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1967

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Thomas H. Jolls
William & Mary Law School

Repository Citation
Jolls, Thomas H., "Investment Securities" (1967). *Faculty Publications*. 1583.
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INVESTMENT SECURITIES

By

THOMAS H. JOLLS*
Chicago, Illinois

Since the last Subcommittee report,[1] there have been several decisions under Article 8. The courts have also discussed Article 8 in several cases where it was or seemed inapplicable. A review of these cases is omitted because of space limitations.

Statute of Frauds

There were two cases under §8-319, the statute of frauds for Article 8. In *Konsuvo* v. *Netzke,* 91 N. J. Super. 353, 220 A. 2d 424 (1966), the stockholders of a closely held corporation, following a dispute as to the conduct of the business, held a stockholders meeting to discuss proposals whereby one or more might buy out the interests of the others. The minutes of the meeting apparently indicated, in appropriate detail, that stockholder C had agreed that by October 2 he would either better the offer of stockholder K for everyone's stock, or he would sell out at K's price. Copies of the minutes were sent to each stockholder, but the minutes were never formally approved. C failed to perform on October 2, and K brought suit on the basis that the minutes, which had been signed by the Secretary, constituted the "writing signed by the party against whom enforcement is sought or by his authorized agent" required by §8-319(a). The court held, however, that the secretary was acting for the corporation in signing the minutes and that there was insufficient evidence that he was acting as an authorized agent of C.

This case also construed §8-319(c) which makes a sale contract binding if an appropriate writing in confirmation is received and not objected to within 10 days. On October 2 certain of the stockholders sent a letter to C referring to the minutes "that we all received" and in effect calling on C to perform. The court concluded that C was not bound by his failure to object to the letter because any confirmation under the statute should have included in its own terms the description, quantity and price of the securities; and that to allow this information to be incorporated from another document by reference thereto would defeat the purpose of the statute. A reading of the court's summary of the conflicting evidence of the contending parties as to "Who said what at the stockholders meeting?" fortifies the court's action in adopting a strict construction of §8-319.

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* Member of Illinois Bar; Chairman of the Subcommittee on Investment Securities. This survey was prepared with the assistance of Subcommittee members Donald C. Anton, Lawrence A. Coles, Jr., William Mellon Eaton and Samuel L. Rosenberry.

1. 21 BUS. LAW. 789 (1966).

Mortimer B. Burnside & Co. v. *Havener Securities Corp.,* 25 A.D. 2d 373, 269 N.Y.S. 2d 724 (1966), arising on a motion for summary judgment, presents a more complex statute of frauds problem. The complaint alleged that defendant owner of certain stock purchase warrants issued by X corporation had orally agreed to assign them to plaintiff provided plaintiff would, in a separate transaction, purchase specified shares of X corporation stock from a third party. Plaintiff purchased the shares but defendant refused to turn over the warrants. A majority of the court held for defendant, looking at §2-106 for the definition of "sale," which requires a "price," and to §2-304 for the meaning of "price," and concluding that the contemplated assignment of the warrants was a "sale" for a "price" and hence would not be enforceable unless in writing. The contention that payment of the price had been made as contemplated by §8-319(b) because plaintiff had performed his unilateral contract was rejected on the basis of pre-Code cases cited holding that such performance is ineffectual to satisfy the statute of frauds unless "unequivocally referable" to the alleged promise. Obviously in this case plaintiff's performance did not of itself prove anything except that he had bought some stock.

While the decision may be justifiable as consistent with the policy of the statute, it has some weak spots and there is a thoughtful dissenting opinion. Basically this was not a "contract for sale of securities for a price" as understood in the usual securities market transaction. The thrust of the statute of frauds is directed at market transactions—not transfers of title generally. Also, the court's reference to portions of Article 2 of the Code for solution to a problem under Article 8 are questionable. Article 2 deals with "goods," which term specifically excludes "investment securities" under §2-105. While the Official Comment to §2-105 indicates that reference to Article 2 for guidance on an Article 8 problem is in some circumstances permissible, it can certainly be argued that the question of the meaning of "sale" and "price" in the context of investment securities transactions should not be determined by definitions designed to include the wide-ranging practices of merchants in dealing with goods.

Purchasers

Another case where the use of basic principles of law supplemental to Article 8 as permitted by §1-103 might have avoided excursions into various inapplicable Code provisions is *E. F. Hutton & Co.* v. *Manufacturers Nat'l Bank of Detroit,* 259 F. Supp. 513 (E.D. Mich. 1966).

Plaintiff, a stockbroker, held for customers bearer warrants, each of which represented the right to subscribe to 100 shares of Vernors, Inc. stock at $8 a share. Vernors, Inc. was in liquidation and its board of directors had declared a $9 first liquidating dividend. Rather than requir-

ing the warrant holders to purchase 100 shares of stock for $800 and then surrender it to defendant bank (Vernors' liquidating agent) for 900, Vernors authorized defendant bank to pay the warrant holders $100. Plaintiff's cashier surrendered the warrants to defendant for payment, allegedly without authority from plaintiff. Moreover, it was doubtful that plaintiff itself had underlying authority from its customers to surrender the warrants. When plaintiff discovered the error, it tendered to defendant the payment it had received from defendant and demanded the return of the warrants. Defendant refused. Plaintiff obtained a temporary restraining order and requested that it be converted into a preliminary injunction. Defendants requested that plaintiff's complaint, which sought a permanent mandatory injunction compelling the return of the warrants, be dismissed for failure to state a claim upon which relief could be granted.

The court found that the bearer warrants were "investment securities" governed (per §8-102(1)(b)) exclusively by Article 8, but lost no time in going to Article 3 for guidance notwithstanding §3-103(1) thereof. There is lengthy discussion ranging over many sections, on such questions as: (1) Is the issuer a bona fide purchaser under Article 8 or a holder in due course under Article 3? (2) Are the warranties of a presenter applicable? (3) Are the procedures for transfer of a security applicable to the situation? The court was reluctant to give the issuing corporation the preferred status of a bona fide purchaser or a holder in due course and rightly so. The court denied the motion to dismiss and granted a preliminary injunction.

But suppose that the court had started out with Article 8 as determinative, to be supplemented by the common law as contemplated by §1-103. Admittedly the warrants are investment securities, but they were utilized in a transaction which Article 8 does not purport to deal with. Vernors, Inc. was not a going concern, buying securities for investment or for its treasury—it was a corporation in process of liquidation. It was paying a liquidating dividend, which it owed to all its stockholders, including those whom it had elected to treat as such because they held warrants entitling them to attain stockholder status. Vernors was not a purchaser of anything, in the ordinary sense, or under the Code definition found in §1.201(32), (33):

> "Purchaser" means a person who takes by purchase. "Purchase" includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction *creating an interest in property*. (Italics added.)

The warrant holders had to turn in their bearer warrants, of course, to show their entitlement to payment; and apparently the stockholders were required to surrender their stock certificates permanently or for endorsement, but such surrender did not create a "purchase." In the corporation's hands the warrants and stock certificates became scraps of paper—not assets.

The court mentions a possible right of rescission. This was the basic question. Article 8 of the Code does not and should not provide the answer. (See §1-103). The nature of the injury suffered by the warrant holders is not described. Whatever it may be, recourse against their broker would certainly be available if the broker in fact acted to their detriment and without authority. Equitable considerations may suggest that this should be regarded as their problem rather than that of the corporation.

Adverse Claims

Kanton v. United States Plastics, Inc., 248 F. Supp. 353 (D.N.J. 1965), involved the "adverse claim" problems growing out of presentment of so-called "investment stock" for transfer. Plaintiff, owner of 10,920 shares of Plastics (a Florida corporation), requested a mandatory injunction in New Jersey to compel Plastics and its transfer agent (a New Jersey corporation) to transfer the stock. Kanton had purchased his stock several years before from Scharps, president of Plastics. The purchase was made for investment purposes and a legend to that effect appeared on the certificates. At that time Kanton was employed by Plastics as special counsel—later this relationship was terminated due to differences between him and Scharps, and he determined to dispose of his shares. The certificates were forwarded for transfer on March 10, accompanied by a "no action" letter from the SEC and an opinion of counsel. After an exchange of telegrams the transfer agent on March 24 returned the certificates with advice that Plastics had instructed it not to make the transfer. On March 30 the transfer agent resigned and a Florida bank was appointed. There was also a suit filed in Florida by Scharps to rescind the original sale of stock to Kanton, but this suit was later dismissed. The court first considered the question of conflict of laws. New Jersey having adopted the Code, §8-106 thereof directed application of the law of the state of incorporation of the issuer (Florida, where the Code was not in effect). In the absence of Florida authority in point, the court turned back to the Code as a respectable body of law dealing with the subject matter. Nominally at least, Plastics had received an "adverse claim" from Scharps and per §8-401 and §8-403 needed to do something to discharge its duty either to transfer or to inquire. The court pointed out that Plastics should have served a 30-day notice on Scharps per §8-403, and that, apart from the Code, common law principles would sanction a reasonable and temporary period of delay where an adverse claim is filed but thereafter the issuer would be obligated to act. The identity between Plastics and the adverse claimant, Scharps, its president, who was guiding its action in this connection, was emphasized. The court found no justification for further delay, and on June 1 entered a summary judgment against Plastics directing immediate transfer.