forgery or counterfeiting." Section 1-201(18).

38. Section 8-202(3); *Buckley v. Second National Bank*, 35 N.J.L. 400 (1872).

39. Section 8-205.

40. Section 8-206.

41. N.I.L.; 5 U.L.A. § 23. See also *Ruben v. Great Fingall Consolidated* [1906] A.C. 439, indicating that this is a rule of universal application.

42. We are here concerned with signatures of the issuer and not those of an indorser, as to which see Section 8-311.

43. *Supra* note 41. See *Thompson, Company Law Doctrines and Authority to Act*, 11 U. of Toronto L.J. 248 (1956) and *Campbell, Contracts with Companies*, 75 L.Q. Rev. 482 (1959), 76 L.Q. Rev. 115 (1960) for the approach in Canada and in England. The basic distinction which has to be drawn is between a forgery *per se*, *e.g.*, A, without authority, signing a document *as B*, and a forgery where A had no authority to sign *for B*, *e.g.*, A signs as agent of B not having been authorized by B. The former can never be validated.

44. N.I.L.; 5 U.L.A. § 19; *Federal Deposits Ins. Corp. v. Bleakley Corp.*, 124 N.J.L. 445, 12 A.2d 700 (1940). It is clear that a course of conduct would be sufficient to establish such an agency. *Silver v. Commonwealth Trust Co.*, 22 N.J. Super. 604, 92 A.2d 125 (1952).

45. *Buckley v. Second National Bank*, *supra* note 38.

46. *Budelman v. White's Express & Transfer Co.*, 49 N.J. Super. 511, 140 A.2d 552 (1958).

has sufficed to estop the maker from raising the defence of non-authorization.

The existing N.I.L. seems to apply a presumption that an employee of the maker is an honest one, and thus only the employer or principal requires protection in the rare case of such employee or agent being dishonest. Commercially such presumption is unsound when it results in placing the loss on a third party dealing with the employee or agent. The principal is in a much better position to assess the honesty of his employees and agents and is much better able to guard against their dishonest acts.<sup>47</sup> What is more, it was he who placed them in the position where they are able to act dishonestly. Thus the burden should be on him rather than on the third party dealing with the employee or agent. Section 8-205 introduces an objective standard to determine the liability of an issuer to a purchaser for value without notice of the forgery or unauthorized signature. The liability of the issuer depends on his having *entrusted* the wrongdoer with the signing of the security, or of similar securities, or with their immediate preparation for signing, or with responsible handling<sup>48</sup> of the security. Liability will also extend to the acts of an employee of someone so entrusted, to whom these duties have been delegated.

This makes more explicit those situations which preclude the issuer from setting up the defence of forgery or lack of authority. It also places the burden of choosing a responsible and reliable agent on the issuer. This responsibility is confined, however, only to an employee or agent who has been entrusted with the duties set out in the section. The form by which such trust is conferred can be of various kinds. It is no longer necessary to seek negligence or an apparent authority to make the issuer liable. A difficulty may be met in the phrase "entrusted with responsible handling of the security." It will be for the court to determine how far that phrase refers to, or is similar to, "scope of employment."

(b) The securities with which we are here concerned contain all the necessary signatures, but are either incomplete or have been altered, and the issuer desires to raise the incompleteness or alteration as a defence to liability. In relation to negotiable instruments, the N.I.L.<sup>49</sup> provides that a possessor has a *prima facie* authority to fill in blanks.<sup>50</sup> In order to be effective against a person who became a party to the instrument prior to the completion, the instrument must have been completed according to authority and within a reasonable time. A holder in due course may, however, enforce

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47. E.g., by taking a fidelity bond.

48. Note here the similarity with "the Organic Theory" of corporations. Gower, *Modern Company Law* Ch. 7, 8 (2d ed. 1957). The provisions of the Code do not cover as restricted an area for under the Code rather minor officials of the Company issuer could act so as to make their acts those of the issuer, it being a question of having been entrusted to act.

49. 5 U.L.A. § 14.

50. *U.S. v. Sonnenberg*, 158 F.2d 911 (1946).

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it in accordance with the authority actually granted, even though such authority has not been complied with prior to his obtaining the instrument.<sup>51</sup>

The Code in Section 8-206 introduces some changes here. It permits anyone to fill in blanks in a security, so that the security is in the form in which it was authorized to be issued. The section also holds the issuer liable even though the person who had filled in the blanks did so incorrectly, provided that the person attempting to enforce the security as completed is a purchaser for value without notice. The right is thus not confined to a "subsequent purchaser."<sup>52</sup>

Under the N.I.L. non-delivery is a personal defence.<sup>53</sup> Neither would the existence of blanks make the instrument void.<sup>54</sup> But, incompleteness due to blanks plus non-delivery would amount to a real defence.<sup>55</sup> Thus in *Joseph Heimberg Inc. v. Lincoln National Bank*,<sup>56</sup> the drawer of a blank cheque was able to raise the fact of non-delivery so as to defeat the claims of a holder in due course.<sup>57</sup>

The reason for this illogical rule in the N.I.L. is difficult to discern. The rule has been ignored in Pennsylvania<sup>58</sup> but is accepted in New Jersey.<sup>59</sup> The Code eliminates this illogicality by providing that the existence of both, incompleteness caused by blanks and non-delivery, shall not constitute a real defence in relation to investment securities. Underlying this new approach is the recognition of the fact that incomplete securities would generally be appropriated and filled in by employees of, or agents of, the issuer. Thus since it is the issuer who reposes trust in such persons, it is only fair to let the issuer assume responsibility for the acts of his own employees and agents, even where the issuer had not been negligent.<sup>60</sup>

Under the N.I.L.,<sup>61</sup> an alteration which amounts to a "material altera-

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51. *First National Bank of Springfield v. Di Taranto*, 9 N.J. Super. 246, 75 A.2d 907 (1950).

52. Article 8 also draws a distinction between "purchaser" and "subsequent purchaser." See Section 8-202(2). By validating a security in the hands of a purchaser for value without notice of a defect, even though it may go to the validity of the security, Section 8-202(2) appears to indicate the possibility of a "payee" being a "holder in due course." Cf. Sections 3-302 and 3-304. Such validation is subject to the proviso that the defect is not a violation of a constitutional provision, in which case validation is confined to securities in the hands of a "subsequent purchaser," for value and without notice.

53. N.I.L.; 5 U.L.A. § 16.

54. N.I.L.; 5 U.L.A. § 14.

55. N.I.L.; 5 U.L.A. § 15.

56. 113 N.J.L. 76, 172 Atl. 528 (1934).

57. I.e., the drawee bank could not debit drawer's account with the amount of the cheque. Of course if there would have been negligence on the part of the drawer he would not have been able to raise the defence of non-delivery. But the cheque had been stolen from the drawer's safe. See also *Budget Corp. of America v. De Felice*, 46 N.J. Super. 489, 135 A.2d 31 (1957).

58. E.g., *Weiner v. Pennsylvania Co. for Insurance on Lives and Granting Annuities*, 160 Pa. Super. 320, 51 A.2d 385 (1947).

59. *Joseph Heimberg, Inc. v. Lincoln National Bank*, supra note 56.

60. *Ibid.*

61. 5 U.L.A. § 124.

tion"<sup>62</sup> results in avoidance of an instrument, except that a holder in due course can enforce the instruments according to its original tenor.<sup>63</sup> Of course, authorization, ratification, waiver or estoppel could prevent the raising of this defence. Section 8-206(2) provides that the alteration of a completed investment security shall not avoid the security, but that the security shall be enforceable according to its original terms. As a result, in so far as investment securities which formerly came under the provisions of the N.I.L. are concerned, it will no longer be necessary to draw distinctions between "alterations" and "material alterations,"<sup>64</sup> nor between "holders" and "holders in due course." The first steps in this direction were already taken in the Uniform Stock Transfer Act,<sup>65</sup> which recognized the commercial policy making certificates of shares enforceable according to their original tenor, and conferred on the transferee a good title to the shares represented thereby.<sup>66</sup>

In view of the fact that the completion of an incomplete security may amount to an overissue, it is important to point out here that the validation of any security by such action is subject to the provisions of Section 8-104 dealing with overissues.

An overissue is the issuance of securities in excess of those authorized by the charter or other corporate constitution of the issuer.<sup>67</sup> It is viewed as the "most heinous crime a corporation may commit by almost every court that thinks about mentioning the subject."<sup>68</sup> An overissue is generally considered void,<sup>69</sup> and nothing can validate it. Even though it be within the powers of a corporation to increase its stock, it is not possible for the holder of overissued stock to demand that the corporation amend its charter, etc., so as to provide for such increase. It is further submitted that even if there is such an amendment, the overissue itself would still be void; there would have to be a re-issue of authorized securities.<sup>70</sup>

Controversy exists as to the effect of an overissue on the liability of the corporation. It is generally accepted that there will be a liability to the innocent holder of such overissued stock.<sup>71</sup> Yet what would be the amount of damages? The prevalent approach is to assess damages on the basis of the market price of valid shares on or about the date the cause of action arose.<sup>72</sup>

62. 5 U.L.A. § 125.

63. *Smith, Kline & French Co. v. Freeman*, 93 N.J.L. 45, 106 Atl. 22 (1919).

64. Section 8-206(2) uses the term "improperly altered even though fraudulently."

65. 6 U.L.A. § 16.

66. *Pequannock & Wayne Building & Loan Ass'n v. Pritchard*, 134 N.J. Eq. 563, 36 A.2d 755 (1944).

67. Section 8-104(2).

68. Note to the Proposed Final Draft No. 1, April 26, 1948.

69. *New York & Eastern Telegraph & Telephone Co. v. Great Eastern Telephone Co.*, 74 N.J. Eq. 221, 69 Atl. 528 (1908), *aff'd*, 75 N.J. Eq. 279, 78 Atl. 1135 (1908).

70. Gower, *Alteration of a Company's Objects and the Ultra Vires Doctrine*, 67 L.Q. Rev. 41 (1952). The submission made in the text is criticized by *Israels*, 16 *Law & Contemp. Prob.* 248, 254-5 (1951).

71. *New York & Eastern Telegraph & Telephone Co. v. Great Eastern Telephone Co.*, *supra* note 69; *Edmund Wright-Ginsberg Co. v. Carlisle Ribbon Mills*, 105 N.J. Eq. 411, 148 Atl. 178 (1929), *aff'd*, 108 N.J. Eq. 206, 154 Atl. 632 (1931).

72. *Douglas v. Merceles*, 25 N.J. Eq. 144 (1874).



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The U.C.C. in Section 8-104 introduces a new method of dealing with overissues. Thus if the security be "reasonably available for purchase," the person entitled to issue or validation of a security "may compel the issuer to purchase and deliver such security to him. . . ." <sup>73</sup> Otherwise only the value last paid is recoverable. <sup>74</sup> The question of "reasonable" availability will have to be determined by the court. It is submitted that where there is no person willing to sell such securities at a reasonable price, the security is not "reasonably available." But, if the security is "reasonably available," must the issuer buy such securities if not "compelled"? And, if he does, must it be accepted? The section places in the person entitled "to issue or validation" the power to compel the purchase. The price paid may exceed the present market price. Would a refusal to accept entitle the person to the price last paid or to the market price? It is submitted that "may" in this context will have to be construed as a *duty* placed upon the issuer to buy such security, and the person entitled to issue or validation of a security *must* accept it. Only if there is no such security reasonably available, will it be possible to recover the price last paid. <sup>75</sup>

The requirement for reasonableness gives rise to a further difficulty. Although generally a corporation has power to buy its own stock, <sup>76</sup> usually such power is restricted. Thus it is usual to find that such power can only be exercised (a) in the absence of any restriction in the company's charter, <sup>77</sup> (b) if such purchase is in the course of its corporate business, <sup>78</sup> (c) out of surplus or accumulated profits, as otherwise such purchase would be a reduction of capital, <sup>79</sup> and (d) provided that sufficient assets remain to pay creditors. <sup>80</sup> As against these requisites there is the express wording of the Code demanding that the security be bought. Would this give rise to a conflict in obligations? It would appear that the only restriction indicated by the Code is that the security be not "reasonably available." Thus, the difficulties indicated here will have to be reconciled so as to enable the issuer to comply

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73. Section 8-104(1)(a).

74. Section 8-104(1)(b).

75. The official Comment to this Subsection states that this test is to reduce "speculation by the purchaser." Admittedly speculation should be avoided. But what if the security has increased in value since the last purchase? What if the security has been received in the course of a testamentary disposition? Should the sum receivable in damages be only the small purchase price? The Code seems to reach this conclusion and allows interest only from the date of demand.

76. Such power does not exist in an English court. Companies Act, 1948, § 54, 11 & 12 Geo. 6, c. 38. A recent commission in the United Kingdom recommended a stricter enforcement of this section and the raising of the fine attached as a sanction, since, as at present constituted, the section has no effect because the fine is infinitesimal in relation to the amounts involved in "Takeover Bids." Board of Trade, Companies Act, 1948, Investigation into the Affairs of H. Jasper & Co. Ltd., Report by Neville Faulks, Q.C., December 1, 1959 (51/358). It is likely that there may be an alteration in English law on this point as a result of the recent investigations by the Jenkins Commission.

77. Chapman v. The Iron Clas Reostat Co., 62 N.J.L. 497, 41 Atl. 690 (1898).

78. In the light of the Code, would this become part of its corporate business?

79. King Machine Co. Inc. v. Caporaso, 2 N.J. Super. 230, 63 A.2d 270 (1949).

80. Wolff v. Heidritter Lumber Co., 112 N.J. Eq. 34, 163 Atl. 140 (1932).

with the obligation cast upon him by the Code. This could require a change of a state's corporation law.

Under the N.I.L. a person can only qualify as a holder in due course so as to cut off the personal defences of the maker where he takes an instrument prior to its maturity.<sup>81</sup> Difficulties are often caused by the case of acceleration of maturity dates.<sup>82</sup> It is to obviate these difficulties, as well as to provide a trading device during a reorganization of a corporate issuer, that Section 8-203 provides that even though a purchaser takes after maturity, he will nonetheless have protection from issuer's defences. This more realistic approach is only possible by a separation of investment securities from commercial paper. Investment securities are often still dealt with on the market even though they have been defaulted on. But, after a reasonable time, the fact that a matured security is still in circulation "must give rise to the question in a purchaser's mind as to why it has not been surrendered."<sup>83</sup> An issuer ought to be able to know his liability on an invalid or improper issue. Thus, where there has been no default on maturity, a purchaser is deemed to take subject to the issuer's defences where he takes more than one year after maturity. But should there be a default on maturity, then a purchaser has two years from maturity during which he can still take without implied notice of defences.<sup>84</sup> This provision introduces an uncertainty into the Code. After one year has elapsed, staleness will not be measured from the fact of maturity, but from the fact—not generally within the knowledge of a purchaser, though easily ascertainable to commercial men—that the funds were available to meet the security on maturity. This provision is also unusual, in that it is one of the few instances in the Code providing for constructive notice of defences in commercial transactions.

### III

An analysis of existing commercial legal rules will reveal that legal concepts have not always kept up with developments in the commercial field, and "how inadequate traditional legal concepts and doctrines may be when a real attempt is made to make them correspond with the customs and practices of the 'market place'."<sup>1</sup> Part 3 of Article 8 deals with the questions of negotiability of investment securities in relation to persons other than the issuer.

In analyzing the nature of the transaction by which securities ultimately reach a purchaser, it is seen that in most instances the security would go

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81. N.I.L.; 5 U.L.A. §§ 52, 53; see also *McCormack v. Williams*, 88 N.J.L. 170, 95 Atl. 978 (1915).

82. Chafee, *Acceleration Provisions in Time Paper*, 32 Harv. L. Rev. 747 (1919).

83. Official Comments, Point 1, to Section 8-203.

84. Compare the provisions as to claims of ownership under Section 8-305, which cuts these periods by one half on the theory that a purchaser has more reason to suspect ownership claims than issuer's defences.

1. Briggs, *Article 8: Investment Securities*, 21 Mont. L. Rev. 64, 75 (1959).

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through the hands of a selling-broker and those of a buying-broker before reaching the purchaser.<sup>2</sup> In the course of such movement, correspondent-brokers and stock-exchange clearing houses may be employed as well, with the result that only rarely would the purchaser get the same security initially handed to the selling-broker by the seller. This would especially be the case where the security passes through the hands of the issuer for a new or re-registered security to be handed to the purchaser or where securities in fungible bulk are sold. Can such transactions be termed *a sale*?

The relationship of broker and customer also reveals that it partakes of various aspects. The relationship may include agency, bailment, trust and pledge. In addition, where the customer buys on margin, the relationship of debtor and creditor will also arise.<sup>3</sup> Is it adequate to term this relationship an *agency relationship* or a *fiduciary relationship*?

It is clear that existing concepts of sale and of agency are not very helpful to us in these modern commercial relationships. A complicated set of rules and regulations have been formulated by the commercial markets in securities, to which the law must give recognition, lead and guidance. The problem for the law is, therefore, to formulate rules which, though comprehensive, must be flexible in order to give effect to the complexities with which the transactions here involved abound.

Article 8 attempts to do this by recognizing that a security transfer involves a multiple-step affair, and that at each step certain rights arise to which recognition must be given.<sup>4</sup> In the first place it is recognized that "purchase" and "sale" need not be the same thing,<sup>5</sup> though a purchase could include a sale. Under the Code, a purchase is the acquisition of an instrument in a voluntary transaction creating an interest in property. Thus, it is possible that there could be more than one taking by purchase but only one sale. In the multiple-step affair surrounding a transfer of a security, there would be many purchasers,—buying broker and their corresponding brokers and the buyer, but not the selling broker since he does not acquire an interest in the property—but only one sale, *i.e.*, from the seller to the buyer of the security.

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2. The transaction would involve a transfer from the seller to the selling-broker; from the selling-broker to the buying-broker; and from the buying-broker to the buyer. The fact that there are these three steps involved does not mean that three sets of transfer taxes will have to be paid. Federal Tax Regulations 1960, Reg. §§ 43.4322-1(c) and (d), 43.6001-1 and 43.6001-2 (Fed. Tax Regs. to 26 U.S.C.A. (I.R.C. 1954) § 4322 and § 6001) indicate that no tax is payable on a transfer from a customer to his broker or vice versa. See also Carlos L. Israels, 1954 (2) N.Y.L. Rev. Com. Rep. (U.C.C.) 897.

3. Note *Denton v. Gurnett & Co.*, 69 F.2d 750 (1st Cir. 1934) where the court investigated the two theories which have become known as the New York Rule (majority) and the Massachusetts Rule (minority). See also Smith, *Margin Stock*, 35 Harv. L. Rev. 485 (1922), and *In re Codman*, 284 Fed. 273 (1922), *aff'd*, 287 Fed. 806 (1923), cert. denied, 263 U.S. 704 (1923).

4. See e.g., Sections 8-303, 8-306, 8-313, 8-314 and 8-316.

5. Section 1-201(32). The term "transfer" would have been preferable to that of "purchase," for that term generally connotes a "transfer for a quid pro quo."

The reason behind this distinction between purchase and sale was indicated by Carlos L. Israels to the New York Law Revision Commission:

The purpose of it is in order to make possible the whole set-up of the rights of the bona fide purchaser, the two attributes of negotiability, issuers' defenses, which requires merely purchase for value, and the defense against prior claims of ownership which requires the bona fide purchaser, and you have to go through this whole scheme in order to do that. If you get yourself complicated by, and it only complicates it, I think, dragging in the question of title to the stock itself, the shares of stock, I think you do nothing but make the drafting of a negotiability statute intended to affect the certificate alone that much more difficult.<sup>6</sup>

In the light of this new approach, can the retention of a statute of frauds provision really be justified? The Official Comment to Section 8-319 indicates that its purpose is to bring the statute of frauds provisions relating to investment securities in line with the policy enunciated by the U.C.C. in relation to sales. It is to be regretted that the draftsmen of the Code were not prepared to grasp the thistle and throw it out of the arborial path they were breaking in the confused jungle of security transfers. W. D. Hawkland<sup>7</sup> has dealt with the development of the statute of frauds in relation to U.C.C. Article 2, Sales, and indicated the diverse reactions which this most controversial statute has evoked.<sup>8</sup> Let us examine the need for such an anachronism in modern Commercial Law. i. Introduced into English law in 1677, at a time when it was not possible for parties to give evidence on their own behalf and when, in theory, juries were still to act on their own knowledge of the facts in dispute, it improved the then existing situation by admitting the evidence of the parties themselves, at least in the restricted form allowed by the statute. Is such a restriction valid in 1961? ii. Though the statute attempts to exclude perjured evidence, it also excludes the truth. As FitzJames Stephens, J., wrote: "In the vast majority of cases its operation is simply to enable a man to break his word with impunity, because he did not write it down with sufficient formality."<sup>9</sup> Is formality paid such high regard in modern times?

iii. The operation of the statute is lopsided and partial, favoring the rascal. W. D. Hawkland<sup>10</sup> gives an example of how an honest person sending a confirmatory note would be penalized in having provided evidence against himself, but would be unable himself to enforce the agreement, for the rogue, of course, would not leave himself open in this manner. Is this something to be retained in the law?

iv. The language of the statute, as enacted in the Uniform Sales Act, is obscure and ill drafted, *e.g.*, much litigation has centered around the meaning

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6. 1954(2) N.Y.L. Rev. Com. Rep. (U.C.C.) 1003.

7. Hawkland, Sales and Bulk Sales Under the Uniform Commercial Code (1958).

8. Compare, Lives of the Norths, 141 with Note, 43 L.Q. Rev. 1, 3 (1927).

9. FitzJames Stephens and Frederick Pollock, Section 17 of the Statute of Frauds, 1 L.Q. Rev. 1 (1885).

10. *Supra* note 7.

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of the term "memorandum" and what are the necessary ingredients thereof. Should litigation be promoted by obscurities in statutes?

v. A statute of frauds is out of accord with the way in which business is normally conducted. Thus FitzJames Stephens, J., as early as 1884, wrote: "I am informed that in some large towns, Liverpool for instance, mercantile men repudiate it in practice."<sup>11</sup> Should a provision to a similar effect be retained in a codification which intends to illumine the legal paths of the market place?

However much such an anachronism may have wormed its way into the law relating to the sale of goods, what right has it in the law relating to transactions in securities? In *Humble v. Mitchell*,<sup>12</sup> Lord Denman remarked that he could find no case in point where the statute of frauds had been held applicable to a sale of shares in an incorporated company. He therefore held that such shares were mere choses in action and thus not within the statute. Admittedly, in three earlier cases during the eighteenth century the question was discussed before English courts,<sup>13</sup> and two of these cases seem to imply that the court was prepared to hold the statute applicable.<sup>14</sup> However, in *Pickering v. Appleby*,<sup>15</sup> all the judges in England heard argument on this point in Serjant's Inn, to which the Court of Common Bench had adjourned, and could not agree whether the statute of frauds was applicable to shares, stocks, bonds, etc. As a result, the decision of Lord Denman has been followed in England, and the statute has been held inapplicable.

In the United States, however, a different approach was adopted. In New Jersey, for example, Van Sykel, J., happy at having found Lord Denman in error, was able to follow earlier American decisions and to hold the provisions of the statute of frauds, as adopted in New Jersey, applicable to a parol agreement to assign a bond and a mortgage.<sup>16</sup> It is thus not unreasonable that the statute of frauds provision of the Uniform Sales Act,<sup>17</sup> when adopted in 1906, should define its scope as applicable to "any goods or choses in action,"<sup>17a</sup> making it absolutely clear that the statute applies to securities, and

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11. Supra note 9.

12. 11 Ad. & El. 205, 113 Eng. Rep. 392 (1840).

13. *Crull v. Dodson*, 2 Eq. Cas. Abr. 51, Sel. Cas. T. King 41, 22 Eng. Rep. 44, 25 Eng. Rep. 211 (1725); *Mussell v. Cooke*, Prec. Ch. 533, 2 Eq. Cas. Abr. 49, 70, 22 Eng. Rep. 43, 62, 24 Eng. Rep. 239 (1720); *Pickering v. Appleby*, 1 Comyns 354, 92 Eng. Rep. 1108 (cir. 1721).

14. *Crull v. Dodson*, supra note 13; *Mussell v. Cooke*, supra note 13.

15. Supra note 13.

16. *Greenwood v. Law*, 55 N.J.L. 168, 26 Atl. 134, 192 L.R.A. 688 (1893).

17. U.S.A., 1 U.L.A. § 4.

17a. It is submitted that one of the possible causes which has led to the conclusion that the Statute of Frauds provisions should be applicable to transactions in shares could be that bonds had already been held by American courts to be "goods." The idea of the transferability of a chose in action such as a share in a company by mere negotiation of the share certificate appears to create a conceptual difficulty. It is submitted that the effect of making such negotiability possible is not just the creation of a negotiable chose in action, such as the share in the company, by means of the transfer of the share certificate, a situation already recognized in the N.I.L. It is submitted that by conceptualizing the situation in this way it would have been possible to avoid the confusion with goods which has led to the applicability of the Statute of Frauds provisions.

resulting in these transactions joining the merry-go-round of avoiding the statute's application.<sup>18</sup> The heavy morass in which this subject is steeped requires no further elaborations.<sup>19</sup>

Having been given the opportunity of avoiding all the complications surrounding a statute of frauds, the Law Commissioners failed to grasp the opportunity to emulate the English law and suggest the repeal of the statute.<sup>20</sup> It must be borne in mind, however, that it took seventeen years for the report of the English Law Revision Committee to be acted upon.<sup>21</sup> We can only hope that it will not take as long as that before some further alteration in the Code is adopted which will remove the last vestiges of this anachronism.

Moving in the right direction, Section 8-319 tries to ameliorate the more outstanding iniquities of the statute of frauds. There still remain two hurdles to be surmounted by a plaintiff. He must produce proof sufficient to surmount Section 8-319 before he can prove the terms of his contract. But in this respect the most objectionable term is no longer in this new statute of frauds. It is no longer necessary to produce a memorandum; a signed writing sufficient to "indicate that a contract has been made,"<sup>22</sup> will suffice. This will prevent the rather fraudulent plea of confession and avoidance by which there would be an admission of a contract, followed by a claim that the memorandum did not contain all the terms thereof, so that the contract is unenforceable.<sup>23</sup> The important elements which must appear in the writing are the quantity of the described securities and a definable or stated price. Once these matters are ascertained it is easy for the court to discover the other terms of the contract.

Section 8-319 applies to all contracts for the sale of securities. There are no price limits set, as exist in the Uniform Sales Act.<sup>24</sup> It is to be regretted, however, that the present law, which provides that if there was part payment, or part delivery, the statute would be satisfied as to the total contract, is not continued. Under Section 8-319(b), where there has been part payment or part delivery and acceptance of part of the contractual amount, the contract is only enforceable to the extent of such payment or such delivery.<sup>25</sup> It would have been better to have retained the existing provision and enabled parol evidence to be adduced to prove the totality of the contract.

The real recognition of mercantile usage occurs in Section 8-319(c).

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18. *Melniker v. Winter*, 105 N.J.L. 278, 145 Atl. 318 (1929), *Fenning Dornbush & Co., v. Greenfield*, 107 N.J.L. 272, 153 Atl. 574 (1931).

19. See *Hawkland*, op. cit. supra note 7.

20. Law Reform (Enforcement of Contracts) Act, 1954, 2 & 3 Eliz. 2, c. 34.

21. Law Revision Committee, Sixth Interim Report (1937).

22. Section 8-319(a).

23. See Professor Llewellyn, 1954(1) N.Y.L. Rev. Com. Rep. (U.C.C.) 163. Section 8-319(d) would also prevent this, in that an admission in the pleadings, testimony or otherwise in court, that there was such contract suffices. This would appear to include oral admissions.

24. Supra note 17.

25. In this respect the Code would appear to adopt the reasoning in *Canister Co. v. Wood & Sellick*, 73 F.2d 312 (3d Cir. 1934) by holding such contract severable and enforceable as to the severed part.

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Brokers and others dealing in securities transact the major part of their business over the telephone. It is usual for them to send a letter of confirmation subsequent to such telephonic conversation. To hold one party liable on the basis of the letter and to release the other party on the ground that he has not signed, has been shown to be most conducive to fraud. Section 8-319(c), therefore, enacts that a recipient of such letter of confirmation has ten days within which he can object to the terms set out therein or he will be bound by the terms thereof.<sup>26</sup>

The basic question underlying the negotiability of an investment security is whether a transfer is subject to, or free from, adverse claims.<sup>27</sup> This in turn is dependent upon the nature of the transferee, who is either a purchaser<sup>28</sup> or a bona fide purchaser.<sup>29</sup> We have already seen that a purchaser need not have given consideration for the security, but could have acquired the security by way of gift or in any other manner which transferred an interest therein to him. A bona fide purchaser, however, will have had to have given "value"<sup>30</sup> on taking the security.

The N.I.L.<sup>31</sup> in setting out the requirements for a holder in due course demands that he take the instrument (1) which is complete and regular on its face, (2) before it is overdue and without knowledge of its having been dishonoured, (3) in good faith and for value and (4) without notice of any infirmity in the instrument or defect in the title of the transferor. Under the U.C.C. there is no requirement for completeness or regularity to qualify a purchaser as a bona fide purchaser. In fact, incompleteness would not be a defence to the issuer against a purchaser for value without notice, even though the instrument had been completed incorrectly. The fact that an investment security is overdue, will also not necessarily deprive a purchaser of the preferred condition of a bona fide purchaser. It is only when the periods of time indicated in Section 8-305 have been exceeded that questions of implied notice of adverse claims can be raised.<sup>32</sup> In determining whether the security has become stale, time is measured from the date the "principal obligation" becomes due. Thus, the fact that coupons attached to the security have not been met on presentment will not bring the section into operation. This

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26. This time is rather a long one in relation to the fluctuations which are encountered on the stock exchange. On the other hand there is no need to reply to any letter where there is no contract. For the fact that this hurdle has been surmounted does not mean that the actual terms of the contract have not to be proved and then, of course, the existence of a contract would once more be in issue.

27. Section 8-301.

28. Section 1-201(32) and 1-201(33).

29. Section 8-302.

30. Section 1-201(44).

31. 5 U.L.A. § 52.

32. As has been indicated in connection with issuer's rights, the period of time here is shorter on the ground that a purchaser taking securities after they had matured, would be more likely to suspect claims of ownership in others than the issuer. The validity of this reasoning is suspect in the light of Section 8-304 which enables an owner to protect his interests, i.e., by indorsement on the security. There are, however, rights which cannot be protected by this method. It is in relation to these that staleness will become relevant.

clearly differs from the position adopted by the N.I.L.<sup>33</sup> where a failure to meet any one of a number of obligations due will be notice of a defect sufficient to prevent the holder from being a holder in due course.<sup>34</sup>

Both requirements, for good faith and for value, exist under the N.I.L. and under the U.S.T.A.<sup>35</sup> No definition of "good faith" is given by the N.I.L., but that set out in the U.S.T.A.<sup>36</sup> is very similar to the one given by the U.C.C.<sup>37</sup> There must be "honesty in fact in the conduct or transaction concerned." Negligence of itself would not be sufficient to indicate dishonesty.<sup>38</sup> It will in all cases be a question of fact.<sup>39</sup>

The 1958 draft of Article 8 of the U.C.C. does not contain a section defining "value." Thus reference must be made to Section 1-201(44). There is no presumption of the existence of "value" as under the N.I.L.<sup>40</sup> Of the various means indicated in this Section whereby value can be given, two require discussion. First, what is immediately available credit? This question is of especial importance in connection with payments made into a bank account. No value will have been given until the deposit has been cleared, *i.e.*, until there has been a removal of any "flag" from the account, unless there be a "binding commitment to extend credit." The mere fact that a bank reserves the right to reverse an entry will not preclude the giving of value. This is an alteration in the law of those states where the courts have held that unless credit is absorbed by antecedent indebtedness, or exhausted by withdrawals, a bank will not have given value so as to be a holder in due course.<sup>41</sup> Secondly, Section 1-201(44)(c) states that a "person gives 'value' for rights if he acquires them by *accepting delivery* pursuant to a pre-existing contract for purchase." This provision makes it clear that a future obligation which is contingent can be changed into a fixed obligation by accepting delivery.<sup>42</sup>

The bona fide purchaser must take the security free from notice of adverse claims.<sup>43</sup> This requires actual notice<sup>44</sup> and only rarely will such notice be implied.<sup>45</sup> The necessity for some clear intimation of adverse claims, as

33. *Supra* note 31, § 52(2).

34. *E.g.*, *Cramer v. Weith*, 20 N.J. Super. 577, 90 A.2d 524 (1952).

35. 6 U.L.A.

36. 6 U.L.A. § 22(2).

37. Section 1-201(19).

38. In many States, *e.g.*, New Jersey, mere suspicious circumstances will not be enough to show that a person had acted in bad faith. Actual bad faith will have to be shown. *Driscoll v. Burlington-Bristol Bridge Co.*, 8 N.J. 433, 86 A.2d 201 (1952). Should there be no reason for inquiry, then a person taking an instrument for value without notice of a defect will have acted as a good faith purchaser thereof. *Edmund Wright-Ginsberg Co. v. Carlisle Ribbon Mills*, 105 N.J. Eq. 411, 148 Atl. 178 (1929). But if the person taking the instrument is intimately connected with the transfer or issuance thereof, he will not be able to claim that he was without knowledge.

39. *Driscoll v. Burlington-Bristol Bridge Co.*, *supra* note 38.

40. 5 U.L.A. § 24.

41. *E.g.*, *New Jersey, Hightstown Trust Co. v. American Equity Corp.*, 7 N.J. Misc. 135, 144 Atl. 599, *aff'd*, 150 Atl. 918 (1930).

42. *Atlantic Pebble Co. v. Lehigh Valley R. Co.*, 89 N.J.L. 336, 98 Atl. 410 (1916).

43. Section 8-302.

44. Section 1-201(25).

45. *E.g.*, Section 8-305.



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shown in relation to issuer's liens<sup>46</sup> and restrictions on transfers imposed by the issuer,<sup>47</sup> is continued by Section 8-304. Under the U.C.C. questions of indorsement of securities only arise in connection with registered securities. The common law rule, "once a bearer instrument, always a bearer instrument," is supported by the U.C.C., provided that the security when issued was payable to bearer.<sup>48</sup> In the case of a registered security, however, an indorsement in blank will include an indorsement to bearer.<sup>49</sup> In this respect the U.C.C.<sup>50</sup> resolves a difficulty of interpretation between N.I.L. Section 40 and Sections 9(5) and 34. "The method of negotiation of an instrument payable to order on its face is controlled by the last indorsement. If the last indorsement is in blank, it is negotiable by delivery. If a blank indorsement is followed by a special indorsement, the special indorsement controls. . . ."<sup>51</sup> "An instrument payable to bearer on its face remains negotiable by delivery alone despite a special indorsement thereon, but such special indorser is liable only to subsequent holders who derive title through the indorsement of the special indorsee."<sup>51a</sup> But even though an indorsement will be ineffective in relation to the negotiability of an investment security payable to bearer, such indorsement may give notice of the existence of adverse claims.<sup>52</sup> Merely putting one's name on the security, however, will not be sufficient.<sup>53</sup> The form which a restrictive indorsement must take is such as to indicate clearly that the indorsement has not been made for the purpose of transfer. There is no need for the purchaser to inquire as to the extent of the adverse claim, but such intimation as would be given by such indorsement would show that the purchaser, by ignoring the restriction, would be taking the instrument with "knowledge of such facts that his action in taking the instrument amounted

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46. Section 8-103.

47. Section 8-204.

48. An exception to the common law rule exists under Treasury Department Circular No. 853 § 328, 14 Fed. Reg. 6171 (1949) which provides that United States Bearer Securities issued by the Treasury Department can be specially indorsed and will be non-negotiable during their transit, so as to protect the owner thereof against theft, loss and destruction. A similar approach is also adopted by brokers or dealers when sending investment securities through the mail, by indicating the name of the addressee broker who is to have the authority to fill in the name of the transferee of the security. In this way it is intended to make the security non-negotiable during transit. This is, however, only possible with a security requiring an indorsement to be negotiated. An explanation why the rule regarding "order instruments" has not been adopted in relation to investment securities lies in the very nature of the latter. Investment securities are issued in large numbers so that equality of treatment as well as continuity of treatment is desirable for the purpose of bookkeeping. Compare Section 3-204 which adopts the rule regarding order instruments to all commercial papers including those originally issued to bearer.

49. Section 8-308(2).

50. Section 8-310.

51. Britton, Bills and Notes 247 (1943).

51a. *Id.* at 245. This interpretation has the support of a number of writers, see Hawkland: Bills and Notes, Cases and Materials, pp. 149-51 (1956).

52. Section 8-310.

53. Section 8-304(1)(b).

to bad faith," *i.e.*, he would not be taking as a bona fide purchaser.<sup>54</sup> This does not mean that a purchaser taking an investment security from a fiduciary would be deemed to have notice of the contents of the trust instrument so as to be chargeable with a breach thereof. Unless there be knowledge that the fiduciary is using the proceeds for his individual benefit,<sup>55</sup> all that has to be considered is the existence of a power to negotiate the security.<sup>56</sup>

The U.C.C. in Section 8-308(5) and in 8-301(3) deals with the situation where there has been a purchase of and consequently an indorsement of a part of a security only.<sup>57</sup> This raises the question whether a person taking only a part of the security represented by the certificate can be a bona fide purchaser. The term used in Section 8-301(3) is "limited interest." Does this refer to a quantitative or a qualitative limitation? If it is a quantitative limitation, then although it was intended that the provisions of Section 8-301(2) should extend to a bona fide purchaser,<sup>58</sup> it is clear that this is not the effect of the wording of Section 8-308(5). The Official Comment to Section 8-308(5) intends to leave the solution of this problem to the case law. But the fact that there were other claims of ownership in existence would be so apparent as to preclude a finding otherwise than that the purchaser would take subject to adverse claims. A qualitative limitation, on the other hand, would not prevent such purchaser being a bona fide purchaser. The answer would appear to be that Subsection 8-301(3), though intending to refer to qualitative limitations, merely indicates the possibility of acquiring a limited interest in the security and leaves it to Sections 8-301(1) and 8-301(2) to determine the rights of the purchaser.

Before a purchaser can take an investment security as a bona fide purchaser he must have had the security, properly indorsed where necessary, delivered to him. Both delivery and indorsements are required. Thus, should the security have been delivered but not properly indorsed, the purchaser will only become a bona fide purchaser from the moment he obtains the

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54. Subsection 8-304(2) applies to both bearer and registered investment securities. In this respect this section widens the provisions of the Uniform Act for the Simplification of Fiduciary Transfers which extends only to registered securities, and rephrases the Uniform Fiduciary Law. See, however, *Israels, Investment Securities as Negotiable Papers—Article 8 of the Uniform Commercial Code*, 13 *The Business Lawyer* 676, 681 (1958).

55. *E.g.*, by paying cheques made out to the trust into his personal account. *Westerhoff v. Citizen Trust Co.*, 15 N.J. Misc. 202, 190 Atl. 84, *aff'd* 117 N.J.L. 453, 190 Atl. 88 (1937).

56. There is no need to see whether the fiduciary is dealing with the instrument in accordance with the trust imposed upon him. *Dennis Metal Manufacturing Co. v. Fidelity Union Trust Co.*, 99 N.J.L. 365, 123 Atl. 614 (1923); *O'Connor v. First Bank & Trust Co.*, 12 N.J. Super. 281, 79 A.2d 687 (1951).

57. Such transfer of part of a security could occur either where part of the security has been redeemed, or where the issuer intended such parts to be separately transferable. Section 8-201(1)(b).

58. *Eliot B. Thomas, In re Article 8*, 28 *Temple L.Q.* 582, 592 (1955) and Memorandum submitted by Mr. Carlos L. Israels to the New York Law Revision Commission, 1954 (2) N.Y.L. Rev. Com. Rep. (U.C.C.) 892.

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requisite indorsement.<sup>59</sup> Intervening notice of adverse claims is thus possible.<sup>60</sup> But not until there has been a delivery<sup>61</sup> can there be a claim to the requisite indorsement, for only then will there have been a transfer effective as between transferor and transferee.<sup>62</sup> To complete a delivery there must be a "voluntary transfer of possession."<sup>63</sup> This requires both a tradition and an intention to make a transfer,<sup>64</sup> so that in the case of a conditional delivery no transfer occurs until the condition has been satisfied.<sup>65</sup> Once there has been a delivery effective between the transferor and the transferee, then, by virtue of Section 8-316, the transferee can demand the assistance of a transferor in completing the transfer. But in the case of a purchaser who has not given value, the transferor can demand to be reimbursed for his expenses.<sup>66</sup>

The shelter provision covering negotiable instruments contained in the N.I.L.<sup>67</sup> is re-enacted in Section 8-301(1). Thus, provided the purchaser has not been a party to any fraud or illegality affecting the security, he will acquire such rights as his transferor had or had power to transfer. Is it possible under this provision for a purchaser to acquire those rights which normally apply to a bona fide purchaser?<sup>68</sup> We have seen that a purchaser who acquires notice of adverse claims prior to the completion of the transfer, *e.g.*, after delivery but before all requisite indorsements are obtained, will not be able to claim the rights of a bona fide purchaser. But what if he takes

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59. Section 8-307.

60. *Ibid.*; *O'Keefe v. Hill*, 105 F.2d 325 (3d Cir. 1939).

61. Section 1-201(14) a "voluntary transfer of possession." The Official Comments contemplate a constructive delivery. See further Sections 8-313 and 8-314.

62. The U.C.C. leaves it to the general law of the State to determine what would be the effect of an attempted transfer of a security without delivery. Generally an equitable right would come into existence in the claimant-transferee. *First National Bank of Fort Lee v. Englewood Mutual Loan & Building Association*, 124 N.J. Eq. 360, 1 A.2d 871 (1938); *Manna v. Pirozzi*, 44 N.J. Super. 227, 130 A.2d 55 (1957).

63. *Supra* note 61.

64. Mere delivery alone will not suffice, *Zoller v. State Board of Tax Appeals*, 127 N.J.L. 376, 11 A.2d 833 (1940); nor will an indorsement without delivery suffice, Section 8-309.

65. *Introcasso v. Orrock*, 124 N.J.L. 4, 10 A.2d 272 (1940).

66. No difficulty ought to arise in those cases where the transfer is effected through brokers. The usual practice is for securities to be taken in the "street name" and then to be transferred to the buyer. The New York Stock Exchange Rules also demand that the broker complete the transaction obtaining a certificate in registrable form. What if no brokers are involved? Once the security has been indorsed and delivered the transfer is completed. Sections 8-307 and 8-309. Would it be possible for a purchaser to claim a rescission when the transfer has been completed? It is submitted that Section 8-316 must be read in the light of Section 8-306(2)(a) indicating that the transferor gives a warranty that his transfer is effective and rightful. Section 8-402 sets out the evidence demanded to support this warranty, and thus Section 8-316 entitles the purchaser to demand such evidence for purpose of registration and can rescind if the transferor does not support his warranty under Section 8-306(2) with the requisite evidence.

67. 5 U.L.A. § 58.

68. *United States v. Perpignano*, 86 F. Supp. 105 (D.C.N.J. 1949) seems to indicate this possibility. In *McAllister v. McAllister Coal Co.*, 120 N.J. Eq. 394, 184 Atl. 716 (1936), *aff'd* 121 N.J. Eq. 248, 190 Atl. 52 (1936), the brother who claimed to have received the stock as a gift from his father could not claim to have greater rights than those possessed by his transferor, father. Since the previous owner had not transferred the stock to the father with a donative intent, the brother could not lay claim to the stock. He had not given value and thus could not claim to be a bona fide purchaser.

from a bona fide purchaser? Further, the U.C.C. enables a broker to be a bona fide purchaser,<sup>69</sup> and thus it could be argued that there should be no right to reject a security in these circumstances, for although not a bona fide purchaser, the purchaser would have all the rights of such. The New York and the Philadelphia-Baltimore Stock Exchange Rules permit a broker to return such securities to the broker who introduced them onto the market. What if there be no possibility to return the securities, *e.g.*, where they have been obtained by the broker from another customer? It is no consolation to the broker that he could attempt to sell the securities on the market and use the proceeds to obtain similar securities as to which his customer is not aware of adverse claims. But to grant protection to a broker in these circumstances would be contrary to the policy of the Code, which expressly rejects the decision in *Isham v. Post*,<sup>70</sup> which would allow a broker to recover from his customer though he had failed to procure the exact instrument he was asked to acquire.<sup>71</sup>

A question which has generated considerable discussion is that posed by Chafee in his article, "Reacquisition of a Negotiable Instrument."<sup>72</sup> Chafee maintained that the courts would hold that a person who once had knowledge of a defect while in possession of a negotiable instrument could not rely on the shelter provision in the N.I.L.,<sup>73</sup> where his transferor is a holder in due course.<sup>74</sup> It is clear that a person having knowledge of a defect cannot take as a holder in due course, but would such person be affected by knowledge he received after he has negotiated the instrument, when he has an opportunity to reacquire the instrument from a bona fide purchaser? The Code only deals with the case where notice of an adverse claim has been obtained when "a prior holder."<sup>75</sup> It is submitted, however, that in these circumstances there will be actual notice of adverse claims and this would prevent a taking free from adverse claims.

#### IV

Although certain warranties are implied into every transfer of investment securities or their presentment for registration of a transfer, this does not leave out of consideration the possibility of the parties themselves adding to, or limiting, warranties,<sup>1</sup> provided that the obligations of good faith, dili-

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69. Official Comments to Sections 8-302 and 8-304. The Code nowhere expressly states this although an indication to this effect would assist. This is apparent, however, from the position of a broker.

70. 141 N.Y. 100, 35 N.E. 1084, 23 L.R.A. 90 (1894).

71. *I.e.*, a security free from all defects.

72. 21 Colum. L. Rev. 538 (1921).

73. *Supra* note 67.

74. The one case to the contrary is the New York case, *Horan v. Mason*, 141 App. Div. 89, 125 N.Y. Supp. 668 (2d Dep't 1910).

75. Section 8-301(1).

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1. See Section 8-306 which sets out the warranties which are implied on presentment or transfer of securities.

gence, reasonableness and care as laid down by the Code are not altered.<sup>2</sup> The Code thus attempts to leave open the development of the law, for "one of the debit items to be charged against codifying statutes is the possibility of interference with evolutionary growth. It is the ancient conflict between flexibility and certainty."<sup>3</sup> The course of dealing between the parties will be of importance,<sup>4</sup> though it will have to be proved that there was reliance on the different warranties to enforce any changes.<sup>5</sup>

Section 8-306(1) deals with the situation where a security is presented to the issuer for registration of transfer, for payment, or for exchange. The position of a purchaser for value without notice of adverse claims is protected in accordance with the approach taken in Section 8-301(2); he only warrants his lack of knowledge that signatures necessary for indorsement in the transfer are unauthorized. The importance of this warranty can be seen in that, subject to Section 8-311, an owner is able to assert that a signature, on the basis of which the purchaser may have acquired the security, is a forgery.<sup>6</sup> It should be noted here, however, that there could be situations which would preclude the raising of this defence. Thus estoppel, contributory negligence and ratification may prevent this defence from being raised. An instance of contributory negligence is set out in Section 8-405(1), which provides that an owner who has lost a security will have to notify the issuer within a reasonable time or he will be precluded from setting up his rights under Section 8-311, where the issuer has registered a transfer prior to receiving such notice. The possibility of ratification is new. A Pennsylvania court has held that a forgery being "an heinous crime" cannot be ratified.<sup>7</sup> New Jersey courts have been less absolute in their approach.<sup>8</sup> But would not such ratification be void on the ground of public policy? The Code in allowing ratification avoids the difficulty which a distinction between a forgery and an unauthorized signature could have led to. It would not be necessary to investigate the existence of fraudulent purposes. By protecting the bona fide purchaser, provided he has received a new, reissued or re-registered security from the broker, or has himself sent in the transfer and received such security in return while still in good faith, the Code gives recognition to the fact that in the case of registerable

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2. Section 1-102(3).

3. *Manhattan Co. v. Morgan*, 242 N.Y. 38, 52, 150 N.E. 594, 599 (1926). Compare *Edelstein v. Schular & Co.*, [1902] 2 K.B. 144 and *Hoppel v. Cleveland Discount Co.*, 25 Ohio App. 138, 157 N.E. 414 (1927).

4. Section 1-205.

5. Section 1-103, *Gluckman v. Darling*, 85 N.J.L. 457, 89 Atl. 1016 (1914).

6. Section 8-311 refers to unauthorized indorsements. For the effect of an unauthorized signature on issue, see Section 8-205. The term "unauthorized" is defined in Section 1-201(43) as being without "actual, implied or apparent authority and includes a forgery." This does not necessarily effect a change in existing law; e.g., *Teas v. Third National Bank & Trust Co.*, 125 N.J. Eq. 224, 4 A.2d 54 (1939).

7. *Austin v. Marzolf*, 294 Pa. 226, 143 Atl. 908 (1928).

8. *Russell v. Second National Bank of Paterson*, 136 N.J.L. 270, 55 A.2d 211 (1947); *Harter v. Mechanic's National Bank*, 63 N.J.L. 578, 44 Atl. 715, 76 Am. St. Rep. 224 (1899).

securities bought through a broker, the purchaser is not aware of any indorsement that may appear thereon. He would normally receive a new or reissued security from the issuer.<sup>9</sup>

In giving recognition to this existing commercial practice, the Code does not leave the defrauded owner entirely without a remedy. Provided that he has not precluded himself from raising the ineffectiveness of the unauthorized signature,<sup>10</sup> the issuer will be liable for an improper registration of the transfer.<sup>11</sup> In turn the issuer can protect himself by taking a signature guarantee under Section 8-312 and will also have the right of recourse against the unauthorized signatory.<sup>12</sup>

The importance of the relevant indorsements being on, or attached to, the investment security cannot be overemphasized. Thus, Section 8-401(1)(a) imposes a duty on the issuer to register a transfer where the security has been indorsed by the appropriate person, and Section 8-404(1)(a) relieves the issuer from all liability to the owner or any person suffering loss as a result of such transfer. The indorsement required is that of an "appropriate person."<sup>13</sup> Section 8-308(3) sets out who would be such "appropriate person"; whereas, Section 8-308(6) indicates the time of signing as determining whether or not the signatory is an "appropriate person." A subsequent change in circumstance will thus not make the signature an unauthorized one.

Section 8-402(3)(a) entitles an issuer to request the production of a certificate of appointment or incumbency from a fiduciary appointed by the court; such certificate is to be dated within sixty days from presentation or transfer. A difficulty arises here from a confusion of the two fundamental types of responsibility to which a fiduciary is subject. As was pointed out by F. T. Christy:<sup>14</sup>

The failure of many lawyers and legislators to grasp the distinction between those two types is surprising and is one reason why some of the statutes heretofore adopted are useless and, indeed, dangerous. The first type is responsibility for unauthorized and void transfer, hereinafter called a 'wrongful transfer,' and the second type is respon-

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9. Cf., the position in relation to commercial paper which are themselves transferred until presented for payment. The position would be different in the case of bearer securities.

10. E.g., through estoppel; compare *Weniger v. Success Mining Co.*, 227 Fed. 548 (8th Cir. 1915) with *Board of Education of Jefferson Township v. Union Bank of Dover*, 16 N.J. Misc. 50, 196 Atl. 352, aff'd 121 N.J.L. 177, 1 A.2d 383 (1938) and note *Gluckman v. Darling*, 85 N.J.L. 457, 89 Atl. 1016 (1914), aff'd 87 N.J.L. 320, 95 Atl. 1078 (1915). Contributory negligence; Sections 8-311 and 8-405 (1); and ratification.

11. Sections 8-311(b) and 8-404. The owner will be able to recover a similar security, or, at least, damages under Section 8-104.

12. As W. D. Hawkland stated in relation to Section 3-404(1): "Surely no social policy is violated in making a forger or unauthorized agent personally liable on the instrument. The liability of the forger may not be worth much, but that is no reason not to impose it. The liability of the unauthorized agent may be worth a great deal. . . ." *Commercial Paper*, 33 (1959). There is no equivalent provision in relation to investment securities, but the policy underlying such rule is a sound one and should apply here. See also Official Comment 2 to Section 8-311.

13. Section 8-308.

14. *Responsibilities in the Transfer of Stock*, 53 Mich. L. Rev. 701 (1955).

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sibility for a transfer by a fiduciary in breach of his trust which is voidable by the beneficiary, hereinafter called a 'transfer in breach of trust.'

The primary example of a wrongful transfer is, of course, a transfer on a forged instrument. Other examples are transfers by a corporate officer or by an agent without authority, by a fiduciary who has not been legally appointed or who has been removed and who indorses the stock in the name of a decedent, or a minor or an incompetent, or by a fiduciary without obtaining a court order where a transfer without court order is void. These examples are to be compared with transfers by a fiduciary which are not in the regular course of administration of the estate or in accordance with the terms of the trust. The latter are transfers in breach of trust and may be attacked by the beneficiary or by a successor fiduciary as voidable transfers.<sup>15</sup>

This confusion raises the question whether an issuer could rely on a certificate of appointment or incumbency where the fiduciary indorsed a security after obtaining such certificates, but subsequent to his having been removed. The signature here would be an unauthorized one.<sup>16</sup> There is, however, no intention to relieve the issuer from the established risk of forgery, otherwise than by virtue of the protection afforded by taking a signature guarantee.<sup>17</sup> Should further protection appear essential an indorsement guarantee could be requested, through not demanded, as a condition of registering a transfer.<sup>18</sup>

Most stock-exchanges have enacted rules for taking signature guarantees.<sup>19</sup> Yet the meaning and effect of such signature guarantees is not always agreed upon.<sup>20</sup> Section 8-312 clarifies the position and indicates what are the warranties of the guarantor. It clearly distinguishes between a signature guaranty and an indorsement guaranty, which will warrant "the rightfulness of the particular transaction in all respects."<sup>21</sup>

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15. Id. at 704-705 (footnotes have been omitted).

16. Section 8-311.

17. Section 8-312(1). The distinction between a "wrongful transfer" and a "transfer in breach of trust," is emphasized further by Section 8-308(7), which indicates that a failure to comply with a fiduciary duty will not make the indorsement unauthorized for the purposes of Article 8. Various sections require the existence of an authorized indorsement, Sections 8-301(1) & (2), 8-311, 8-302, 8-315(2), 8-401(1) (a) & (2)(a), and indicate that the fulfillment of the fiduciary duties is not a necessary prerequisite of a valid indorsement, Section 8-403(3 and 8-404(1).

18. Section 8-312(2).

19. E.g., New York Stock Transfer Association Rules, Philadelphia-Baltimore Stock Exchange Rules, etc.

20. R. B. Tuttle, Jr., "The Signature Guaranty," a thesis submitted to the Graduate School of Banking, Rutgers University, 1953, indicates the following results, in relation to the understanding of 27 national banks of the effect of a signature guarantee:

A guarantee of:	Yes	No
Genuineness of signature itself	26	1
Legal capacity of signer	15	12
Authority of signer	14	13
Signature being that of person named on the face of the certificate	23	4
Genuineness of certificate	3	24
Correctness of transaction	4	23

21. Section 8-312(2). Merely placing a signature on the document may indicate an indorsement; would it indicate a signature guarantee? The Official Comment seems to imply

By giving a signature guarantee, the guarantor warrants (a) that the signature is genuine,<sup>22</sup> (b) that the signer was an appropriate person to indorse the security<sup>23</sup> and (c) that the signer had legal capacity to sign.<sup>24</sup> The guarantee only refers to the situation existing at the time of signing. Thus no liability attaches to the guarantor on the basis of supervening events. Capacity may change, a change in fiduciaries may occur and other grounds on which the signature can be attacked may arise.<sup>25</sup> Also an investment security may be outstanding beyond the period of limitation, and here, too, the guarantee would cease to be effective.

In view of the informality which at present accompanies the giving of signature guarantees, a review of policy would be advisable, particularly for banks. The ultimate effect of the signature guarantee is to shift a substantial area of liability from the transfer agent to the guarantor, and a guarantor may not be prepared to assume the risks inherent in such guarantee. A further question also arises as to the capacity of a bank or other legal person to guarantee a signature in those instances where there is no interest in the transaction other than the accommodation of a customer. Although this question has never been raised by banks,<sup>26</sup> a liquidator may have to raise it. It is submitted that as by custom and practice banks have always considered the guaranteeing of signatures to be within their powers, such powers would be implied to them. It would hardly be good business, nor lead to trust, for a bank to deny its liability on such guarantee.<sup>27</sup> The approach would have to be different, however, where an indorsement guarantee is involved. Here the question of capacity really comes to the fore. Having a responsible guarantor is thus essential. But not only must this be checked carefully, an investigation will have to be undertaken to see whether, in view of the divergent views taken as to such guarantees, the guarantor is aware of his responsibilities and has the necessary capacity.

The U.C.C. restricts the warranties given by a transferee.<sup>28</sup> Although its

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this, *Jennie Clarkson Home v. M.K. & T. Ry. Co.*, 182 N.Y. 47, 74 N.E. 571 (1905). It is, however, advisable to give some indications as to the nature of signature. See further, New York Stock Transfer Association Rules.

22. Section 1-201(18). The term "genuine" has been used instead of "not a forgery" so as to obviate the necessity of proving that there was an intent to defraud or to injure. See 1954(2) N.Y.L. Rev. Com. Rep. (U.C.C.) 840.

23. Section 8-308(3).

24. This refers to mental capacity and full age.

25. See Section 8-308(6).

26. In three New York cases, *Mohr v. J. C. Penny Inc.*, 242 App. Div. 385, 275 N.Y. Supp. 50, aff'd 270 N.Y. 606, 1 N.E.2d 352 (1934); *Schneider v. American Tel. & Tel. Co.*, 169 Misc. 939, 9 N.Y.S.2d 564 (1939); and *Rosler v. Gen. Gas & Electric Corp.*, 142 Misc. 596, 255 N.Y. Supp. 342 (1932) the banks did not raise this point at all, though it was open to them to do so.

27. A ruling by the Comptroller of Currency, applicable to national banks, indicates that it is an incident to the power to purchase and to sell securities for customers, for banks to guarantee the signature of such customers, provided the bank has satisfied itself adequately of the genuineness of the signature and the guarantee is limited to a guarantee of facts. Digest of Opinions, Office of Comptroller of Currency, Treasury Department, para. 230.

28. Section 8-306(2).



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provisions closely follow those of the N.I.L.<sup>29</sup> and of the U.S.T.A.,<sup>30</sup> two points require consideration. First, though the validity of the security is warranted, its payment when due is not. The indorser does not guarantee the obligations of the issuer.<sup>31</sup> Secondly, how far do the warranties extend? Do they extend to others than the immediate transferee? A registered security is not one to which the N.I.L. applies, but it is the intention of the Code to make investment securities negotiable. Should not then the warranty run to an ultimate holder?<sup>32</sup>

It is submitted that a more restrictive interpretation would be more consonant with the nature of the transfer involved, as Section 8-306 applies to both a transfer of bearer securities as well as one of registered securities. Such an interpretation does not conflict with existing concepts of negotiability. The restrictions in the N.I.L.<sup>33</sup> applicable at present to negotiable instruments restrict warranties to the immediate transferee, and a similar restriction is imposed by the N.I.L. on transfers of bearer instruments which have been indorsed.<sup>34</sup> In any case, a reference back to the issuer for registration of the transfer would soon disclose existing infirmities. All these factors would seem to indicate that the warranties are only intended to extend to the immediate transferee who, as a result of attempting to register his transfer, would immediately become aware of a breach of warranty.

The position of agents and intermediaries requires special consideration. Under the present N.I.L., an agent who does not disclose that he has a principal is deemed to give the warranties set out in Section 65, N.I.L. If the agent indorses the instrument, full responsibility would be implied to him.<sup>35</sup> This is continued by the U.C.C.,<sup>36</sup> but it is realized that intermediaries would not normally be aware of the validity of a security. Thus, if it is known that a person is acting as an intermediary, concerned merely with the delivery or collection of securities, he will be deemed only to give a warranty of authority.<sup>37</sup> In addition, a ruling long accepted in New York and Massachusetts has been adopted by the U.C.C.<sup>38</sup> An agent or bailee, who in good faith and without knowledge of any lack of power in his principal, deals with a security should not be liable in conversion.<sup>39</sup> The agent or bailee must have acted in a purely ministerial capacity. No distinction is made should the agent or bailee have

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29. 5 U.L.A. § 65, 66.

30. 6 U.L.A. § 11.

31. Section 8-308(4). Compare U.S.T.A., Section 11, which contains no express provision on this point and the N.I.L., Section 66, which does, whenever the indorsement is without qualification and the necessary proceedings on dishonour are followed.

32. 5 U.L.A. § 66.

33. 5 U.L.A. § 65.

34. 5 U.L.A. § 67.

35. 5 U.L.A. §§ 69, 65, 63.

36. See Section 1-103.

37. Section 8-306(3).

38. Section 8-318.

39. See *Pratt v. Higginson*, 230 Mass. 256, 119 N.E. 661 (1918); *Gruntal v. United States Fidelity & Guaranty Co.*, 254 N.Y. 468, 173 N.E. 682, 73 A.L.R. 1337 (1930).

received a remuneration, nor on the ground that the principal was *mala fide* or *bona fide*.

Although the reasoning behind this approach is understandable, it is difficult to see why Section 8-306(3) exempts an intermediary from liability where the intermediary "has purchased or made advances against the claim to be collected against delivery." In such cases, the intermediary would have an interest in the claim represented by the security and would not be representing only the principal. He should therefore not merely be warranting his authority. It may be desirable to grant an intermediary protection from actions in conversion where the principal has no authority to deal with the security. But such protection seems unnecessary in those cases where the intermediary has a proprietary interest.<sup>40</sup>

It is clear that a transfer, though appearing to be in order, may suffer from such invalidity as to make it voidable by the purported transferor. Section 8-315 provides an action to an owner who wishes to invalidate a transfer as against the purchaser. The transfer may have been induced by fraud or duress, or may have been made at a time when the owner had no capacity to transfer the security. In order for fraud to be established, there must be more than an expression of disappointment in the profits made by the corporation;<sup>41</sup> whereas, the test of duress is "was the person so acted upon by threats of the person claiming the benefit of the contract as to be bereft of the quality of mind essential to the maker of a contract thereby obtained?"<sup>42</sup>

When we consider that rescission can be had, where the delivery had been without authority, or after the owner had died or lost his legal capacity, we are mainly in the realm of agency law.<sup>43</sup> The U.C.C. in Article 8 extends the protection granted to a bona fide purchaser of investment securities beyond that presently extended to the holder in due course, both under the N.I.L.<sup>44</sup> and under the U.C.C.<sup>45</sup> in relation to commercial papers. Thus once a bona fide purchaser has obtained a new, reissued or reregistered security

40. A broker will in many cases be treated as a purchaser or even a bona fide purchaser. But though he would be able to take advantage of the protection granted to agents and bailees by Section 8-318, he is expressly excluded from Section 8-306(3) which deals with ministerial agents who may claim a possessory lien on the security for their fees.

41. Compare *Eddis v. Solomon*, 8 N.J. Misc. 529, 151 Atl. 87 (1930) with *Hager v. Thomson*, 66 U.S. 80 (1861). See also *Riviere, et al. v. Berla*, 89 N.J. Eq. 596, 106 Atl. 455 (1918).

42. 9 R.C.L. 716. Compare the application of this test in *Hemenway v. Smith*, 104 N.J. Eq. 529, 146 Atl. 301 (1929) where the threat of dissolution proceedings was acted upon but was not such as to prevent the complainant from resisting such proceedings, with *Ryle v. Ryle*, 41 N.J. Eq. 582, 7 Atl. 484 (1896) where such threats left the transferor helpless and were the real inducement for the transfer being executed.

43. E.g., *Manna v. Pirozzi*, 44 N.J. Super. 227, 130 A.2d 55 (1957) shows that the agent's authority to transfer shares to intending purchasers will not authorize him to transfer them to himself on trust, or to make gifts of the certificates. Death of the principal will terminate the agency unless there be an interest in the subject matter of the agency, i.e., not merely an interest in the execution of the power. Such is unlikely to exist. Other legal incapacities would be infancy or mental incapacity.

44. *Supra* note 29, § 23.

45. Section 3-404.

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while still in ignorance of any defect in the transfer, it will not be possible to obtain a rescission of the transfer even on the ground of an unauthorized indorsement.<sup>46</sup> In any event the bona fide purchaser will always be protected from claims for damages. In all other cases, however, an owner, who is not prevented by acquiescence or laches from bringing an action, can obtain a reclamation or at least damages from a purchaser. It is even possible to obtain damages from a purchaser who has transferred the security to a bona fide purchaser, though neither damages nor a reclamation is possible against the bona fide purchaser. To summarize: it will be possible to reclaim a security i. from a purchaser, ii. from a bona fide purchaser who has not obtained a new, reissued or reregistered security, iii. from a bona fide purchaser who was not in good faith when he received a new, reissued or reregistered security, but not iv. from a bona fide purchaser, who has received a new, reissued or reregistered security whilst still in good faith. Damages, on the other hand, can only be recovered from a purchaser, but not from a bona fide purchaser, nor from a broker or other agent or bailee who has acted in good faith. These rights can be enforced by an action, *i.e.*, a judicial proceeding for recoupment, or in a counterclaim, set off, suit in equity or any other proceedings in which rights are determined.<sup>47</sup>

To enforce any claims which a purported transferor or any other person may have against a security, it will be possible to obtain specific performance and to impound the security.<sup>48</sup> This will involve an attachment and subsequent levy on the security itself. It is here that the effect of making investment securities negotiable has been fully realized.<sup>49</sup> At common law, shares of corporate stock, being intangibles and incapable of physical seizure, and not being debts due and collectible from the corporation at the will of the stockholder, were not the subject of attachment and levy. Statute law<sup>50</sup> altered the common law on this point and it became possible to levy on a security at the domicile of the corporation, irrespective of the location of the stock certificate or the stockholder. The introduction of quasi-negotiability by the U.S.T.A.<sup>51</sup> led to the requirement that the security itself be within the jurisdiction of the court,<sup>52</sup> so that it could be seized by the sheriff. Alternatively, the holder of the stock certificate could be enjoined from transferring it, in which case it would not be necessary to obtain the surrender of the certificate.<sup>53</sup> But, if the security is to be considered as negotiable, then

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46. Section 8-311(a).

47. Section 1-201(1).

48. Section 8-315(3).

49. Section 8-317.

50. *E.g.*, New Jersey P.L. 1841-42, p. 130.

51. 6 U.L.A. § 1 et seq.

52. *I.e.*, the situs of the certificate became its actual situs. *Elgar v. Mintz*, 123 N.J. Eq. 404, 197 Atl. 747 (1938), 16 N.J. Misc. 289, 199 Atl. 68 (1938). There had to be an actual seizing of the stock certificate. A momentary holding and return would not suffice, *Mulock v. Ulizio*, 102 N.J.L. 251, 131 Atl. 622 (1926).

53. *Progressive Building & Loan Association v. Rudolph*, 133 N.J.L. 204, 172 Atl. 884 (1934).

the security itself will have to be attached, as otherwise the whole concept of negotiability would be destroyed. Should the security have been surrendered to the issuer, however, questions of negotiability will not arise, and it is possible to go against the obligor under the contract to prevent him from releasing a negotiable security onto the market and to demand that he hand it over to the officer attaching or levying on the security. The U.C.C. realizes that an injunction against the holder of a security will not prevent its negotiation in defiance thereof and will not affect the negotiability of the security so released onto the market. Section 8-317 therefore requires that in all cases there be an actual seizure of the security before there can be an attachment or levy, though an attachment and levy at source will still be possible where the security has returned to the issuer.<sup>54</sup>

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Under existing law, the difficulties surrounding the transfer of securities mainly apply to those securities which can be transferred only by an entry in the books of the issuer, *i.e.*, registered securities. It is in this field that the Taney doctrine<sup>1</sup> has wrought its greatest havoc. The purpose of Part 4 of Article 8 is to simplify the formal procedure surrounding the transfer of securities, without, in any way, negating rights which might be affected by an invalid transfer. In this connection it is important to bear in mind the distinction between the validity of a transfer and its rightfulness. In regard to the former, there is no intention to change the liability of issuer or transfer agent. As to the question of rightfulness of a transfer, however, it is intended to provide protection, so as not to make the issuer, transfer agent, etc. liable for a transfer unless the circumstances be such as to indicate knowledge of adverse claims.

The Code grants no protection in the case of an unauthorized signature.<sup>2</sup> The application for a transfer need only be accompanied by suitable assurances that the signature is genuine and that the person signing has the appropriate authority. There is no right to investigate the rightfulness of a transfer, and thus to demand an indorsement guarantee.<sup>3</sup> This indicates that the right to demand a signature guarantee does not shift the burden of inquiry from the issuer or transfer agent to the guarantor. It does impose, however, a duty

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54. It will still be necessary for the security to be within the jurisdiction of the court. It is not possible to use this method to make the holder bring the security within the jurisdiction. *Nederlandsche Handel-Maatschappij v. Sentry Corp.*, 163 F. Supp. 800 (1958). A decision of a Federal District Court in Pennsylvania, interpreting Section 8-317. According to the Official Comment to Section 8-317, the Federal Government's power to confiscate enemy property is however not affected by this provision, for the Federal Government would not be acting as a creditor. However, Section 8-317(1) seems to be absolute in its terms and only Subsection (2) refers to creditors. A provision to this effect in Subsection (1) would clarify this point more.

1. Taney, C. J., *Lowry v. Commercial & Farmers Trust Co.*, 15 Fed. Cas. 1040 (1848).  
 2. Section 8-311.  
 3. Section 8-401 and Section 8-312(2).

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to investigate the ability of the guarantor to stand by his guarantee, which in most cases means his financial responsibility.<sup>4</sup>

In addition to an assurance that the signature is genuine, the issuer may also require an assurance that the signatory is an appropriate person,<sup>5</sup> having the proper incumbency to give his signature to the transfer, and, where there are more than one fiduciary involved, the issuer is entitled to an assurance that all who have to sign have done so.<sup>6</sup> What is such "appropriate evidence of appointment or incumbency" is indicated by the Code.<sup>7</sup> The position of the court appointed or qualified fiduciary is clear.<sup>8</sup> In the case of other fiduciaries, three alternative forms of evidence are indicated: the appointing document; an assurance by a responsible person; or, in the absence of an appointing document, any other reasonable evidence. A reference to such document or other evidence for the purpose of satisfying the questions of authorized signatures and appropriateness of the person signing will not result in notice of the existence of adverse claims, so as to result in liability for a registration which amounts to a breach of trust.<sup>9</sup> In those cases where a fiduciary, whose name appears on the instrument, attempts to transfer securities, there should be no need to make further inquiries, for the issuer can rely on the continuance of incumbency until notice to the contrary is received by him.<sup>10</sup>

It is realized that circumstances may arise which demand that there be further investigation to satisfy the requirement of appointment or incumbency. The obligations under the Code are all subject to the obligation of good faith in performance. Thus although the duty to register a transfer is stated in mandatory terms,<sup>11</sup> this must be read subject to the overriding obligation of good faith.<sup>12</sup> On the other hand, the purpose of the Code is to prevent the present excessive documentation. Thus, if an issuer, for a purpose other than the obtaining of "appropriate evidence of appointment or incumbency,"

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4. Unless there be such financial responsibility the issuer would be taking the serious risk of himself having to carry the liability resulting from an invalid transfer.

5. Section 8-308.

6. Section 8-402(1)(b)-(d). In so far as the appropriateness of the person signing is concerned, a signature guarantee will normally have this effect. Section 8-402(1)(b). In the case of an agent's signature it is possible to require that the agent submit his power of attorney, or, where he represents a corporation, the relevant resolution, duly certified as such, authorizing him to act.

7. Section 8-402(3).

8. *Id.* §§ (a)(a).

9. *Id.* §§ (3)(b).

10. Section 8-207 and Section 8-403(3)(a).

11. Section 8-401(1). It is because many transfer agents have avoided complying with similar statutory provisions that mandatory language is used to make this provision effective. Note: New York agents will accept a transfer made in a state which has adopted the Code and made in accordance with Article 8, and will not insist on further requirements. See New York Stock Transfer Association Rules Governing Fiduciary Transfers under the New Simplification Statutes, Rule 1(3).

12. Section 1-203, see also *Seymour v. National Biscuit Co.*, 107 F.2d 58 (3d Cir. 1939), cert. denied, 309 U.S. 665, where the issuer knew the transferee only had a life interest.

requires and receives evidence beyond that which he may require,<sup>13</sup> he will be deemed to have notice of any adverse claims which such evidence would have disclosed.<sup>14</sup> The type of inquiry it is intended to prevent would be such as the Taney doctrine might demand; *e.g.*, should the issuer demand to see the will to see whether all taxes have been paid, he would not be able to evade the imputation of knowledge of adverse claims, which an inspection of the will would have disclosed. Any evidence demanded, which is manifestly unreasonable, would deprive the issuer, etc. of his protection against knowledge of adverse claims. There is thus a strong deterrent effect intended here. This is further supported by the right to refuse to submit evidence beyond that to which an issuer or transfer agent is entitled. If an investment security presented for registration be accompanied by documents going further than would be necessary, it would be advisable for an issuer to return such documents unread, so as not to be deemed to have had notice of any adverse claims contained therein, for argument may be raised as to the reason for such documents having been received.<sup>15</sup>

In two instances a duty to inquire may arise. First, when a written notification of an adverse claim has been received in time for the issuer to act prior to issuing a new, reissued or reregistered security,<sup>16</sup> such notification must identify the claimant, the security and the place where the claimant can be contacted. The requirement for a written notification should not cause too great of an inconvenience.<sup>17</sup> Although the common practice of commercial men is to accept notifications over the telephone, such practice should be discouraged. It could be argued that where the recipient reduces the telephonic conversation into writing, this should suffice. But, in the absence of such writing, and in those cases where it is the recipient of the telephonic communication who raises the absence of writing, difficulties of proof would exist. In any case, on the analogy to the receipt of stop payment orders on cheques, it would be best for a claimant not to rely on such parol stop orders, for there is no duty to accept a parol order.<sup>18</sup> It should be noted that the notification of an adverse claim must be received by the issuer. It is not sufficient for it to have been sent to him.<sup>19</sup> Secondly, there will be notice of adverse claims where the issuer has acted in such manner as to be charged with notice by reason of his having demanded excessive documentation.<sup>20</sup>

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13. Section 8-402(2) and (3).

14. Section 8-402(3).

15. New York Stock Transfer Association Rules Governing Fiduciary Transfers under the New Simplification Statutes, Rule 7 and Comments thereto by F. T. Christy.

16. Section 8-403(1)(a).

17. Section 1-201(46).

18. *Reinhardt v. Passaic Clifton National Bank & Trust Co.*, 16 N.J. Super. 430, 84 A.2d 741, *aff'd* 9 N.J. 606, 89 A.2d 242 (1952).

19. Section 8-403(1)(a). This Section follows the provisions of Section 1-201(26) and (27), which indicate that a notification is only then received when it comes to the attention of the relevant person, or is duly delivered to the place of business of the issuer and should in the ordinary course of business have reached the person acting on the matter, in time for him to take note of it.

20. Section 8-402(4).

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It is usual for stop transfer orders to be given where a holder has lost his certificate or has had it stolen from him.<sup>21</sup> But anyone in fear of a breach of a fiduciary duty can give such notice. The notice should be entered on the register and no transfer registered until the procedure laid down by the Code has been followed.<sup>22</sup>

In case notice has been received in time, the issuer must notify the adverse claimant of an attempted registration of a transfer. It will then be for the adverse claimant to obtain a court order preventing the registration of the transfer.<sup>23</sup> Should it not be convenient to obtain such court order, the issuer can protect himself from loss, though not from liability, by accepting an indemnity bond.<sup>24</sup> In those cases where the issuer has received timely notice of loss, he must issue a new security.<sup>25</sup> In view of the fact that investment securities have been made negotiable, it is necessary, however, for the issuer to demand a sufficient indemnity bond<sup>26</sup> and satisfaction of any other reasonable requirement, such as an affidavit setting out the cause of the loss. Two problems had to be reconciled here. The purpose of Article 8 is to make securities negotiable. On the other hand, the validity of a registration of a security has to be upheld and an overissue prevented. Thus, where an original security turns up in the hands of a bona fide purchaser, such pur-

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21. Section 8-405. This section refers to the security having been "wrongfully taken," thereby clearing up a doubt left by Section 17 of the U.S.T.A. whether lost or destroyed would include a loss by theft.

22. The stop transfer order will remain valid until removed by order of the person who gave the notice to the issuer. It will therefore not be possible to plead any "white heart-empty head" defence here. *Graham v. White-Phillips*, 296 U.S. 27 (1935). A difficulty is caused by the fact that Section 8-405(1) merely requires notification to secure the right of the owner of a lost, destroyed or wrongfully taken security, without indicating the form such notification is to take. It would appear, therefore, that any form of notification (Section 1-201(26)) would suffice for the purposes of that section and of Section 8-404 (2)(b). Admittedly, the facts set out in Section 8-403(1)(a) would in such cases be in the possession of the issuer, but a full notification in accordance with the provisions of Section 8-403(1)(a) could not be objected to. This criticism also applies to Section 8-403 (3)(a), which merely refers to a notification in writing that there has been a change in fiduciary without requiring further identification in the manner set forth in Section 8-403 (1)(a). It is to be regretted that some uniform method of notification has not been adopted.

23. Section 8-403(2). The adverse claimant has a period of thirty days in which to obtain such an order.

24. Compare New York Stock Transfer Association Rules, 15, 16, 38, 133, 134 and 135.

25. Section 8-405(2). Note: This is made mandatory by the U.C.C. Compare Section 17 U.S.T.A. which leaves it to the discretion of the directors to issue a substitute security without an order of the court.

26. The question of sufficiency of the bond raises some interesting problems. E.g., in *Davis v. Frazer*, 307 N.Y. 433, 121 N.E.2d 406 (1954) it was shown that the value of lost shares in the Texas Pacific Land Trust rose from \$500 per hundred shares in 1898 to \$1,280,000.00 per hundred shares in 1952 when oil had been discovered under the land. The bond might be very insufficient in such a case especially as some states, e.g., New Jersey, continue liability in damages unless the bond had been ordered by the court. (N.J.S.A. 14:8-43). Under Section 8-405(3), the issuer may have to produce a security in the market or pay damages in the amount paid by the last purchaser, with interest. (Section 8-104). This may amount to a rather large sum and may not be ascertainable immediately. At least the market price, if any, should be demanded, plus expenses of transfer agents, transfer taxes, etc. It is clear that if the parties cannot agree as to the sufficiency, they will have to have recourse to the courts. See also *Re Petition of Union Savings Bank*, 26 N.J.L.J. 236, 239-240 (1903).

chaser can demand to be registered. The issuer can reclaim the replacement security from the registered holder and will also be protected by the indemnity bond. Negotiability of a security demands, however, that the registered holder should be able to transfer a good title to the security in his hands. It is therefore not possible to recall such security from a bona fide purchaser. Under the U.S.T.A.<sup>27</sup> once a security has been replaced, the original one loses its status and any subsequent holder is relegated to an action in damages.<sup>28</sup> The U.C.C.<sup>29</sup> requires, however, that the issuer recognize both securities as valid where both are in the hands of a bona fide purchaser and no overissue would result from such recognition.<sup>30</sup> In the case of an overissue, damages will have to be paid to the presenter of the original security, since the replacement security would already be registered in the name of a bona fide purchaser. There is no question of this amounting to a gratuitous issuance of investment securities, for the issuer will have the indemnity bond as payment. There would be merely an increase in the paid-up capital. Investment securities represent an interest in a fungible mass and are not a certificate representing a chose in action limited in amount to the debt individually indicated on such certificate. As a result, the consequences of registering a transfer to a bona fide purchaser has enlarged the traditional principles of negotiability.<sup>31</sup>

Once all the formal requirements of transfer are satisfied, the transfer can be compelled.<sup>32</sup> In return, the issuer is granted immunity from liability to any one affected by such transfer.<sup>33</sup>

Two theories have been advanced as to the basis on which it is possible to compel the registration of a transfer. One<sup>34</sup> maintains that the claimant "is the equitable owner of the security and seeks by transfer to consummate legal title";<sup>35</sup> whereas, Christy<sup>36</sup> suggests that the real reason for this rule

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27. 6 U.L.A., § 17.

28. The holder of the replacement security must have taken it bona fide. *Edmund Wright-Ginsberg Co. v. Carlisle Ribbon Mills*, 105 N.J. Eq. 411, 148 Atl. 178, aff'd 108 N.J. Eq. 206, 154 Atl. 632 (1930).

29. Section 8-405(3).

30. Christy: *Transfer of Stock* (3d ed. 1958) criticizes this provision as "not only unsound in principle but unrealistic in practice."

31. There would appear to be only two situations when it would be possible for a bona fide purchaser to take advantage of the rights here indicated, without having Section 8-311 raised against him, for he must hold the "original" security. I.e., where the security had been endorsed prior to its loss, presumed destruction, or wrongful taking, or where a mala fide person had acquired the security and had it transferred to himself, a new, reissued or reregistered security being then transferred by him to a bona fide purchaser, prior to the true owner giving notice under Section 8-405(1) or Section 8-403(1). It is rather difficult to speak of an "original" security in such case.

32. Section 8-401. At least, it is possible to recover damages.

33. Section 8-404. Note however that liability to taxes will remain.

34. See *New Jersey, Lockwood v. Evans*, 88 N.J. Eq. 530, 102 Atl. 19, aff'd 88 N.J. Eq. 597, 102 Atl. 1053 (1918).

35. *Id.* 102 Atl. 19, 21. I.e., the issuer is the trustee of the legal title and can be compelled to transfer it to the transferee.

36. Christy: *Transfer of Stock* § 265 (3d ed. 1958).



is the specific enforcement of the contract appearing on the face of the certificate, that the security is transferable. Be that as it may, it is clear that an equitable action to compel registration of the transfer is possible, and it is further possible to restrain intermediate dealings with the security until the rights of the presenter have been determined.

One method by which it has been attempted to compel a registration of a transfer is by *mandamus*. The use of this method is unwarranted where no public officer is involved. New York rejects the application of *mandamus* for such purposes;<sup>37</sup> Pennsylvania severely restricts its use.<sup>38</sup> In New Jersey, the courts have held that *mandamus* would not lie in the ordinary case, but only if the issue is clear and there is no other satisfactory remedy available. Since damages have in all cases been held to give an adequate remedy, *mandamus* has never been granted to secure registration of a transfer.<sup>39</sup> The basis on which such damages will be assessed must be considered. The general rule is that an unreasonable refusal to register a transfer will amount to a conversion, for it is an exercise of dominion over the security.<sup>40</sup> The cases will have to be reviewed, however, in light of the policy indicated by the U.C.C.<sup>41</sup> Where other evidence as to value is available, the measure of damages would not necessarily be the par value of the security, even though the securities have a par value.<sup>42</sup> Also, if the complainant claims to retain the shares, he can only claim special damages and not the value of the shares. But if he sues in conversion, the value taken will be as of the date of conversion, *i.e.*, the date the refusal to register the transfer occurred. This will prevent speculations as to whether or not an action will be brought, even though it may result in a profit to the wrongdoer.<sup>43</sup> Where there is no market value for the security, the court may consider the value of the assets of the issuer, his recent liabilities, earning power, etc. in order to find a reasonable value.<sup>44</sup> It is also possible to recover dividends which have been declared in the interval prior to registration, as well as interest charges on the damages recovered, for the issuer will be liable for all loss resulting from his refusal to register the transfer or from an unreasonable delay on his part to register the transfer.<sup>45</sup>

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37. *People ex rel. Rottenberg v. Utah Gold & Copper Mines Co.*, 135 App. Div. 418, 119 N.Y. Supp. 852 (1st Dep't 1909).

38. *Solz v. Exhibitor's Service Co.*, 334 Pa. 211, 5 A.2d 899 (1939).

39. *State ex rel. Galbreith v. Peoples' Bldg. & Loan Ass'n*, 43 N.J.L. 389 (1881); *Bush v. Warren Foundry & Machine Co.*, 32 N.J.L. 439 (1868); *Archer v. American Water Works Co.*, 50 N.J. Eq. 33, 24 Atl. 508 (1892).

40. 54 A.L.R. 1157 (1928).

41. Sections 8-401 to 8-404. What had hitherto been a "reasonable refusal" to register a transfer may now be "unreasonable."

42. *Siegel v. Riverside Box & Lumber Co.*, 89 N.J.L. 595, 99 Atl. 407 (1916).

43. Alternate dates, such as the date of trial and the highest value between conversion and a reasonable time thereafter, had been considered but were rejected.

44. *Christy*: *op. cit. supra* note 36, § 271.

45. Note, it is, however, possible to delay registering a transfer where books are closed for audits.

## VI

We have seen that the Code imposes on the issuer the responsibility of ensuring the honesty of his authenticating trustee, registrar, transfer agent or other person entrusted with the signing of a security.<sup>1</sup> Such persons in signing the security for the issuer warrant their authority to do so and further warrant not only the genuineness of the security,<sup>2</sup> but also that the security will not result in an overissue.<sup>3</sup> In its final section,<sup>4</sup> Article 8 assimilates the position of the authenticating trustee, registrar, transfer agent or other similar person acting for the issuer, to that in which the issuer stands in relation to a holder. In this respect the liability of such agents to the holder is extended beyond what is at present law in most non-Code States. The general approach at present is to hold an agent liable for both misfeasance and malfeasance but not for nonfeasance.<sup>5</sup> It is submitted that such distinction in the law of agency is most irrational. The abolition of it, albeit within the narrow confines of the Code,<sup>6</sup> is to be welcomed. The Code makes the agent liable not only for a wrongful cancellation, wrongful registration of a transfer, or malicious refusal to register a transfer, but also imposes liability where the agent refuses to register a transfer, though all conditions required by the Code have been fulfilled.<sup>7</sup>

It is clear that the presenter has a remedy against the issuer for a refusal to register his security.<sup>8</sup> But since the presenter will have dealt with the transfer agent, he should be entitled to a remedy against him. In any case, it is difficult to see why the presenter of a security should have to prove malice before he can succeed in an action against the agent. It is the agent who has been held out, and has held himself out, to have the necessary authority to act, and if there be any right of indemnity in the agent, that is a question between the agent and his principal. Also when we look at a refusal of the agent to register a transfer from the point of view of the issuer, we find great difficulty in seeing this as a mere nonfeasance as opposed to a misfeasance by an active refusal. The whole distinction between nonfeasance and misfeasance and malfeasance seems to be not only irrational but also artificial.

The relationship of the agent to the issuer is governed by the general law of agency and is subject to any agreement between them. Such agreement may contain provisions exempting the agent from liability. Under the general law of agency, an agent is entitled to an indemnity, unless he has

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1. Section 8-205.

2. Section 8-208.

3. Section 8-104.

4. Section 8-406.

5. E.g., *Heuser v. Reilly*, 128 N.J.L. 533, 27 A.2d 4, aff'd 129 N.J.L. 388, 30 A.2d 27 (1943).

6. I.e., in relation to the holder of a security.

7. Section 8-401.

8. Section 8-401(2).

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been guilty of neglect in the discharge of his duties. In view of the more specific nature of the duties imposed on the type of agent here involved, and the fairly high degree of skill and care expected from him, the mere exercise of "ordinary prudence," in the sense in which that term is generally used, is insufficient. The agent has to exercise "good faith and due diligence" in the performance of his functions. A compliance with the requirements of Article 8 is thus necessary. The agent must perform his duties in accordance with reasonable commercial standards and must not insist on over-caution nor raise supertechnical objections and requirements.<sup>9</sup> In this manner, it is hoped, the transfer of securities will be achieved more smoothly and with less insistence on those technicalities to which the Taney doctrine has given rise.

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9. Official Comment 3, to Section 8-406.