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INVESTMENT SECURITIES

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Fictitious Person as a Registered Holder of Stock

Probably the most significant and the most interesting case to be reported is *Hartford Accident & Indem. Co. v. Walston & Co.*, 21 N.Y. 2d 219, 234 N.E. 2d 230, 287 N.Y.S. 2d 58. (1967). The case was reargued and affirmed under the same title at 22 N.Y. 2d 672, 291 N.Y.S. 2d 366 (1968).

This was not a decision under the Code, as the events took place before its effective date in New York. In attempting, however, to come to grips with what seems to be a case of first impression, both the majority and the minority in this 4-to-3 decision did not hesitate to range over statutory materials characterized by varying types of inapplicability: Article 8 of the Code (not yet law); Article 3 of the Code (not yet law, and if it were, inapplicable per section 3-103); the Negotiable Instruments Law (applicable only to instruments payable in money; restrictive fictitious payee provision therein expanded in scope by the Code in section 3-405).

The only statutes clearly applicable were the New York Personal Property Law sections corresponding to the Uniform Stock Transfer Act, which does not in terms deal with the "fictitious person" problem—as the court saw it, the heart of the case.

Brokerage firm A was the holder and owner of stock certificates of three companies, duly indorsed in blank by prior owners, which it desired to have transferred to its own name, either for its own account or for the account of customers. One of A's clerks, M, whose duty it was to prepare transfer instructions and forward certificates to the appropriate transfer agents, inserted in the instructions the name "Jack Arbetell" as the transferee, instead of the name of A as he was supposed to do. Apparently this transmittal went forward in the routine of the hundreds or thousands of such transactions which a large brokerage firm would be handling daily; the shares were transferred per instructions; when the new certificates came back from the transfer agents, the clerk, M, who was apparently in a position to do so, simply took possession of the certificates. An accomplice of M then presented himself to Brokerage firm B seeking to sell the securities; B's employee or employees accepted the somewhat scanty identification of "Jack Arbe-

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tell," opened an account, guaranteed the signatures, and paid over the proceeds of \$76,000. "Arbetell" was a non-existent person, at least if one is willing, as the majority of the court was, to take M's word for this vital fact. The fraud having been discovered, A's assignee, its insurer, now sues B for conversion.

The majority of the court, centering its attention on §168 of the New York Personal Property Law (§7, Uniform Stock Transfer Act), under which the true owner can reclaim a stock certificate and rescind the transfer unless it has been transferred to a purchaser for value in good faith, concluded that Broker B was guilty of conversion as against A, and must pay A the value of the stock. The court found that under the applicable New York law the test of good faith of the selling broker (B) was at least as strict as that expressed in Code section 8-318, which provides that in the case of a selling broker good faith includes "observance of reasonable commercial standards," and it held that Rule 405 of the New York Stock Exchange "formulates what are 'reasonable commercial standards' in this context by requiring the broker to use due diligence to learn the essential facts relative to its customers." However, the final decision in favor of A must be considered as based on §162 of the New York Personal Property Law—i.e., there was no proper indorsement of the certificates.

The dissenting opinion favors B on the ground that the accomplice's signature on the certificates constituted the indorsement "by the person appearing by the certificate to be the owner of the shares represented thereby," which was required by §162 of the New York Personal Property Law (§1, Uniform Stock Transfer Act) in order to transfer title. Application of the fictitious payee doctrine is the key element in this rationale, and its application was apparently thought justified in part by the fact that the larceny began when the original certificates (bearing proper indorsements in blank by the actual owners thereof, and therefore "negotiable") were sent to the transfer agents for reissuance in the name of the fictitious person.

It is difficult to accept the majority's portrayal of A as one who has suffered a wrong. One looks in vain for a finding that A had some duty to someone in this case. A delegated to its clerks, and placed within the scope of their employment, the matter of giving issuance instructions to transfer agents (an accepted commercial practice). A's employee committed fraud on his employer, and on his employer's customers (not to say the issuers and transfer agents). B's employee was at most negligent.

Whether or not the "fictitious payee" analogy is accepted, should not the case have been decided on the basis of an estoppel against A, to reach a just result, contrasting A's employee's fraud with B's employee's negligence?

A number of problems may well arise out of this case to which the majority opinion will not provide satisfactory answers. If this case had

come up under the Code, an analysis based on the application of several Code provisions would have been in order here, space permitting.

Perhaps the conclusion should be that an amendment to Article 8 is needed, to incorporate the substance of section 3-405, to put the risk of the "fictitious ownership situation on the presentor for transfer—not on issuers, signature guarantors, or subsequent intermediaries and purchasers. It is at the point of registration of transfer that the damage is done, and at that point the means of prevention lies solely with the presentor."

Delivery to a Purchaser

In *The Berkeley, Inc. v. Brettler*, 234 N.E. 2d 742 (Mass. Sup. Jud. Ct. 1968), the court held valid a gift of corporate stock, where the stock certificate belonging to and issued in the name of M was in possession of the corporation's attorney, and M signed and delivered to him a stock power in blank, intending thereby a gift to her husband, A, of the shares represented by the certificate. The inference was that the attorney was acting on behalf of A who was hospitalized. The attorney later filled in the stub in the corporation's transfer book to show A as having become the shareholder, although a new certificate was not in fact issued.

The court referred to two Massachusetts cases indicating that delivery of a stock power alone would not make an effective transfer, but pointed out that in the present case there was a settled donative intention together with an actual or symbolic delivery of the subject matter in such manner as completely to transfer the dominion and control of it. Section 8-313 was cited, wherein it states "(1) Delivery to a purchaser occurs when (a) he or a person designated by him acquires possession of a security." While the Code definition of "delivery" as "voluntary transfer of possession" [section 1-201(14)] was not mentioned, the holding seems consistent therewith. Reference was made to the inclusion of a donee in the definition of "purchaser" in section 1-201(32). It was pointed out that to require the attorney to hand M's certificate to her, so that she could hand it back to him, would have involved a futile and unnecessary act.

Statute of Frauds

Cohn, Ivers & Co. v. Gross, 56 Misc. 2d 491, 289 N.Y.S. 2d 301 (App. Term 1968), involved a "call" on stock. The plaintiff was a "put and call" broker who, as found by the court below, orally purchased from an individual (the defendant), for a premium, a call on 100 shares of X Corporation stock at a specified price. Such a "call" is in the nature of an option giving the optionee (plaintiff) the right to claim the subject matter upon payment of the agreed price by a specified date.

In finding for the plaintiff, the court held that this oral contract

was not governed by section 8-319 relating to the sale of securities, because the call was not a "security" as defined in section 8-102. It can also be pointed out that securities as so defined are "negotiable instruments" (section 8-105) and there is no document of this character arising out of the acts of the parties. Rather, we are looking at a simple contract falling within the "catch-all" statute of frauds section 1-206, as pointed out by the court. This section exempts from the requirement of a writing a contract, such as this was, involving not more than \$5,000 (either as to the price paid for the call, or the value of the stock deliverable upon exercise).

Lindsey v. Stein Brothers and Boyce, Inc., 433 S.W. 2d 669 (Tenn. Sup. Ct. 1968), raises the question of the applicability of the statute of frauds (section 8-319) to a brokerage transaction. The plaintiff claimed that in a telephone conversation he directed his broker to sell 100 shares of X stock at 85; two days later the stock reached that price and nothing was done; after plaintiff's further inquiry and further lapse of time, the stock was sold at 64. Upon a suit against the broker to recover the difference between \$6,400 and \$8,500, the lower court held that the statute of frauds was a good defense and that the plaintiff's bill of complaint was insufficient in law.

The Tennessee Supreme Court, however, concluded that the relationship between the plaintiff and defendant being one of principal and agent rather than buyer and seller, the statute of frauds did not apply. The court relied on *Stott v. Greegos*, 95 N.J. Sup. 96, 230 A.2d 154 (1967), directly in point and discussed in last year's survey.¹ It was there suggested that Official Comment 2 to section 8-319 should be clarified and, in effect, purged of references to strictly brokerage transactions. Such action might avoid the necessity of re-litigating this same question in still other jurisdictions.

Possible Violation of Securities Act of 1933 as a Bar to Transfer

In *Shearson, Hammill and Co., Inc. v. Yankee Plastics, Inc.*, 5 U.C.C. Rep. 224 (N.Y. Sup. Ct. N.Y. County 1968) it was held, consistently with section 8-401 of the Code, that there was no restrictive legend on stock certificates (section 8-204) the issuer was obligated to make transfer, and could not advance an unsupported claim that a "no-action" letter from the SEC should be presented. However, in *Travis Inv. Co. v. Harwyn Publishing Corp.*, 288 F. Supp. 519 (S.D. N.Y. 1968), where the presenter was a broker seeking transfer into his own name for the purpose of sale, the court held that under the common law of New York (the Code not yet being effective at the time of the transaction) the issuer was justified in withholding transfer where the New York Regional Office of the Securities and Exchange Commission had served written notice on the transfer agent that "con-

1. Jolls, *Investment Securities*, 23 Bus. Law. 849 (1968).

trol" stock of the issuer was likely to be presented for transfer in connection with sales in violation of the Securities Act of 1933. *Quaere*, under the Code whether there would be a duty to register transfer (section 8-401); whether the Securities and Exchange Commission is an "adverse claimant" (section 8-301); whether the issuer's duty of inquiry could be discharged by notice to the Commission per section 8-403 coupled with a failure on its part to take injunctive action; or whether such informal notification does not, of itself, place the issuer under a duty to inquire and thus negate the statutory obligation to register transfer.

