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RESPONSIBILITIES IN THE TRANSFER OF STOCK*

Francis T. Christy†

During the past few years there have been increasing efforts on the part of a number of organized groups to establish statutory definitions of the responsibilities of corporations and their transfer agents in the transfer of stock. Among these groups are the Commission on Uniform State Laws, which sponsored the Uniform Fiduciaries Act, the American Law Institute and the National Conference of Commissioners on Uniform State Laws, which have jointly produced the new Uniform Commercial Code, the Committee on Simplification of Security Transfers of the Real Property, Probate and Trust Law Section of the American Bar Association, of which Committee I am a member, the Trust Division of the American Bankers Association, the New York Stock Transfer Association, some stock exchanges, and special committees representing a number of local bar associations. The efforts in this direction stem largely from the annoyance that is often caused by the rules laid down by transfer agents to govern transfers of stock other than normal transfers by individuals in their own right. These transfers are generally called "fiduciary transfers."

Most transfer agents (and when I speak of "transfer agents" I include both professional transfer agents and corporations which transfer their own stock) have taken little part and have displayed little interest in this movement. There are a number of reasons for this. One is that the practice of transferring stock has been well developed over the years and the transfer clerks have been thoroughly trained to follow such practice. Another reason is that the Rules of the New York Stock Transfer Association, the membership of which includes the large banks and corporations all over the country and Canada, have become so well established and recognized that they have almost the force of law. A third reason is that most of the so-called "exoneration statutes" adopted or proposed to date are so badly conceived, and present so many problems, that they offer danger rather than safety to the transfer agents. A further reason is that many transfer agents now carry insurance protecting them against claims arising from improper transfers of stock, so that they are not vitally interested in securing statutory protection.

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They are, of course, interested from a public relations standpoint in simplifying the transfer of stock, but no one has yet devised a method whereby they can do this with propriety and safety. They cannot just ignore the usual requirements in the case of fiduciary transfers and rely on their insurance, as the insurance companies expect them to use the degree of care established by law in making transfers.

In order to understand the responsibilities in transferring stock it is necessary to review, briefly, some ancient history. The cause of the confused thinking as to the duty and responsibility of a transfer agent, which persists to this day, can be traced back to an unfortunate remark by Judge Taney in *Lowry v. Commercial & Farmers Trust Company*[1] decided in 1848. Judge Taney said that a corporation is "the custodian of the shares of stock, and clothed with power sufficient to protect the rights of every one interested, from unauthorized transfers; it is a trust placed in the hands of 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." By this remark, Judge Taney rejected the English theory, which had been developed a number of years earlier, that a corporation was not bound to notice trusts of its stock and could look solely to the legal estate.[2] An outstanding authority on the law of trusts, Professor Austin W. Scott of Harvard Law School, has condemned the view expressed by Judge Taney and the American courts:

> "In the United States it has been held that where the name of the holder of shares of stock or other corporate securities as registered on the books of the corporation, is followed by the word 'trustee' or other words indicating a fiduciary character, and the holder transfers the securities in breach of trust, the corporation is liable for participation in the breach of trust if it registers the transfer without making inquiry as to the extent of the powers of the trustee, if such inquiry would have disclosed the breach of trust. The effect of this doctrine, which has never prevailed in England, is to put upon the corporation responsibility for preventing breaches of trust. But it seems absurd to compel the transfer agent of a corporation to determine the different questions which may arise as to the powers of a trustee. The effect is seriously to obstruct the administration of trusts and to increase the expenses of administration."[3]

[1] 15 Fed. Cas. 1040 at 1047, No. 8,581 (C.C. Md. 1848).

[2] Hartga v. The Bank of England, 3 Ves. Jr. 55, 30 Eng. Rep. 891 (1796).

[3] Scott, "Participation in a Breach of Trust," 34 HARV. L. REV. 454 at 465-466 (1921).

During the flourishing growth of the corporate business form following the *Lowry* case and up to the early 1920's when the practice of transferring stock became more or less standardized, there were many instances of litigation involving stock transfers.[4] No clear pattern of responsibility on the part of the transfer agent appeared in these cases. Many courts went to extremes to impose onerous duties on the transfer agent,[5] which gave rise, necessarily, to the imposition of requirements often considered harsh and unnecessary by an honest fiduciary attempting to transfer stock belonging to his estate. It is significant, however, that during the past twenty-five or thirty years there has been little litigation in this field. This is due mainly to three things. The first is that the practice of transferring stock and the requirements for transfer have become standardized and are better understood.[6] The second is the clarification by stock exchanges, brokers and transfer agents of the effect of the signature guaranty.[7] The third is the modern practice, which has become widespread, of holding fiduciary stock in the name of a nominee. This nominee practice is now supported by statutory authority in over thirty states.[8]

However, the old cases exist as a body of law defining the responsibilities in transferring stock, and the transfer agent must necessarily impose the historic requirements for transfer in order to protect itself.

There are only two ways in which this situation can be corrected and brought into line with modern business practice. A decision by an

[4] See collection of cases in CHRISTY AND MCLEAN, THE TRANSFER OF STOCK, 2d ed., p. 6, n. 8 (1940).

[5] Most of the decisions in themselves were quite proper but the general language used by the courts in their opinions was so broad that it gave warning to transfer agents of possible liability in other types of transfer. For instance, see Wooten v. Wilmington & W.R. Co., 128 N.C. 119 at 127, 38 S.E. 298 (1901). Compare this with the statement of the court in Peck v. Providence Gas Co., 17 R.I. 275 at 284, 21 A. 543 (1891): "Ordinary diligence, and not suspicious watchfulness, is the measure of duty which a corporation owes to its stockholders. . . ."

[6] Standardization has been promoted by Rulings of the Standardization Committee of the New York Stock Transfer Association, which are generally followed by the members of the association. Increased understanding has come from the publication of loose-leaf services on stock transfers by Commerce Clearing House and Prentice-Hall. Prior to the publication of the first edition of CHRISTY, THE TRANSFER OF STOCK (1929), the only textbook on the subject was LOWELL AND LOWELL, THE TRANSFER OF STOCK IN PRIVATE CORPORATIONS (1884).

[7] Rule No. 198 of the New York Stock Exchange reads "An endorsement or guarantee of an assignment or a power of substitution shall be a guarantee of the signature to such assignment or power of substitution and shall also be a guarantee of the legal capacity and authority of the signer." Rule No. SR-48 of the American Stock Exchange is the same. See THE SIGNATURE GUARANTY by R. B. Tuttle, Jr. of The Bank of New York (a thesis submitted to the Graduate School of Banking conducted by the American Bankers Association at Rutgers University, June 1953).

[8] The statutes are cited in CHRISTY AND MCLEAN, THE TRANSFER OF STOCK, 2d ed., §74a (1940; Supp. 1954).

authoritative court (probably it would have to be the Supreme Court of the United States) defining the duties and responsibilities of a transfer agent would, of course, replace the old body of law and give the transfer agents a reason for modernizing their requirements. It is not likely, however, that such a decision could be secured. The other way is the widespread adoption of a uniform and practical statutory definition of the responsibility of a transfer agent in making fiduciary transfers. I want to stress the words "widespread," "uniform" and "practical" for reasons which will appear later. Parenthetically, I might explain that I am calling such a statutory definition an "exoneration statute" because that is the term popularly used, although it is not a very good one from the standpoint of accurately describing the subject matter.

Two other suggestions have been made for simplifying fiduciary transfers. One is the extension of the use of the so-called "Standard Indemnity Agreement," which is given by a bank or trust company acting as fiduciary to the transfer agent in lieu of the usual documents to support the transfer.[9] This would not help the individual fiduciary, whose agreement would not be accepted by the transfer agent. The other suggestion is some form of cheap insurance which could be purchased by the fiduciary and offered to the transfer agent in lieu of documents. This is shortly to be considered by the Court and Judicial Bond Advisory Committee of the Surety Association of America.[10]

Before proceeding to a discussion of the statutory attempts to define the responsibility of a transfer agent, it is advisable to get clearly in mind that there are two fundamental types of responsibility. The failure of many lawyers and legislators to grasp the distinction between these 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 an unauthorized and void transfer, hereinafter called a "wrongful transfer," and the second type is responsibility 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."

[9] The Standard Indemnity Agreement reads 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."

[10] Under the English Forged Transfers Act of 1891, 54 and 55 Vict., c. 43, a company may charge a fee not exceeding one shilling per one hundred pounds on transfers in order to provide a fund to meet any claims arising from forged transfers.

The primary example of a wrongful transfer is, of course, a transfer on a forged indorsement. 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.[11] 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.[12]

No one quarrels much with the requirements imposed by a transfer agent to protect itself against wrongful transfers, such as a signature guaranty, a certified copy of a corporate resolution, evidence of the appointment of the fiduciary, and a court order where it is necessary for the validity of the transfer. The quarrel comes when the transfer agent asks to look at the will or the trust instrument and then requires an executor to prove that the debts of the estate have been paid or that the transfer is by way of sale of the shares or that the transferee is a legatee; or requires a trustee to prove that he has a power of sale, or that the life tenant is dead, where the transferee is a remainderman, or that the transferee has reached the age when distribution to him is directed by the trust instrument; or requires a guardian to prove that his ward has reached majority, where the transfer is to the ward; or requires any fiduciary to prove that a transfer to his individual name is proper. But, under existing law, the transfer agent must look at such papers and must require such proof. To eliminate this duty of a transfer agent is not unfair to the beneficial owner of the stock. The fiduciary was selected by the person creating the fiduciary relationship, and the transfer agent should not have to be a watchdog to keep him honest.

Attempted Statutory Solutions

England. The difference between a wrongful transfer and a transfer in breach of trust has always been recognized in England. As long ago as 1845 the Companies Clauses Consolidation Act contained a provision to the effect that "the company shall not be bound to see to the execution of any trust, whether express, implied, or constructive,

[11] See cases cited in CHRISTY AND MCLEAN, THE TRANSFER OF STOCK, 2d ed., §243 (1940).

[12] Id., §256.

to which any of the said shares may be subject. . . ."[13] A substantially similar provision reading, "No notice of any trust, expressed, implied or constructive, shall be entered on the register, or be receivable by the registrar, in the case of companies registered in England," appears in the Companies Acts,[14] and it has been the practice to incorporate the same provision in the charters of English companies. Canada and its provinces follow the English practice and have similar statutes.[15] There is also a statute of similar import in Massachusetts, and, at one time, there were such statutes in Pennsylvania and Illinois.[16]

Although the English type statute has merit in that it strikes at the true evil to be corrected, namely, responsibility for transfers in breach of trust, it is too broad in language to suit the American practice where statutes are supposed to spell out the subject matter in considerable detail. This devotion to detail has been the ruination of some of the American statutes which have tried to define the responsibilities of a transfer agent.

Fiduciaries Act. The Uniform Fiduciaries Act[17] made a good start in trying to adapt the English type statute to the American practice with a minimum of detail. Section 3 of this act provides, in substance, that a transfer agent in transferring stock registered in the name of a fiduciary is not bound to inquire whether the fiduciary is committing a breach of trust and is not liable for registering such a transfer unless it has actual knowledge that a breach of trust is being committed. The major weakness of the Uniform Fiduciaries Act is that it is limited to the case where the stock is registered in the name of the fiduciary, thus eliminating cases where the stock is registered in the name of the person for whom the fiduciary is acting in indorsing and transferring the stock, such as a decedent or a ward. According to a commentary by the draftsmen of the act, this limitation was used to avoid interference with the waiver provisions of inheritance tax statutes. The limitation could

13 Companies Clauses Consolidation Act of 1845, 8 and 9 Vict., c. 16, §20.

14 Companies Act of 1948, 11 and 12 Geo. VI, c. 38, §117. This provision appeared also in the Companies Acts of 1908 and 1929.

15 The statutes are cited in CHRISTY AND MCLEAN, THE TRANSFER OF STOCK, 2d ed., §224 (1940).

16 The Pennsylvania statute [Pa. Stat. Ann. (1933) tit. 20, §3151] was the earliest (1874) American exoneration act. The Illinois statute appeared in Ill. Rev. Stat. (Cahill, 1929) c. 32, ¶29. Both statutes were superseded by §3 of the Uniform Fiduciaries Act. Pa. Stat. Ann. (Purdon, Supp. 1955) tit. 20, §3351; Ill. Rev. Stat. (1953) c. 98, §236. The Massachusetts statute is discussed on p. 709 infra.

17 9A ULA. There are a number of states in which only §3 and not the whole act has been adopted. As used herein, Uniform Fiduciaries Act is deemed to include the statutes which are limited to §3.

have been avoided, however, by an express provision that the requirements of inheritance tax statutes would not be affected by the act. The wording of the act also technically bars from the benefit of the statutes stock standing in the name of a person known by the transfer agent to be a nominee, but this has been corrected in a number of states by amending the act to include stock registered in the name of a nominee of the fiduciary.

The Uniform Fiduciaries Act or statutes similar to section 3 of the act have now been adopted in thirty jurisdictions.[18] In one state, New York, an attempt has been made to correct the defect in the Uniform Fiduciaries Act above mentioned, namely, that it is limited to cases where the stock is registered in the name of the fiduciary. When section 3 of the act was adopted in New York in 1937, an additional section was added providing, in substance, that a transfer by an acting fiduciary of stock in the name of a decedent or a minor or a ward or an incompetent or a deceased or discharged fiduciary imposed no duty on the transfer agent to inquire whether the fiduciary was committing a breach of trust or to see to the performance of the fiduciary obligation, and that a transfer agent would not be liable for any such transfer unless it had actual knowledge of a breach of trust or knowledge of such facts as to make its action in transferring the stock amount to bad faith.[19]

There are two points of importance in the Uniform Fiduciaries Act as adopted in New York. One is that the transfer agent is relieved expressly of the duty to inquire as to the nature of a transfer by a fiduciary. This means that the transfer agent does not have to examine wills or trust instruments, although it does, of course, have to satisfy itself that the fiduciary is the proper person to assign the stock.

The second point of importance is that the transfer agent is held liable only where it has *actual knowledge* that the fiduciary is committing a breach of trust or has knowledge of such facts that its action amounts to *bad faith*. This means that knowledge only that the transfer may or may not be a breach of trust, such as a transfer to the individual name of the fiduciary, would not be enough to make the transfer agent liable if it turned out that the transfer was a breach of trust. There has been some criticism of this provision, however, in that it does not go far enough and that a recorded will or trust instrument

[18] The citations appear in CHRISTY AND MCLEAN, THE TRANSFER OF STOCK, 2d ed., §225 (1940; Supp. 1954).

[19] N.Y. Consol. Laws (McKinney, 1941) §359-k.

might be held to give actual knowledge. This argument seems to be rather far-fetched, as a transfer agent could not be expected to search the records at the domicile of the fiduciary. The argument could be overcome by a clause similar to the clause in the Massachusetts statute that actual knowledge is not given by a recorded instrument.

Uniform reliance on these two points in the act would do away with a good deal of the annoyance involved in fiduciary transfers of stock. If this is so, then why don't transfer agents rely on the Uniform Fiduciaries Act? One answer is that the act, except in the form adopted in New York, is not complete in that it is restricted to cases where the stock stands in the name of the fiduciary or a nominee. Another is that it has not yet been adopted in enough jurisdictions. It can be relied upon safely only where it has been adopted in every jurisdiction in which a claim might be made by the beneficiary—the domicile of the corporation, the domicile of the transfer agent, and, possibly, the situs of the trust or fiduciary relationship.

Ohio. A number of states have adopted special exoneration statutes which do not fall into any uniform pattern. The best of these is in Ohio, where the defining of the responsibilities of a transfer agent has been the subject of considerable study for a number of years by legislative commissions and the bar associations. The first Ohio statute was based on the English law and provided that, if stock should be registered in the name of a fiduciary, the transfer agent could treat the fiduciary as the unqualified owner for all purposes and would not be bound to recognize any equitable interest in the shares or to see to the execution of any trust or obligation.[20] This was superseded by a new statute in 1949[21] which went into much more detail. In addition to incorporating the substance of the old statute, the new statute provides that a transfer agent incurs no liability for a fiduciary transfer where it secures proof, satisfactory to it, of the appointment and qualification of the fiduciary. The statute also includes a few frills, such as a provision that when a corporation treats a minor as entitled to exercise any rights of ownership no subsequent avoidance of the transaction by the minor shall be effective against the corporation. According to the statute, participation by the transfer agent in a breach of trust makes the transfer agent liable only where it acts in bad faith.

California. In California there is a statute to the effect that a fiduciary is presumed to have the power to accept and transfer stock,

[20] Ohio Code Ann. (Throckmorton, 1948) §8623-33.
[21] Ohio Rev. Code Ann. (Page, 1953) §1701.38.

and the transfer agent is under no duty to inquire into any trust or other document or appointment under which the fiduciary is acting, or whether the fiduciary is committing a breach of trust or exceeding his authority.[22] The liability of a transfer agent for a breach of trust is limited to where it has actual knowledge of the breach or of the invalidity of the trust or other document or appointment under which the fiduciary is acting.

Massachusetts. A short statute in Massachusetts provides that a transfer agent is not bound to see to the execution of any trust to which any shares are subject, or to ascertain or inquire whether the trust authorizes a transfer by the holder of the shares.[23] The statute imposes a liability where the transfer agent had actual knowledge of the breach of trust, but the fact that the trust is of record does not constitute such actual knowledge. It is the practice of some Boston transfer agents to rely on this statute in certain cases.

Wisconsin. The most recent of the non-uniform acts is the statute adopted in Wisconsin in 1953[24] at the instance of the joint committee on revision of the Wisconsin corporation laws appointed by the State and Milwaukee Bar Associations. The Wisconsin act goes into more detail than the other statutes. It specifies six cases in which a transfer agent is not bound to make inquiry and is not to be held liable for lack of power, authority or capacity of the person indorsing the stock or for unrightfulness of the transfer. These six cases are (a) indorsements by an executor, administrator or testamentary or other trustee if proof is furnished that the signer was such at the date of signing; (b) indorsements by a guardian, conservator, receiver or other successor to, or custodian of, the interest of any person by operation of law if proof is furnished that the signer had been appointed as such by a court and was such at the date of signing; (c) indorsements by a nominee of a fiduciary or other person where the stock is registered in the name of such nominee; (d) indorsements by an incompetent unless the transfer agent has actual knowledge that the signer is under adjudication of incompetence or under guardianship; (e) indorsements by an infant unless the transfer agent has actual knowledge that he is under guardianship, and (f) indorsements by a surviving joint tenant if proof is furnished that the other joint tenant is dead.

22 Cal. Corp. Code (Deering, 1953) §2411.
23 Mass. Ann. Laws (1933) c. 203, §21.
24 Wis. Stat. (1953) §180.85.

The main trouble with the Wisconsin act is that it requires proof that a fiduciary indorser was the fiduciary *at the date of his indorsement.* From the practical standpoint, this means, for instance, that the fiduciary and the transfer agent would have to make sure that the date on a surrogate's certificate showing the appointment of an executor or administrator and the date of the indorsement were one and the same—the protection of the statute would be lost if there was any variance in the dates. From the legal standpoint, the date of indorsement has little importance, as the indorsement is ineffectual until the stock is delivered, and the transfer can be a rightful one, insofar as the authority of the fiduciary to make the transfer is concerned, only if the indorser is the fiduciary at the date of delivery as well as at the date of signing. It is quite possible, if not probable, that an executor, upon being appointed, would get a supply of surrogate's certificates and then indorse all of the stock certificates in the estate as of the date of the surrogate's certificates, but it might be months before he made any delivery or before the stock was presented to the transfer agent for transfer. If the executor should be a bad actor and should be removed by the surrogate, he could, after his removal, sell the stock and deliver the certificates, accompanied by one of the old surrogate's certificates, to a purchaser, who could then present them to the transfer agent. The transfer agent, noting that the date of indorsement and the date of the surrogate's certificate were the same would properly transfer the stock in reliance on the statute, unless, of course, it had knowledge that the old executor had been removed. It would be useless to try to change the wording of the act to require proof that a fiduciary was the fiduciary at the date of delivery, because the transfer agent would then have to secure evidence as to the date of delivery, which could only be a self-serving statement by the fiduciary or the transferee.

Another defect in the Wisconsin act is that it requires proof that a testamentary or other trustee was trustee at the date of signing. A certified copy of the will would, of course, be proof that a testamentary trustee was appointed, but how could it be proved, other than by a self-serving statement by the trustee, that he was the trustee at the date of indorsing the stock, which might be many years after the probate of the will? The situation would be even worse for a trustee of an inter vivos trust, as he would have to submit the original trust agreement to the transfer agent, which no trustee wants to do because of the risk of losing the agreement. A copy certified by a bank might not be considered "proof" under the statute.

The Wisconsin act also contains a provision which, presumably, is an attempt to make the act apply where a corporation may transfer stock outside of the state. Such provision is that a corporation acting outside the state in connection with the transfer of its stock shall have no greater obligation to the holder or owner of any certificate for the shares than one acting within the state. Whether or not the attempt will be successful seems open to some doubt.

The Commercial Code

The latest and most powerful attempt to define the responsibilities of a transfer agent by statute is the new Uniform Commercial Code. The code, of course, covers a wide range of subjects in addition to stock transfers. The relevant provisions are contained in article 8 of the code, although there are sections in other articles which are of interest to transfer agents and others in the field.

Unfortunately, the provisions of article 8 of the code reflect little knowledge on the part of the draftsmen of the practical aspects of the transfer of stock and little effort to consider the views of those who are familiar with such practical aspects. The code has been submitted to the legislatures of a number of states with a strong drive behind it. It has already been adopted in Pennsylvania.[25] In New York hearings on the code have been held by the Law Revision Commission, and the views of some transfer agents as to article 8 have been expressed at such hearings. The substance of such views is that article 8 requires some rather substantial amendments in order to make it workable. Similar views have been expressed by the Subcommittee on the Uniform Commercial Code of the American Bankers Association[26] and by the Committee on Simplification of Security Transfers of the American Bar Association.[27] The Committee on Uniform State Laws of the Association of the Bar of the City of New York acting jointly with the Special Committee on the Uniform Commercial Code of the New York State Bar Association recommends further study of the entire code before adoption. The soundness of these views is demonstrated by the fact that the backers of the code have already appointed a subcommittee to consider revision of article 8.[28] It is hard to understand why the bugs in article 8 were not exterminated before the code was turned loose.

[25] Pa. Stat. Ann. (Purdon, 1954) tit. 12A.

[26] Report dated October 17, 1954, p. 68.

[27] A.B.A. PROCEEDINGS, SECTION OF REAL PROPERTY, PROBATE AND TRUST LAW, Part 1, Probate and Trust Law Divisions, p. 130 (1954).

[28] Some amendments to article 8 are contained in Supplement No. 1 to the Uniform Commercial Code issued in January 1955.

It may be assumed that groups in states other than New York also will want amendments in article 8, which means that, if the code is to be amended before passage by various state legislatures, the vital element of uniformity will be destroyed. One of the New York transfer agents (John C. Bancroft of The Bank of New York), in testifying before the Law Revision Commission, said: "New York may adopt Article 8 with revisions such as are suggested here; but if each subsequent state adopts Article 8 with greater or less revisions, the transfer agents will be in a very difficult position in trying to bring together the varying wordings of the laws of the different jurisdictions which might apply to the particular transfer in question."

The provisions of the Uniform Commercial Code relating to the responsibilities of a transfer agent in making a transfer of stock are contained in sections 8-401, 8-402 and 8-403. Section 8-401 imposes a duty on the transfer agent to make a transfer and relieves the transfer agent from liability if (a) the certificate is fully indorsed in conformity with section 8-402, (b) the transfer agent has no knowledge of the unrightfulness of the transfer and no duty to inquire into its rightfulness, and (c) inheritance tax waivers are submitted if the stock is in the name of a decedent. Note that this section makes it the *duty* of the transfer agent to transfer the stock if these conditions are fulfilled. Does this mean that a professional transfer agent in a state which has adopted the code must transfer the stock even though the state in which the corporation may be domiciled has not adopted the code? For instance, under the code a transfer agent could not require a court order for a transfer by a guardian even though the law governing the guardianship may provide that a transfer by a guardian without court order is void. A transfer agent in a code state might be protected in making such a transfer, but would the corporation in a non-code state be protected against a claim by the ward for wrongful transfer?

Section 8-402 defines sufficiency of indorsement. It states in clause (1) that a certificate is fully indorsed for transfer when the indorsement is sufficient to make the person presenting it a holder of the security. This seems to assume that it is always the assignee of the certificate who presents it for transfer. In fiduciary transfers this is rarely the case; the person presenting the stock for transfer is generally the fiduciary or his bank or broker. Furthermore, it might be argued that this definition requires the transfer agent to make a transfer without any supporting documents, as section 8-401 compels the transfer agent to register a transfer if the certificate is "fully indorsed" and it has no knowledge of any unrightfulness and no duty to inquire. According to section 8-403, a transfer agent has no duty to inquire unless it has notice of another claim to an interest in the stock, and notice of a fiduciary situation does not impose such a duty.

Clause (2) of section 8-402 provides that, unless the transfer agent has notice that the indorser lacks power to indorse, it shall not require more than the following evidence to establish the necessary indorsement:

> If the person whose indorsement is required is *at the time of signing*
>
> (a) an adult not under guardianship, his indorsement and a signature guarantee;
>
> (b) an infant or an adult under guardianship, the indorsement of his guardian, a signature guarantee, and proof that the indorser was such guardian at the date of signing;
>
> (c) a decedent, the indorsement of his executor or administrator, a signature guarantee, and proof that the indorser was such executor or administrator at the date of signing;
>
> (d) a partnership, the indorsement of a partner or an authorized agent, a signature guarantee, and proof that the indorser was such partner or agent at the date of signing;
>
> (e) a corporation, the indorsement of any officer, a signature guarantee, and proof that the indorser was such officer at the date of signing;
>
> (f) an executor, administrator, trustee, receiver, or other fiduciary, the indorsement of such fiduciary, a signature guarantee, and proof that the indorser was such fiduciary at the date of signing;
>
> (g) a person not covered by any of the foregoing, papers appropriate to the case corresponding as nearly as possible to the foregoing.

Date of signing. The first and most obvious defect in clause (2) of section 8-402 of the code is that proof must be furnished that the person indorsing the certificate as a fiduciary was such fiduciary *at the date of the indorsement.* This defect has been discussed above in connection with the Wisconsin statute and it need not be mentioned further. The American Law Institute and the National Conference of Commissioners on Uniform State Laws have attempted to correct this defect by adding a new paragraph providing that, the fact that the indorser was the fiduciary at the date of signing may be established by an appropriate certificate of appointment or incumbency dated within a reasonable period prior to the date of presentation.[29] This would appear

[29] See Supplement No. 1 to the Uniform Commercial Code.

to be a patch-up job which might encourage further patch-up amendments so that in the final result article 8 might become a hodge-podge of words. It would also seem somewhat illogical to tie the date of indorsement to the date of presentation for transfer—such dates might be two or more years apart. And is it proper to make something proof of a fact which is, on its face, not proof of the fact?

Another defect which appears in both clause (2) of section 8-402 of the code and the Wisconsin act, namely, the difficulty, if not impossibility, of securing adequate proof that a person indorsing as trustee was the trustee at the date of signing, has also been discussed above.

Indorsement by a partnership. A further defect, which does not appear in the Wisconsin statute, is that in the case of a transfer by a partnership the code requires proof that the indorser was a partner at the date of signing. Although theoretically necessary for protection, no such proof is now generally required by transfer agents, so that the code, in this case, imposes an additional burden on the transfer of stock. Inasmuch as a great deal of stock is registered in the names of brokerage and nominee partnerships, this burden would be a very real one. And what would such proof be? The original partnership articles would be proof that the indorser was a partner at the time the partnership was created, but the only proof that he was a partner at the date of signing would be either a statement to that effect by all of the partners or a self-serving declaration by the indorsing partner. It may be said that a transfer agent could ignore this requirement for a partnership transfer and follow the current practice. But suppose it does and it turns out that the indorser was not a partner at the date of signing, and the partnership claims a wrongful transfer. The transfer agent would look to the signature guarantor to make good, but, obviously, the guarantor is going to claim a discharge of his obligation because the transfer agent did not follow the code standard of care, and it may well be that his claim would be successful.

Indorsement by a corporation. One other defect in clause (2) of section 8-402 is that the indorsement of any officer is sufficient for a transfer of stock in the name of a corporation.[30] This is a drastic departure from the established legal practice, which prevails not only in the transfer of stock but in all other transactions by a corporation, that the authority of the officer must be supported by a by-law provision or

[30] Supplement No. 1 to the Uniform Commercial Code recognizes this defect and amends the clause to require, also, evidence of the power of the signing officer.

by a resolution of the board of directors. A transfer by an unauthorized officer is not a breach of trust—it is a void transfer just the same as a forged indorsement. There is grave doubt that any statute can confer authority where authority does not exist, except possibly a general statute as part of the corporation law that any officer of a corporation shall have authority to bind the corporation. In view of the fact that many banks and corporations have scores of officers with limited authority, no such broad statute would be proper.

Court orders. A further defect in clause 2 of section 8-402 is that a transfer agent is not permitted by the code to require a court order for a transfer of stock by an executor, administrator or guardian even though the law of the state from which such a fiduciary derives his authority requires a court order and makes any transfer without a court order void. Here, again, the question may be raised as to whether a statute at the domicile of the corporation can make such a void transfer a valid one.

Guarantee of signature. The third clause of section 8-402 defines a signature guarantee for the purpose of the section. A signature guarantee is defined to mean a guarantee signed by or on behalf of a person *reasonably* believed by the transfer agent to be responsible. This destroys the right of the transfer agent to decide for itself, without the risk of its decision being questioned, whose guaranty it is willing to accept, and is a distinct step backward from the standpoint of the transfer agent.

This brings up some other provisions of the Uniform Commercial Code relating to signature guarantees. These provisions are contained in section 8-312. They define the responsibility of a signature guarantor and set up two forms of guarantee. The first is a guarantee of signature which is defined to mean that the signature is not forged, that the signer is the holder or has authority to sign in the name of the holder, and that the signer has legal capacity to sign. It is expressly provided that the guarantee of signature is not a warranty of the rightfulness of the transfer. The second form is a guarantee of indorsement, which is not only a guarantee of signature but also a warranty of rightfulness. But the transfer agent is expressly forbidden to require a guarantee of indorsement as a condition to a transfer of stock.

No reason for setting up two distinct forms of guarantee is apparent. It has been well established by the *Jennie Clarkson Home* case that the form of guarantee now used universally covers not only a forgery, but also the authority and capacity of the indorser.[31] The question of whether it covers rightfulness of the transfer has never been decided, but it would follow from the reasoning of the court in the *Clarkson Home* case that it should. The court's reasoning was that the guarantor is in a much better position to verify the capacity and authority of the indorser than the transfer agent. It would appear, therefore, that these provisions of the code represent a further backward step from the point of view of a transfer agent. From the practical standpoint, the wording of the code would seem also to eliminate reliance on the mere signature of a broker under the indorsement as a guarantee of signature.

As a matter of fact, the subject of signature guarantees really has no place in an exoneration statute if the signature guarantee is intended to replace other proof of the rightfulness of the transfer. A signature guarantee does not make rightful something which may be wrongful. It is only a practical safeguard to the transfer agent, just as an indorsement on a note is only a practical safeguard to the payee, and is always subject to the risk that the guarantor may go bankrupt or go out of business or that the statute of limitations may run out before the guarantee is invoked.

The idea of injecting the signature guarantee into an exoneration statute has stirred up the conflict between bankers and brokers on the one hand and transfer agents on the other hand as to the meaning of the signature guarantee. The tendency is to put less responsibility on the guarantor, possibly because the bankers and brokers are more numerous and more vociferous than the transfer agents. In my opinion this is wrong. No responsible banker or broker will guarantee the signature of a stranger—the person requesting a guarantee must either be a customer, which is generally the case, or some one introduced by a customer. The banker or broker is, therefore, in a much better position to evaluate the honesty of the indorser than is the transfer agent, to whom the indorser is a stranger. Furthermore, although the banker or broker may derive no direct pecuniary benefit from guaranteeing a signature, he does derive an indirect pecuniary benefit in providing a service for his customer. A banker or broker who declined to guarantee his customers' signatures would lose a lot of customers. Compared to this, the professional transfer agent derives no pecuniary benefit from transferring the stock other than the fee paid by the corporation, which fee is the same for fiduciary transfers and individual transfers and

[31] Jennie Clarkson Home v. M. K. & T. Ry. Co., 182 N.Y. 47, 74 N.E. 571 (1905).

allows no margin for taking any risks.[32] And the corporation which transfers its own stock makes no money out of its stock transfer department.

Duty to inquire. Section 8-403 of the Uniform Commercial Code deals with the duty of the transfer agent to inquire into the rightfulness of a transfer of stock. It provides that, where the certificate is fully indorsed for transfer, the transfer agent need not make any inquiry unless it has notice of another claim to an interest in the stock. Notice that the registered owner holds the stock for a third person or that the stock is registered in the name of a fiduciary does not create a duty of inquiry. Inquiry must be made, however, if the transfer is to a fiduciary in his individual capacity, or if the transfer agent has notice that the proceeds of a sale of the stock have been placed in the individual account of the fiduciary or are made payable in cash or to the fiduciary individually, or otherwise has reason to know that the transfer is for the individual benefit of the fiduciary.

An obvious unfavorable comment on section 8-403 can be made by the large banks and trust companies which maintain stock transfer departments. If they are to be protected by the code in the case of transfers of stock by fiduciaries by way of sale, they would have to inquire of their banking and other departments as to whether such departments have any knowledge of the transfer or the disposition of the proceeds. Although the code contains a definition of notice to an organization in section 1-201 (27), it is not clear that the transfer department would be relieved of the duty of inquiry in this case.

Replacing missing certificates. Some other provisions of the Uniform Commercial Code which are unfavorable to transfer agents might be mentioned. Under the wording of section 8-404 a situation may arise where a transfer agent may be forced to issue a new certificate in place of a lost or stolen certificate without an indemnity bond.

Section 8-405 modifies the existing law relating to lost certificates. If, after the issue of a new certificate in place of a lost one, the lost certificate is presented by a bona fide purchaser, the transfer agent must register the transfer and then chase the holder of the new certificate or his transferee to try to get it back. The transfer agent cannot call on the original holder or the surety on the indemnity bond until it is apparent after reasonable investigation that the new certificate cannot

32 Some professional transfer agents make a charge of $2 or $3 for fiduciary transfers.

be recovered.[33] This changes the present practice of immediately calling on the surety to make good without making any investigation.[34] Also, the code validates the lost certificate and outlaws the new certificate, which is contrary to the view at common law and under other statutes.[35]

Liability of transfer agents. Section 8-406, which defines the liability of professional transfer agents and registrars, provides that such liability shall be the same as that of the corporation. This would seem to make the professional transfer agent liable for a refusal to transfer stock, which is not the case at common law.[36]

There are other sections of the Uniform Commercial Code relating to the transfer of stock which, also, have been the subject of some criticism. I have, however, confined my comments to the sections which relate directly to the responsibilities of the transfer agent.

The foregoing comments on the Uniform Commercial Code indicate that, at the very least, article 8 needs rather drastic amendment. It would seem better, however, to reject article 8 completely rather than permit each state legislature to tinker with it and thereby destroy the vital element of uniformity.

Now, as a preliminary to considering what form an ideal exoneration statute should take, let us examine the most frequently occurring types of fiduciary transfers. In doing this, we should keep in mind the distinction between wrongful transfers and transfers in breach of trust. We should also keep in mind that what we are trying to accomplish is the simplification of stock transfers with adequate protection to the transfer agent. We are not trying to codify the complete law relating to the subject.

1. *Transfer of stock in the name of a decedent on the indorsement of an executor or administrator.* This may be a transfer to the name of the executor or administrator as such, to the name of an individual, partnership, or corporation who may be either a purchaser or a legatee or a nominee, to the name of a trustee under the will, or to the name of a guardian for an individual. Regardless of the character of the transferee, the transfer agent must protect itself against a wrongful transfer by securing evidence that the indorser is the executor or administrator of the estate of the decedent. This is no more than is

[33] Supplement No. 1 to the Uniform Commercial Code removes the requirement for such investigation.

[34] See CHRISTY AND MCLEAN, THE TRANSFER OF STOCK, 2d ed., §278 (1940).

[35] See cases and statutes cited in CHRISTY AND MCLEAN, THE TRANSFER OF STOCK, 2d ed., §§272 and 274 (1940; Supp. 1954).

[36] See cases cited in CHRISTY AND MCLEAN, THE TRANSFER OF STOCK, 2d ed., §281 (1940).

required by anyone dealing with an executor or administrator. Perfect evidence would be a surrogate's certificate dated as of the date of indorsement and delivery of the stock, but this is impracticable. There is some doubt that any statutory definition of proof short of this (such as a statement that a surrogate's certificate dated within a certain time before transfer would constitute such proof) would be valid.

The present practice is for the transfer agent to require a surrogate's certificate dated within a reasonable time prior to the transfer and to take the risk that the executor or administrator may have been removed or discharged prior to the time of indorsement and delivery. Such risk is insured by the signature guarantee, which is required in all cases. If the signature guarantor is unable to pay up, the transfer agent can resort to its own insurance. The transfer agent must also require a court order where a transfer without such an order is void. These requirements, which are customary and are not onerous, reasonably protect the transfer agent against a wrongful transfer, and no statute is necessary either to simplify such transfers or to exonerate the transfer agent. But a statute is necessary for both reasons insofar as the transfer by the executor or administrator might constitute a breach of trust. Such a statute should do away with the necessity of inquiring as to the nature of the transfer or the character of the transferee and of examining the will or any other records and of securing any additional documents except, of course, a tax waiver where necessary.

2. *Transfer of stock registered in the name of an executor or administrator on the indorsement of the executor or administrator.* There are two points to be considered in such a transfer. The first is whether the executor or administrator may have been removed and a new executor or administrator appointed. If such is the case is the transfer by the removed executor or administrator wrongful and void? The answer would seem to be that it is not—the executor or administrator in whose name the stock is registered has the right and is under the duty, after his removal, to transfer the stock to his successor, and if he makes any other transfer it is only a transfer in breach of trust which is voidable by his successor. Ownership of the registered holder of stock is presumed to continue until notice to the contrary, and the transfer agent should be under no affirmative duty to inquire as to whether the registered holder is still acting as executor or administrator. In this respect, there is a difference between the case where the stock is registered in the name of the decedent and the case where it is registered in the name of the executor or administrator.

The second point is whether the executor or administrator in whose name the stock is registered is committing a breach of trust in making the transfer. In this respect, the case is the same as where the stock is registered in the name of the decedent. To make it possible, however, for a transfer agent to permit a transfer without requiring evidence of the appointment of the executor or administrator and without making inquiry as to the nature of the transfer or the character of the transferee, a proper exoneration statute is essential. If such a statute were applicable, the only requirements for transfer would be a signature guarantee and a court order where a transfer without court order would be void.

3. *Transfer of stock registered in the name of a testamentary or inter vivos trustee on the indorsement of the trustee.* Such transfers are generally in the form of a transfer to an individual, partnership or corporation who may be either a purchaser or a beneficiary or a nominee. This is like the case of a transfer of stock registered in the name of an executor or administrator, and no wrongful transfer is involved. The question is one entirely of possible breach of trust. If there were a statute eliminating any duty to inquire as to the nature of the transfer or the character of the transferee and to examine the trust instrument, the transfer could be made on the indorsement of the trustee with a signature guarantee, and no more.

4. *Transfer of stock in the name of a minor.* Such a transfer may be on the indorsement of the minor himself or on the indorsement of a guardian. In the former case, there is some existing law protecting the transfer agent against any subsequent avoidance of the transfer even if it had knowledge that the indorser was a minor. There is room, however, for a statute authorizing a transfer of stock by a minor similar to the New York Banking Law[37] which authorizes a bank to honor checks drawn by a minor. Although the New York General Corporation Law[38] allows corporations to pay dividends to minors and to permit them to vote, it does not go so far as to authorize a transfer by a minor of his stock. The New York Stock Exchange has taken the lead in advocating a statute which would permit the registration of stock in the name of a custodian for a minor, without court proceedings to appoint the custodian the guardian of the minor. This would allow parents to invest in stock for the benefit of their children as they now open sav-

[37] N.Y. Consol. Laws (McKinney, 1950) §134.1.
[38] N.Y. Consol. Laws (McKinney, Supp. 1954) §12-a.

ings bank accounts for their benefit. Such a statute has merit but it should not be made part of a uniform exoneration act. In the other case, namely, a transfer of the minor's stock on the indorsement of a guardian, the same considerations apply as in the case of a transfer of a decedent's stock by an executor or administrator.

5. *Transfer of stock registered in the name of a guardian of a minor or incompetent on the indorsement of the guardian.* The same situation exists here as in the case of stock registered in the name of an executor or administrator.

6. *Transfer of stock registered in the name of a corporation on the indorsement of an officer.* Here the transfer is wrongful unless the indorsing officer has authority to transfer the stock for the corporation, and to protect itself the transfer agent must have proof of such authority. This proof is the standard proof required by everyone transacting business with a corporation—a certified extract from the by-laws or a certified resolution of the board of directors. No statute should or could properly eliminate this requirement.

7. *Transfer of stock registered in the name of a partnership on the indorsement of one of the partners.* If the person indorsing the certificate was not a partner, then the transfer is void, as the indorsement, in effect, is a forgery. To try to get proof that the indorser was a partner at the time of indorsement and delivery in every case of a partnership transfer is so impracticable that, years ago, transfer agents gave up and adopted the practice of relying solely on the signature guarantee. The difficulty of trying to cover this situation by statute, as in the Uniform Commercial Code, has been mentioned above. The transfer requirement of a mere partnership indorsement and a signature guarantee cannot be simplified any further, and, as long as transfer agents are willing to rely on the signature guarantee in such cases, no statute is necessary or desirable.

8. *Transfer of stock registered in the name of a principal on the indorsement of an agent.* Here, also, the primary risk is that the indorser was not the agent at the time of indorsement and delivery, either because the principal had died or had revoked the power of attorney. If such is the case, it is a wrongful transfer and void. The original power of attorney, plus proof that the principal was alive and that the power of attorney was in effect at the time of indorsement and delivery, is the only proper support for a transfer by an agent, and a statute could not very well authorize less proof. Under the present

practice, transfer agents do not require such stiff proof, and rely largely on a certification by a bank or on the signature guarantee.

9. *Transfer of stock on the indorsement of a fiduciary to the individual name of the fiduciary.* There is no question here of wrongful transfer—at the most such a transfer may be a breach of trust if the fiduciary is acting improperly. In view of the widespread practice, now supported by statute in thirty-four states and territories and by specific provisions in most trust instruments, of registering fiduciary stock in the name of a nominee there is little occasion for a transfer to the individual name of a fiduciary. No fiduciary who wants to defraud his estate is going to transfer stock to his individual name when he can transfer it to a purchaser and pocket the proceeds or transfer it to a nominee. Nevertheless, the Uniform Commercial Code (sec. 8-403) imposes a duty on the transfer agent to inquire when a fiduciary presents stock for transfer to his individual name. There should be no such duty.

Objectives for an Exoneration Statute

The foregoing examples give an idea of the purpose to be accomplished by a proper exoneration statute. The purpose should be to do away with the duty of the transfer agent to make inquiry as to whether a fiduciary is committing a breach of trust, and the statute should exonerate the transfer agent from liability to the beneficial owner if, in fact, the transfer was a breach of trust by the fiduciary. This would eliminate the annoyances, delays and hardships involved in the transfer of stock which are the basis of complaints by fiduciaries. This should be the sole purpose of the statute, and all other provisions relating to wrongful transfers, which are of doubtful legality, signature guarantees, and other matters should be discarded.

What form should an exoneration statute take? In my opinion, the requisites for a workable statute are as follows:

1. It should be simple and short so that it can be well understood and easily applied. Most of the statutes on the subject are too long and involved. The English statute is contained in one short sentence.
2. It should be confined to the one purpose mentioned above.
3. It should not be a mandatory statute.
4. It should avoid provocative provisions which lead to arguments among lawyers, legislators, transfer agents, banks and brokers when it is considered for legislative enactment, which, in turn, would lead to different amendments in different states, thereby destroying the most

important factor of all, namely, uniformity. In this respect, the Uniform Commercial Code is a fine example of what an exoneration statute should not be.

5. To insure widespread adoption, it should be patterned on a statute already familiar to the legislatures of as many states as possible. For instance, the adoption of the Uniform Fiduciaries Act or of statutes similar to section 3 of that act in thirty jurisdictions means that more than half of the legislatures have accepted the policy of simplifying fiduciary transfers, at least to the extent provided in the act. Also, the Uniform Stock Transfer Act which deals with transfers of stock between transferors and transferees, has received the unanimous approval of the legislatures of all the states (although the Uniform Commercial Code would supersede it). Would it not be far easier to persuade those legislatures to adopt a simple amendment to one of these acts than to persuade them to adopt a brand new statute, particularly a statute of the type of the Uniform Commercial Code?

The Committee on Simplification of Stock Transfers by Fiduciaries of the American Bar Association has had under consideration a proposed Model Exoneration Act, but the members of the committee are, by no means, in accord as to the form of such act or, indeed, as to the form of any statute so far devised or suggested for the purpose. I believe, however, that the Model Act is far better than the Uniform Commercial Code, and that, with some skillful surgery, it can come as close as humanly possible to being a workable and acceptable statute.

I believe that the laudable movement to simplify stock transfers is doomed to failure unless a statute is devised which will define the responsibility of a transfer agent in a uniform and practical manner and which will be accepted for widespread adoption by the state legislatures. The great bulk of stock transfers is handled by professional transfer agents. The stock transfer department of a large bank or trust company may transfer hundreds of thousands of shares in one day. It may act as transfer agent for hundreds of corporations domiciled in twenty or thirty or more different states. The only way to keep the transfers rolling is to have a single understandable procedure to be followed by the transfer clerks. The present variation among the several states in respect of tax waiver and court order statutes makes fiduciary transfers difficult enough for the professional transfer agents. To pile on top of this exoneration statutes of varying and uncertain wording would just increase the difficulty. From another point of view, many large corporations have separate transfer offices or transfer agents in three or more different states. This situation presents problems of notice or knowledge chargeable to the corporation and problems of conflicting laws. Any exoneration statute, to be workable, must be geared to the conditions under which the professional transfer agents and the large corporations necessarily work. In other words, make it short, make it simple, and above all, make it uniform.