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TRANSFER OF INVESTMENT SECURITIES

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Paper prepared by
Wm. Brown

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Brief History

The concept of a registered interest evidenced by a transferable certificate was first introduced into commercial circles by the Dutch East India Company in 1608. Though a novel idea it was not utilized by the English trading companies until the closing years of the 18th century.(ff) Prior to this in England, shares in the company were transferred by deed in the same manner as an interest in land, thereby necessitating a search of title back through the chain of deeds upon each transfer, a cumbersome and time consuming process.

The share certificate, now issued by a company to its registered shareholder for X amount of shares bore the following:

> These shares are transferable in person or by attorney on the books of the company only on the surrendering cancellation of this certificate, by an endorsement thereof herein, and in the form and manner which may at the time be required by the transfer regulations of the company.

Endorsement on the certificate was in the form of a transfer for value received, blank in the name of the transferor and transferee. When the endorsed transfer has been duly executed by the registered owner of the shares, the name of the transferee being left blank delivery of the certificate in that condition by him, or by his authority, "was thought" to transmit his title to the shares both legal and equitable. The person to whom it was delivered could effectually transfer his interest by handing the certificate to another, and the document could then pass from hand to hand within the market place until it came into the possession of a holder who thought fit to insert his own name as transferee, and

to present the document to the company or its transfer agent for the purpose of having his name entered in the register of shareholders and thereby obtain a new certificate in his own favour. Once the practical aspects were recognized by the law merchants, the share certificate came into wide spread use.

Although the share certificate was highly functional and served a very practical purpose within the market place, from the outset its conceptual framework had not been completel thought out, thus, lacking a clear definition when problems arose the common law courts were called upon to make a decision without the guidance of a body of legal principles dealing specifically with this new creature. This legal vacumn allowed the courts to resolve conflicting claims by application of legal principles developed in relation to other forms of property, and while this led to some just results, it also led to some very peculiar and contradictory decisions.

For years the courts have been called upon "to determine whether a share in a corporation was a moveable or an immoveable, whether a share certificate was simply evidence of ownership of a share in a corporation or instead the embodiment of the title to that share like a negotiable instrument in bear form, or whether a share certificate was a unique institution.(ff) Equally perplexing was the manner in which the courts characterized the share and the share certificate when called upon to resolve some dispute. The following cases illustrate the tortured definition of a share and share certificate that the court would arrive at in order to justify a conclusion it wanted to reach.

In the case of <u>Townsend</u> v. <u>Ashe</u> the court held that the shares of the New River Co. Realty, i.e. immoveables

because the company held immoveables. Shares were held to be goods in case of Evans v. Davies (ff) arising out of a fact situation where the defendant had defaulted on a promisory note given for the purchase of shares. In Rene T. Leclerc Inc. v. Perrault et le banque de la nouvell ecosse (ff) bearer bonds were stolen and the court held them to be "personal property or immoveable in the sense of being tangible property". A decision coming from Exchequer Court, Hunt v. Regina, Jackett P. characterized a share of a corporation, "as a bundle of legal rights distinct from a share certificate" (ff). In addition to the various definitions of a share, the court has characterized the share certificate as a chattel, in Gray v. Gray (ff); as evidence of title to the shares in MacKenzie v. Monarch Life Assurance Co. (ff) and Coplan v. Coplan(ff) and in contrast, as a negotiable instrument, in Patrick v. Royal Bank(ff) and Bank of Montreal v. Isbell(ff).

In an attempt to clear up some of the confusion legislative enactments have declared that shares were personal property or moveables.(ff) This resolved an immediate problem, but confused the issue somewhat by assuming that the basic problem was the distinction between immoveables and moveables. "In fact the problem was considerablly more complicated for an order to resolve the issue clearly it was necessary in addition to determine two other questions implicit in the cases referred to above.

1. If a moveable, was a share a tangible moveable or chose in action?

2. If it was a chose in action, was it simply an assignable document or was it a negotiable instrument?

As Professor Gower points out, the question, what is the nature of a share in a corporation and what is the

role of the share certificate, is more easily asked than answered.(ff) The concept of a share has been refined somewhat, but historical development compells us to explain it by indirection, pointing out what a share is not rather than what it is. It is not an immoveable, and certainly not a contract,(ff), contrary to the case of Rene T. Leclerc Inc. v. Perrault et le banque de la nouvell ecosse, it is not a tangible moveable (ff) and the Sale of Goods Act, (ff) specifically precludes "chosen actions" from the application of its provisions. To this end, a share of a corporation does not fit into any existing conceptual framework: it is neither property or contract but is in fact a unique institution, reflecting aspects of both property and contract, and having free trasferability as a traditional attribute.(ff)

In conclusion, a share in a corporation as evidenced by a share certificate may be said to represent 3 distinct interests.

1. The control of management

2. A rateable share of earnings that are distributed as dividends.

3. A rateable share of the proceeds arising from liquidation of the assets of the corporation either before or at the time of its dissolution.

Practical and Legal Problems with Share Transfers

While there have been legislative enactments attempting to give some direction as to the transfer of shares, they have been of a minor nature and have not addressed themselves to the whole gammit of problems which arise between the various parties involved in a share transfer. The majority of share

transfers involve and effect 5 distinct entities, the issuer, transfer agent, broker, seller(transferor), buyer(transferee). As with most things in life, the more steps one puts in a process, or the more links one places in a chain, the greater the potential for something to go wrong; and where the roles and functions, obligations and duties are not specifically spelled out the greater the opportunity for liability to be shifted from one party to another. Within the English and Canadian common law systems with the exception of two recent enactments (ff) there has been precious little in the way of legislative declaration as to the rights, obligations, duties, and defences attributed to and allowed by the various parties in the share transfer process. Any attempt to seek some guidance from the common law immediately reveals to the inquirer the vast array of confusing, contradictory, and consistent inconsistencies handed down by our courts in their attempts to reach some just result when faced with conflicting claims over share and share certificates keeping in mind the lack of any specific body of law dealing directly with the institution of the share and share certificate. A review of the major problems and solutions attempted by our courts will reveal to the reader the urgent need for reform in this area.

As mentioned earlier, the transferable nature of these share certificates between registration dates, though the high practical value to the businessman in the market place, is not accorded equally smooth functioning or resolution upon conflicting claims arising and subsequent recourse to the courts. While no one case exemplifies all the problems encountered when dealing with shares and share certificates, each of the following cases raises issues that relate to each of the respective parties involved with the issuance and transfer of shares and share certificates.

In every case the question is one of fact and the cases

This is a reminder Bill that when you go back over the paper break down the first section into strictly definitional problems and abbreviate what you've written. And the second portion of the paper should be just strictly procedural problems as experienced when dealing strictly with transfers stolen, lost and destroyed share certificates. Then after that highlight what the perspective legislatures have given in the way of guidance through legislative provisions and then your last section should be a review of the U.C.C. and the Federal Act and after that your own personal recommendations.

(sometimes conflicting in their results) appear not to establish any definite rules, but only to illustrate the view taken by the particular court of the facts aduced in evidence.

The general rule of law of England is that no man can acquire a title to a chattle personal from any one who has himself no title to it, except only by sale in market overt. This rule was first enunciated in the case of Miller v. Rice (ff) a case decided in the mid 17th century. This principle was affirmed in the subsequent land mark decision of Colonial Bank v. Cady (ff) which was decided by the House of Lords in the latter part of the 19th century. The fact situation is relatively simple, the executors of the registered owner of the shares upon his demise, signed the transfers on the back of each share certificate, without filling out the blanks, in order that the shares might be registered in their own names as executors, and sent the certificates to their broker, who fraudently deposited the certificates with the bank, the appellant, which took them bona fide and without notice for security for advances. The court held that the respective rights of the executors and the bank must be determined by English law; and that the conduct of the executors in delivering the transfers was consistent either with an intention to sell or pledge the shares or to have themselves registered as the owners, and therefore did not estop them from setting up their title as against the bank, for the bank ought to have inquired into the broker's authority. Lord Hurschell in giving his judgment stated that there are two ways in which according to the law of England at the time a good title could be acquired under such circumstances. "If the instruments of title be negotiable instruments, a person taking them for value without notice of any infirmity in the title would have a right to hold them, even as against a prior owner who had never intended to part with the property in them. Or,

again, such an owner may have so acted as to be estopped from setting up a claim as against a person who has bona fide and for value taken the instruments by way of sale or pledge". Further in his judgment he went on to say, "that the mere delivery of them "share certificates" with the endorsed blank transfer and power of attorney signed, irrespective of any act or intent on the part of the owner of the shares, is not of itself sufficient to pass the title to them". But, he continued, "if the owner of chose an action close a third party with the apparent ownership and right of disposition of it, he is estopped from ascerting his title as against a person to whom such third party has disposed of it, and who received for good faith and value." However, he continued the transfers in this case were not signed by the registered owner, but by his executors, for the purpose of effecting a transfer, into their name, for the purposes of probate of the deceased will. As there was no intention on their part to either sell, transfer, or pledge them, but only to complete their title by obtaining registratio in their own names, they were not estopped from setting up their title or their claim to their title as against the bank. In addition to this the transfers had been endorsed by the executors they were not by the law of England nor by the law of America (were the company which issued the shares was incorporated) in proper order, and would not therefore be recognized in the market place as being capable of passing from hand to hand. This judgment by denying the negotiability of the share certificate, and affirming the principle where a registered owner would be estopped from setting up his title to shares, was cited with approval in numerous subsequent cases.(ff).

In McLeod v. Brazilian Traction Light and Power Co.(ff) a case of the Ontario Supreme Court, where the registered owner of shares deposited with his broker, share certificates endorsed in blank, with instructions to the broker to sell and obtain other securities in lieu thereof, he was estopped

from preventing the registration of the transfer of the shares to an innocent purchaser for value to whom the broker in fraud of his instructions had sold them and failed to purchase and deliver other securities. The general principle as enunciated in Miller v. Rice, and affirmed in Colonial Bank v. Cady, was held to apply here as, the owner had clothed the agent was authority to dispose of the shares thereby allowing the shield of estoppel to be raised.

In the case of Whitehead v. Bridger, Havenor & Co.,and Trust and Guarantee Company Ltd.(ff) a case which went to the Court of Appeal of Ontario, the plaintiff was successful in obtaining an order for delivery of a share certificate from the defendants to himself as the rightful owner. The share certificate was either lost by the plaintiff or stolen from him and upon his becoming aware of its absence he notified the transfer agent of the company and instructed his broker to notify the stock exchange so as to prevent any transfer of his shares being made, in addition he advertised his loss in a newspaper.

The share certificate, commonly known in the market place as a street certificate, passed through several brokers before ending up in the hands of the defendant Bridger, Havenor & Co., Stock Exchange Brokers.

The system adopted by the exchange was that instead of paying the brokers who sold the stock and taking delivery from them, all transactions had to go through a clearing agent; in other words, the selling broker would lodge with the clearing agent certificates representing the shares sold, and the clearing agent would deliver to the purchasing brokers certificates for the number of shares bought by them - but not necessarily the same certificates as were lodged with them by the selling broker. The share certificate of the plaintiff was among those delivered to the defendant

on account of there purchase for a client.

A most interesting fact concerning the second defendant, Trust and Guarantee Co. Ltd., was that they were both the transfer agent for the company whose share certificate the plaintiff had lost as well as the clearing agent of the exchange, and therefore had actual notice of the loss, in both capacities, yet the certificate passed through their hands without detection, and was delivered to the brokers Havenor & Co. as a good and valid certificate.

The court after reveiwing the authorities cited in the arguments by various council, held, that there should be judgment for the plaintiff for delivery of the certificate to him as the rightful owner. This was so, as the plaintiff had not intended that the share certificate should be sold or pledged, he in fact had no intention to part with them at all, and the case of McLeod v. Brazilian Traction Light and Power Co.,(ff) was held not to apply. There was nothing that the plaintiff had done or represented to preclude himself now from setting up his claim to the certificate.

The court went on to cite the rule of law found in Miller v. Rice (ff), holding that there was no evidence that the certificate in question had been sold in the open market, and in fact, the evidence was to the contrary. The defendants had purchased the shares, not the certificate and this certificate was delivered to them as evidence of their ownership, but a stock certificate is only the prima facie evidence of ownership of the shares. And as the certificate had not been obtained in the market overt, it could therefore not give them title.

It was interesting to note that the court felt that the defendant Havenor & Co. might have maintained an action for a claim over against the defendant Trust and Guarantee

Co. Ltd. for delivering a certificate which was not in fact good and valid. Further, Trust and Guarantee Co. Ltd. by virtue of their position of transfer agent and as clearing agent for the exchange having notice of the loss and negligentl allowing the defective certificate to slip through its hands, was not held libel at all and the more innocent of the two parties was in fact settled with liability.

The court had indicated that while there was some peculiarities about the endorsement on the share certificate, had the defendant Bridger, Havenor & Co. made inquiries of the tranfer agent they might have been relieved of liability or received a new share certificate. The case of Fry v. Smellie(ff) was cited as further authority for the position that the court had taken and went on the quote Farwell L.J. "a question arises when the owner of the shares has authorized such dealing with them as is corroborated by possession of the indicia of title. If no authority at all has in fact been given it is quite immaterial whether one subsequently purchasing or lending money thereon inquires and is given an untrue answer or does not inquire at all; in either case he loses his money.

Following this we have the case of Aitken v. Gardiner and Watson(ff), here the basic facts were that the plaintiffs share certificate had either been lost or stolen or mislaid and that when this fact had come to the plaintiffs knowledge a stop order was immediately placed with the transfer agents as well as notice being given to the Toronto Stock Exchange. The plaintiff indicated that there had been approximately a lapse of a year between the last time that she had seen the share certificates and the time that which she realized that they were in fact gone. The share certificates were not in the name of the plaintiff but were registered in the name of a brokerage firm in the city of Toronto. However, they had been endorsed and were in what is commonly referred

to in the market place as street form and or a street certificate. At some time prior to the plaintiff realizing that her share certificates were missing, the defendants a Toronto Brokerage Firm, were instructed by another brokerage firm to sell shares of the same quantities and in some of the same companies that the plaintiff held share certificates for. Subsequent to the defendants making the sales, they were forwarded share certificates to cover these sales, which certificates turned out to be the certificates missing from the plaintiffs residence. These share certificates were delivered by the defendants to the purchasers and the purchase price was paid to them and in turn they paid the brokerage frim which had instructed them to transact the sales. Some of these shares were immediately presented for registration in the name of the purchasers, while others were held and turned up subsequently after the stop order had been placed against them.

Upon the purchasers failure to have the share certificates registered in their names, the defendants obtained other share certificates for them by purchasing in the market place.

The plaintiff was claiming the return of the share certificates presently in the possession of the defendants (those being the share certificates returned by the purchaser upon failure to have them registered) as well as a declaration that the plaintiff was the owner of the share certificates which the defendants had sold prior to the stop order being placed against them and for an order directing the defendants to return them, or, in the alternative, for such damages as the court saw fit to award.

The court held, applying the principles set down in Colonial Bank v. Cady(ff) that the share certificates that had been delivered to the defendants in Gardiner and Watson by the third brokerage firm, which were the share certificates

stolen from the plaintiff, even though street certificates endorsed in blank, were not so negotiable as to permit the defence to hold them free of any claim by the true owner (the plaintiff). In addition, as the plaintiff had done nothing to preclude herself from ascerting her claim.

Spence J., went on to discuss the question of whether the plaintiff could maintain an action for detinue which he answered in the affirmative, as property of the plaintiff had been in the possession of the defendant who had parted with it wrongfully.

Essentially though, the judgment goes off on the principle as enunciated in the earlier cases of Miller v. Rice, (ff) Colonial Bank v. Cady(ff), to the effect that a party could not obtain good title to a share certificate that had been lost or stolen unless such share certificate was purchased in the market overt, and further, that where the share certificates were lost or stolen and the owner had never evidenced any intention to either sell, pledge, or trasfer them, even though endorsed in blank, they were not negotiable and did not pass title upon delivery. This decision emphasizes the trend time and time again the courts ignore the practical treatment of the share certificate in the market place as being negotiable or at least having a negotiable nature and only allow their considerations to fall within a narrow legal field.

It is interesting to note that the certificate as long as they stay within the market place and pass from hand to hand and consideration is given for them that they are acceptable and had not the purchasers attempted to have the share certificates registered in their own names that the defendants would not have been found liable nor would any knowledge of there ever having handled the share certificates come to life.

The following cases when juxaposed illustrate on the one hand a common sense approach to practical problems and on the other hand an example of the judicial decision making process at its best, or with its blinders well in place.

The first case for consideration is that of Guarantee Trust Co. and Dennison Mines Ltd. v. James Richardson and Son (ff), involving an issue which arose between the company, its transfer agent and a brokerage firm. Two share certificates in street form (i.e. registered in the name of one share holder but endorsed so as to be able upon delivery to a purchaser of being presented for registration in the purchasers name) were stolen from an individual who immediately contacted the transfer agent for the Dennison Co. by telephone and followed up by written letter. Subsequent to this an individual approached the defendant brokerage firm and requested that they sell 50 shares in the plaintiff company for which they presented a share certificate to cover the sale. The brokerage firm took the share certificate and tended it to the Guarantee Trust as transfer agent for the Dennison Co. with a request of transfer of the 50 shares into the name of the purchaser. The staff at Guarantee Trust forgot the report of the alleged theft and overlooked the references to it in its files. Sometime later the same individual approached the defendant brokerage firm and requested that they sell 400 shares in the Dennison Co. and again provided a share certificate covering this amount. The brokerage firm upon tendering the share certificate to the Trust Co. for transfer and registration in the purchasers name, which was done, the Trust Co. again forgetting the report of the theft and overlooking the references to it in its files. Sometime after this and it is not stated in the report as to exactly under what circumstances, but the trust company became aware again of the theft and the transfer of the stolen share certificates. The Trust Co. then went into the market place and purchases 450 shares of the stock of the Dennison Co.

in the name of the individual from whom they were stolen. The main issue placed before the court, was, whether the stock broker who delivered the stolen certificates for transfer or the transfer agent affecting the transfers should bear the replacement cost of the new share certificates.

The court held against the brokerage firm and the case went off on the principle of law "that if one person requests another to carry out an act imposed by statute or by common law and in consequence of the doing of the act the latter is subject to liability or suffers loss, he is entitled to be indemnified by the person who made the request unless the act is in itself manifestly tortous or apparently illegal to the knowledge of the person doing it, and provided that he acted without any default in the manner in which he assumed or carried out the request made of him. A second holding, was, that the brokerage firm was also liable for the breach of warranty because by tendering the certificates for transfer it was impliedly vouching for its right to do so and for its title to the shares.

At no time was the brokerage firm given notice of the fact that these share certificates or share certificates bearing those serial numbers were stolen and that a estop order had been placed against them. However, the transfer agent had been given immediate notice of that fact and the court acknowledging that the transfer agent had not once but twice accepted the stolen share certificates for transfer went on to hold that this was not negligence and was not a default such as to disentitle it to indemnity. "Default in this connection denoted either delivered or conscious failure, or one produced by miss of usance or negligence amounted to a breach of duty owing to the brokerage firm in relating to carrying out the transfer the act requested"(ff). The court acknowledged that the transfer agent kept estop order records, but indicated that these were for its own purposes

and its failure to investigate a title accordingly was not a breach of any obligations owed to the brokerage firm.

As the share certificates were in street form and in proper order there was nothing to arise the suspicion of the brokerage firm as to there stolen nature and it seems odd that the transfer agent could obtain an indemnity from the brokerage firm even though (1) it had notice of the theft, (2) it had notice on its records, (3) the transfer of the share certificates was affected by its employees and (4) even though the mistakes of its employees was the main cause of its loss it was still able to obtain redress from a party more innocent than itself.

The case of Chartered Trust and Executor Co. v. Pagon(ff) has a fact situation much in common with the above case, however, the approach taken by the judge reflects a much more common sensible attitude. The defendant had purchased share certificates endorsed in blank (i.e. in street form) but before she could present them for registration in her own name they were either lost or stolen. The plaintiff, as transfer agent was immediately notified and put a estop order in its records. The defendant requested a duplicate certificate from the plaintiff with which the plaintiff agreed but requested an indemnity bond be entered into, indemnifying it against lost by reason of issuing the duplicate certificate and requiring that the plaintiff immediately notify the indemnity company of any claim arising from the original certificate. Subsequently the stolen certificate was presented for transfer and, through the negligence of the plaintiffs employees, it was accepted and a new certificate was issued before the estop order was noticed. The plaintiff then sought to recover on the bond for the amount of the plaintiffs expenditure and providing to meet all the outstanding certificates. The indemnity company and the defendant declined and the court held rightly so. The court in giving

its reasons held that the loss suffered by the plaintiff did not arise from the issuing of the duplicate certificate but by reason of the negligent acceptance of the original stolen certificate from one whom the plaintiffs knew to have no right to deal with it. The books of the transfer agents of the company recorded the estop order, and the loss arose out of the negligence of their servants or agents in accepting the lost certificate for transfer. With respect to the indemnity bond the court was of the view that to force them to indemnify the plaintiff would do violence to the terms of the bond and transform it into an insurance policy against the negligence of the plaintiffs servants. The case of Colonial Bank v. Cady(ff) and Fry v. Smellie(ff) were discussed and it was held that the defendant had done nothing to preclude herself from ascerting her rights and in addition, there had been nothing done on her part that would allow the principl e of estoppel to be raised. Secondly as she had not intended to part with them and had not clothed anyone with authority to deal with them the principle as enunciated in Fry v. Smellie precluded anyone from being able to obtain title to them.

It is interesting to note that both this case and the above mentioned case both came out of the Ontario High Court. McRuer C.J. wrote the decision on the latter case where as Gail J. rendered the decision on the former. Though the Richardson case was subsequent to the Pagon case the former was not cited any where in argument in the latter. Aside from this, McRuer in giving his decision assess the position of each party and finds liability on the basis of fault or in other words the more innocent of the two parties is recognized as such and the party who ultimately had the greatest opportunity to protect itself through proper supervision and such supervision being found wanton was barred from seeking indemnity.

The prior cases illustrate problems arising out of the practical attitude of the market place as recognizing share certificates in endorsed form as negotiable, or negotiable in nature, and problems which arise when a share certificate in street form is lost or stolen and is presented for transfer. The various problems experienced by the share holder, the transfer agent, the brokerage firm and the innocent third party who purchases the share certificate for value. There will be a further discussion of these problems at a later point in this paper.

The following cases illustrate some of the problems that are experienced by individuals and commercial entities dealing with share certificates in the market place which have defects which go to the validity of the certificate or the authenticity of the certificate, i.e. a forged or bogus share certificate presented for transfer or pledged as security for a loan. In addition these cases will illustrate situations where unauthorized signatures have been placed on certificates or the company seal has been fraudulently impressed on a certificate.

The landmark case in this area is that of Ruben et al v. Great Fingell Consolidated and others(ff) a decision of the House of Lords rendered in 1906. The secretary of the defendant company in order to secure a loan tendered a certificate which purported to state that the bankers were the registered proprietors of 5000 shares, the certificate purported to be signed by two of the directors; the seal was affixed to it and it was countersigned by the secretary himself. In fact, the names of the two directors were forged by the secretary and the company seal was affixed fraudulently, and not for or on behalf of or for the benefit of the defendant company, but solely for the benefit of the secretary for his own private purposes and advantage. When the fraud was discovered the plaintiffs were obliged

to repay to the bank the amount of the loan and brought an action against the defendant company claiming that they were liable for the fraud of Rowe, their employee. It was admitted that the secretary was a proper person to deliver certificates on behalf of the company. The court held that the forged certificate was a pure nullity, and even though the persons dealing with limited liability companies were not bound to inquire into their indoor management, and would not be effected by irregularities of which they had no notice; this doctrine was held only to apply to irregularities that might otherwise affect a genuine transaction, but could not apply to a forgery.

With respect to a second argument raised by the plaintiff that as the certificate was delivered by the secretary in the course of his employment, that delivery imported a representation or warranty that the certificate was genuine. The court held that he (the secretary) had not, nor was held out as having, authority to make any such representation or to give any such warranty. And certainly no such authority arose from the simple fact that he held the office of secretary and was a proper person to deliver certificates. Lord Macnaghten had this to say, "the fact that this fraudulent certificate was concocted in the companies office and was uttered and sent forth by its author from the place of its origin cannot give it an efficacy which it does not intrinsically possess.

As a result the plaintiffs had to bear the loss, and though the company had obviously been in a better position to protect itself was off the hook.

There were many cases cited by council for the plaintiff to support the argument raised, however, the court held that there was only one case which was really similar to the point being made in the fact situation with which they were involved,

that being Shaw v. Portfill Gold Mining Co. (ff). The fact situation in this case is almost identical to that of Ruben et al v. Great Fingell Consolidated and others in that the secretary of the defendant company was responsible for procurring the execution of certificates of shares in the company with all the requisite and prescribed formalities, and then to issue them to the persons entitled to receive the same. A resolution of the directors of the company provided that certificates of shares should be signed by one director, the secretary, and the accountant. The secretary executed a deed purported to transfer certain shares of the company to an individual, a purchaser of such shares, such share certificates stating that he was the registered owner of the shares. This individual in turn pledged the share certificate for a loan and eventually executed the share certificate to the favour of the lender. The certificate was in the usual unauthorized form, and sealed with the company seal, but the signature of the director appended thereto was a forgery and in fact the seal had been affixed thereto without the authority of the director. When the plaintiff with whom the share certificate had been pledged for money advanced presented the share certificate for transfer and registration in its name the defendant company refused stating that there were no such shares standing in the other individuals name on their books.

The court in giving its decision held that the defendant company was estopped by the certificate issued by their secretary from disputing the plaintiffs title to the shares. Steven, J. in giving his opinion said, "is the transferee of shares bound to ascertain that the seal has been affixed in the presence of the directors, and that the signature of the director is geniune? How in the ordinary course of business would this be practical?"

Both Steven J. and Mathew J. in giving their opinions

felt that as the company had prescribed certain formalities to be adhered to and in the preparation, execution, and signing of the certificates, prior to issuing them to the persons entitled to receive them and since they had made it possible and afforded the opportunity to the secretary to do what he had done that they were estopped from denying his lack of authority. In addition, they both felt that in the practicable course of business it would be difficult to go behind the certificate and ascertain such matters as whether the signature of the director was genuine or if the seal had been affixed with the authority of the directors. As the company had authorized the secretary, and made it his official duty, to act in such a way that his acts amounted to a warranty by them of the genuineness of the certificate issued by him the sword of estoppel was raised against them.

The distinguishing feature between these two cases as viewed from the eyes of the House of Lords was that in the latter case the directors had appeared to authorize the secretary to perform in this manner thereby impliedly warranting the geniuneness of a certificate issued by him. In the former case the House of Lords felt that the company had not authorized such a wide range of duties for the secretary and had therefore not implicity or explicity warranted the genuineness of any certificate delivered by the secretary. The difference is indeed sulta and one considers it odd that a lending institution should be put on guard when dealing with the secretary of a company and be more at ease when dealing with an average every day citizen off the streets. Surely in the common every day commercial practice a bank would be more inclined to accept a certificate at face value from one they know to hold a substantial position in the company that the certificate represents. The latter cases was decided in 1884 and the former case went to the House of Lords some 22

years later in 1906, but in practice has been the precedent to which subsequent cases have been bound.

A more recent case, Toronto Dominion Bank v. Consolidated Paper Corporation Limited (ff) a 1963 case coming out of the province of Quebec with a similar fact situation to the previous two cases. Essentially a clerk working in the transfer department of the defendant company pilferred some unissued share certificates and completed them by forging the required counter signatures and then passed them for value to the plaintiff. The case was framed in tort law for the court by its decision held that it was not foreseeable by the company that its employee would be faithless and commit a fraud, and that the plaintiff would suffer thereby (a novel and interesting way of characterizing damages or loss from a commercial transaction).

Montgomery J. in giving his decision felt that perhaps the defendant company had not taken all the known precautions in safeguarding its printed forms of share certificates, and that perhaps this constituted negligence on its part, held that this negligence was not the immediate cause of the damage suffered by the plaintiff. He held that the plaintiff had an effective chance of preventing the damage by making an inquiry to the defendant in ascertaining whether any certificate bearing that number had been issued. It was argued on behalf of the plaintiff that bankers could not carry on business if they were obliged to check the validity of every share certificate offered as security to which Montgomery J. responded "this may be so, but there were at least two reasons why special attention might have been given to these certificates. In the first place, the borrower was in no case a regular customer of the branch approached. The bank manager who interviewed him could of ascertained, and in some cases did ascertain, that he was a prior employee of the defendant working for a small

salary. In the second place, the defendant's shares, unlike those of most companies of comparable standing, were not listed by any recognized stock exchange, although they appeared to have been freely traded on the unlisted market. It may be that the risk that the bank manager took was a normal business risk, but, having accepted it, the banks cannot in my opinion recover from the defendants.

With all respect to his Honour Judge Montgomery I fail to see what difference it makes whether the clerk had gone to one branch or another, and further whether his position was with the defendant company in a minor capacity or he worked for a completely different group altogether. Must the bank before it extends credit or advances money on the basis of the strength of a certificate check with the issuing corporation as to the validity of that certificate. If this were to become the practice instead of what is in fact the practice would not the whole commercial credit lending system become awkward, cumbersome and time consuming as well as slowing down the market and reducing the liquidity of share certificates.

The following line of cases will serve to draw out examples of problems experienced by share holders or would be share holders in the purchase, or acquisition of shares or the right to own shares.

In the case of in <u>Re C.A. Macdonald and Company</u> (ff) a case coming out of the Alberta Court of Appeal which held that when a broker sold shares of a block of shares owned by himself that the law of seller and buyer applied (and not that of broker and client) and further held, that even where the broker had recorded the sale in his ledger, indicated the portion sold and subtracting that from the total shares owned by the broker, that this was not sufficient to appropriate those shares to the contract and thereby vest a beneficial

title in the buyer. The court also held, that in the alternative, that, as there was no transfer executed by the broker to the buyer, that no property in these shares passed to the buyer.

This case as well as an earlier case, Re Stobie -Forlong -Mathews Limited(ff) are situations where the broker went bankrupt and claims were made by various buyers of shares upon stock being held by the trustee in banruptcy or liquidator. The common thread running through these cases is the purchase of a portion by the buyer from the mass of the seller and the attendant problems on identifying that portion where there have been definitive steps taken to appropriate that portion to contract. This analysis takes us back to the Re Wait(ff) situation and in both of these cases, though, the purchase money had been paid, as there was no means to trace the funds into the bulk and come out with a clearly defined portion the courts held against the purchasers.

It is interesting that in both cases there were sale notes given to the purchasers, and the sales were recorded in the ledgers of the respective brokers indicating the amount of shares and the price paid for the same. In the latter case there were also sufficient shares on hand to meet the demands of all individuals making claims upon that block of shares.

This raises some interesting questions, as shares by their serial numbers are certainly more readily identifiable than kernels of grain in the hold of a ship. Further to this point, where a block of shares is owned by a broker and the exact amount can be ascertained on a specific day including the day upon which a purchaser pays for a portion of that whole surely within commercial circles the mechanics of tracing the money to the acquisition of a portion of the shares can be achieved without to much difficulty.

Another case highlighting some problems experienced by a purchaser is that of Cooper v. Cayzor Athabasca Mines Ltd. (ff) a case coming out of the Ontario Court of Appeal was an action commenced by the plaintiff to have himself recorded on the books of the defendant as the registered owner of 63,200 shares. The facts were relatively simply, the defendant had some years prior to the commencement of this action in consideration for receiving mining rights had allotted some 4,500 shares of the company to a third party. This third party in turn agreed to transfer to the plaintiff some 63,200 shares, and the plaintiff after inspecting the minute book and share register of the company and being satisfied that the third party was in fact recorded as the holder of more than sufficient shares to meet the assignment, the plaintiff took a transfer of the stated number of shares in which the third party described in the transfer as "standing in my name on the books of the" defendant company. The plaintiff then delivered the transfer document to the company and was informed as the company was presently inactive upon them so becoming active the plaintiff would be forwarded a share certificate for the amount of shares he had purchased from the third party. However, this was not done. A few years later the company changed its name, and reallotted the original shares to the third party for which he received a certificate. The third party then made an assignment of his shares to another individual. The plaintiff did not become aware of these facts until some five years later and after unsuccessfully endeavoring to have his name recorded as share holder for the number of shares transfered to him by the third party, brought action against the company for declaration that he was the owner of 63,200 shares, for a certificate for that number, and to have stock rectified accordingly.

The plaintiff argued that the third party was a de facto share holder of the company and the owner in law of more than

fully paid up and non-accessible shares of stock transfered by him; and that the third party transfered to him (the plaintiff) the right, title and ownership of 63,200 of those shares and that he is now entitled to be registered in the books of the company as a share holder of that number of shares.

The argument put forth by the company was to the effect that there had been no allotment or issue of shares of the cattle stock of the company to the third party; that at the times of the assignments by the third party to the plaintiff, the third party possessed on a right and equity to compel the allotment and issue of shares and certificates thereof and the entry of his name on the stock register of the company pursuant to the agreement of purchase and sale entered into by the company; and that the rights of the third party were chose in actions only and that assignings of such rights the plaintiff could not, maintain the action without the assign or being a party thereto; that since there was no allotment of shares of the cattle stock of the company to the third party until some three years subsequent to the assignment, and since the third party was not otherwise a share holder of the company, he could not get a valid transfer of the shares to the plaintiff; that even if the assignments were valid and sufficient transfers for shares of the cattle stock of the company, the company did not have sufficient notice of them; and that the claim should be dismissed because of laches on the part of the plaintiff in ascerting such rights, if any, as he may have had under the assignment from the third party to him; and that the company was not obliged to see to the execution of any trust, whether expressed, implied, or constructive, which might have been imposed upon shares of his cattle stock by virtue of said assignment; and finally that the action and enforcement of such rights was statute barred.

In every case the question was one of fact and the cases (sometimes conflicting in their results) appear not to establish any definite rules, but only to demonstrate the view taken by the particular court of the facts aduced in evidence.

As the material facts were undisputed, the court of appeal was at liberty, and indeed was bound, to draw its own inference from them. That principle has been applied in many subsequent cases.

The court held, that as there had been an agreement and resolution between the company and the third party over the purchase price of the third parties minings rights and that in consideration of receiving the mining rights the company had agreed and by resolution, had allotted 1,100,000 shares to the various persons entitled to them, one of whom was the third party. As the authority of the proper officers to perform the ministerial acts of recordings the names of allotees and to issue certificates to them can be implied in the circumstances, nothing more remained to be done by the directors of the company to give to the allotees, including the third party, the full status of de facto share holders; in the omission of the officers of the company to do the ministerial acts of recording the allotees names on the records of the company and to issue certificates to them could not deprive them of that status and the rights arising therefrom.

As the third party had become a de facto share holder, one of the rights arising upon this was the ability to assign a portion of his shares or all of his shares to the plaintiff.

Upon having the assignment executed and the documents delivered to him, the plaintiff, in turn brought these documents to the attention of the company by delivering them to the head office, at which time he was informed that upon the company becoming active and retaining a transfer agent that a share certificate for the amount signed would be forwarded to the plaintiff. It was on this basis that the court was able to find that the company was barred from denying the validity of the plaintiff's claim on two grounds, the ground supporting the estoppel have been set out above, and acquiescence on the part of the company occurred at the time when the plaintiff presented the assignment executed by the third party and the company did not deny that shares of the capital stock of the company were standing in the name of the third party on the books of the company. The court went on to dispose quite quickly of the various arguments put forth on behalf of the defendants; the agreement and resolution entered into named only the third party as the sole individual entitled to the allotment and issue of such shares; there was no laches on the part of the plaintiff because there had been no activity on the part of the company and no transfer agent appointed for a long period of time; the name of the company was changed, and there are many circumstances which explain satisfactorily any delay on the part of the plaintiff in asserting his rights. On the authority of Smith v. Gowganda Mines Ltd. (ff) the company was not capable of accepting a surrender of issued shares and reallotting them. With respect to the defence by the company that it was not obliged to see to the execution of any trust imposed upon shares of its capital stock, the court held that it had failed to show that any trust existed in respect to the shares of stock claimed by the plaintiff.

This case serves to highlight many of the pitfalls set before a shareholder in his attempts to have himself recorded on the books of a company as the registered owner of capital shares

in that company. Given this situation, where the shareholder was astute enough to inspect the minute book of the company and to examine the share register to ascertain the holdings of the third party, and after having obtained a properly executed assignment of a portion of those shares and bringing it to the notice of the company, the plaintiff was still put to the task of having to litigate the matter before he could be properly recorded on the books of the company. Granted, this is an extreme case, it is still a case which illustrates the need for some form of legislative guidance as to the responsibilities of the various parties involved in share transfers. Secondly, these cases should service to illustrate the consistent inconsistencies obtained by application of prevailing principles by common law courts, such principles applied, after the court has characterized the fact situation so as to be consistent with the conclusion it has already pre-determined. A review of these cases indicate that they, develop no set trend, give no firm guidance, and do not always protect the individual whom one might characterize as the most innocent of all the parties concerned. These matters will be assessed more thoroughly at a later stage in this paper.

This should be incorporated into the beginning of the discussion on the common law principles.

"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 documents may be when a real attempt is made to make them correspond with the customs and practices of the market place." (ff)

Briggs, 21 Montana Law Review.

Present Legislative Guidelines

A brief discussion of the Alberta Company Act as it provides for share transfers and certain specific related definitions, will serve to illustrate the manner in which legislatures have directed or given direction to companies vis-à-vis the manner in which shares and securities were to be transferred. Differences between the Federal Corporations Act, Ontario's Corporations Act and Alberta's Company Act are very few, but where they occur, attention will be drawn to them.

The Alberta Companies Act in giving some direction provides certain definitions; debentures include debenture stock and bonds (ff); securities, means notes, bonds, debentures or other evidences of indebtedness issued by a corporation, whether secure or unsecure (ff); share means share in the share capital of the company, include stock, except where distinction between stock and shares is express or implied (ff); a private company is one which, restricts or prohibits the right to transfer any of its shares and/or prohibits an invitation to the public to subscribe for any shares or debentures of the company (ff).

In setting out the mechanics of transfer the Act provides for a register which shall include; alphabetical list of its members and the amount of shares held and the amount paid for those shares, the date entered as a member and ceasing to be a member; particulars of transfer by any member of his shares; and the description of the capacity in which a person represents a shareholder or estate, i.e., executor, administrator, comity, guardian, or trustee (ff). Provisi made for a register, its location, and access for inspection (ff) as well as providing for a trust company to be the transfer agent for a corporation (ff).

Upon registering a transfer, a company is not bound to see to the execution of any trust, express or implied or constructive (f

and the receipt of the registered shareholder is a good and valid discharge to the company for an amount payable or sum payable, for dividend or other interest (ff). Shares are declared to be personalty, and transferable in the manner provided by the articles of the company (ff); that a shareholder is entitled to a share certificate indicating the capacity in which the shares are held, i.e. executor, administrator, trustee, guardian (ff); that the share certificate is "prima facie" proof of the title of the member to the shares (ff). The Act goes on to provide transfer by personal representatives (ff) and that the liability for unpaid shares shall not fall upon the executor of the estate but upon the estate itself (ff).

The Act sets out provisions which allow for shares without nominal or par value with the further proviso that any preferences, rights, etc. must be stated on the share certificate (ff). There is also provision within the Act for a "share warrant" which may be issued in bearer form, which is transferable by delivery of the share warrant (ff). There are also further provisions for the keeping of records for the issuing and cancelling of share warrants and the procedure to be followed (ff).

The manner, or mechanics, provided by the articles of the company for transfer of shares, were not specifically drafted to suit the company or governed by the articles incorporated in the Act, which set out; the form of the share and transfer form (ff); execution by the transferor and transferee (ff); that the directors may decline to register any transfer of shares for the following reasons; where the shares are not fully paid up (ff) to a person of whom they do not approve; to a share upon which the company has a lien (ff); in addition to which the share certificate must accompa the instrument of transfer and any other evidence that the directors may reasonably require (ff). Where an executor or administrator or other individual represents a trust or an estate that individual is the only person recognized by the company as having title to the sha (ff).

The direction given by the articles is not binding upon the company except in a situation where they have not included a set of articles with the documents given to the Registrar of Companies for incorporation of the company.

Both the Ontario Companies Act and the Federal Corporations Act are very similar to the Alberta Act with the exception of the following provisions. Ontario makes provision for the directors to refuse registration of a transfer of shares on the books "for the purpose of notifying the person registered in the books," following such notice the registered owner has seven days to lodge a caveat and upon filing a caveat has 48 hours in which to obtain an order of the court in joining the registration of a transfer. Failing this the company is at liberty to proceed with the registration of the transfer (ff). In addition, provided the company follows the above outline procedure it shall not be held liable in respect to such shares to a person whose rights are purported to be transferred but nothing prevents the transferor from asserting a claim against the transferee (ff).

There is also provision made for fractional shares or scrip, which when you have sufficient numbers of fractional shares to equal a whole share, you may exchange them for a whole share and be registered on the books of the company (ff). The Federal Act contains similar provisions to those as outlined above within the Ontario Act. In addition there are also certain provisions covering the situation where a call is made by the company on the amount of money unpaid on shares issued and attaching liability for the amount of the call to any transferee of the shares (ff).

That these provisions are inadequate for dealing with present day practical problems arising in the market place and give little guidance to the practitioner in ascertaining a client's position arising out of a fact situation, for example, such as arose in Toronto Dominion Bank v. Consolidated Paper Company Limited (ff).

or in the Chartered Trust Company v. Pagan situation. Little if any legislative guidance is given to assist an individual or for that matter any individuals involved in a share transfer as to what their respective duties are and what defences they may be allowed to raise after having complied with their duties and in addition what defences they will not be able to raise where they have not complied with their duties or obligations. Reference to the legislative guidelines arising in foreign jurisdictions as well as other jurisdictions in Canada only tend to amplify the inadequacy of our present day provisions as they attempt to give direction to the resolving of substantive issues.

Legislative Reform Developments in Foreign Jurisdictions

U.S.A.--Article 8

Background: Execonomic Function of Securities

Within the market place today, there are basically two types of investment paper, commercial paper which will include promisory notes, cheques, drafts, and secondly, securities which would include bonds, debentures, certificates representing both common and preferre shares. While both are forms of investment paper and function as such there is a definite functional distinction between them. Commercial paper is used within the market place, more to finance the manufacture or marketing of goods or rendition of services, i.e. for a specific transaction, or a series of transactions. On the other hand, investment securities are issued to finance the enterprise as such, providing capital without which the business could not successfully function.

Categorized on another basis, commercial paper will be expressed as payable to "bearer" or to the "order" of a specified person; thus transferable in the former case by delivery of the instrument, and the latter by delivery of the instrument bearing

the endorsement of the named payee or endorsee. It is therefore possible to break securities down into two further classifications, equity securities which are customarily issued in "registered form" as evidence of the rights and interests of a named holder. And secondly, debt securities which are commonly issued payable to "bearer" but may also express the issuer's obligation to a named "payee or registered assigns."

Securities in "registered form" are stated to be transferable only by delivery of the instrument "appropriately endorsed." A surrender of the endorsed instrument to the issuer or "transfer agent" or "registrar" against delivery of a new security registered in the name of the transferee, is contemplated here. (ff)

Another good distinction between commercial paper and securities is found in the relative duration of the obligation or relationships evidenced thereby. Essentially, commercial paper is a short term credit device, while, securities normally reflect long term or even nominally perpetual investment. From this distinction flows the essential difference between the market for the two varieties of paper. With commercial paper it is open to the original payee to present it to the bank at a discount on his debtor's obligation, for immediate cash. The form he tenders to the bank, will have clear obligations to pay set forth on the instrument. Securities, do not move with such speed and the entire contractual relationship between issuer and holder will not be found on the share certificate, but will be incorporated by referenc as to a certificate of incorporation or trust indenture.

Uniform Commercial Code: Article 8

Article 8 of the Uniform Commercial Code deals solely with investment securities and for security to come within the code it shall be "commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt

in as a medium for investment" (ff).

The definition of "security" is functional rather than formal, and it is believed will cover anything which security markets, including not only the organized exchanges but as well the "over the counter" markets, are likely to regard as suitable for trading. For example, transferable warrants evidencing rights to subscribe for shares in a corporation will normally be "securities" within the definition, since they (a) are issued in bearer or registered form, (b) are of a type commonly dealt in on securities markets, (c) constitute a class or series of instruments, and (d) evidence and obligation of the issuer, namely the obligation to honour the warrant upon its due exercise and issue shares accordingly (ff). On the other hand the definition does not cover anything which is either "of a type commonly dealt in on security exchanges or markets" or "commonly recognized...as a medium for investment." Therefore, investments, securities, instruments which evidence long term investments, such as stock certificates, scrip certificates, bonds payable to registered holders and other certificates evidenced in long term financing would generally be considered securities under the code. This new (new to us, old to the Americans) stance embraces the policy embodied in the English Bills of Exchange Act, 1882 (ff), which enables "the custom of merchants to develop new negotiable instruments as commercial necessity arises, i.e. common law negotiability (ff).

Certain formalistic requirements for investment securities were also incorporated within the definition, such that it must "be issued in bearer or registered form" (ff).

The Code is intended to make provision for the ready and easy transfer of investment securities dispensing with excessive investigation of quests for title.

"The share itself is an object of dominion, i.e. of rights in Rem, and not so to regard it would be barren and academic

in the extreme. For all practical purposes are recognized in law as well as in fact, as the objects of property which are bought, sold, mortgaged and bequeathed. They are indeed the typical items of property of the modern commercial area and particularly suited to its demands because of their exceptional liquidity. (ff)

There is never any doubt about whether something is a share, but there is considerable doubt about what a share is.

In general the provisions of the various Acts, both federal and provincial, pertaining to transfer of various securities, and common law principles were applied and misapplied by the courts to solve issues arising in relation to stocks, bonds and other evidences of ownership or indebtedness commonly sold to and traded among investors.

Article 8 fulfils the need for clear and concise rules to guide the nation-wide business community in dealing with investment securities. Article 8 can best be described as as "negotiable instrument's law for investment securities."

The following discussion will examine the effects of Article and The Canada Business Corporation provisions for security certific registers and transfers, upon the rights and obligations of the five parties most affected by the Article 8 code and The Canada Business Corporations Act provisions and involved in the ordinary security transactions; 1) the issuer; 2) the stockholder and his rights in relation to (a); the issuing corporation and (b) his transfe or transferee; 3) the transfer agent, be it a coroporate agent or issuer acting for itself; 4) the broker, when acting as agent for

buyer or seller; and lastly 5) the bank, when acting in various capacities other than as transfer agent.

The Issuer

8-201.

"Issuer"

(1) With respect to obligations or defences to a security "issuer" includes a person who

(a) places or authorizes the placing of his name on a security (otherwise than as authenticating trustee, registrar, transfer agent or the like) to evidence that it represents a share, participation or other interest in his property or in an enterprise or to evidence his duty to perform an obligation evidence by the security; or

(b) directly or indirectly creates fractional shares in his rights or property which fractional interests are evidenced by security; or

(c) becomes responsible for or in place of any other person described as an issuer in this section.

(2) With respect to obligations on or defences to a securit a guarantor is an issuer to the extent of his guarantee whether or no his obligation is noted on the security.

(3) With respect to registration of transfer (Part 4 of thi article) "issuer" means a person on whose behalf transfer books are maintained.

Section 44(2) "issuer"

Issuer includes a corporation

(a) that is required by this Act to maintain a securities register, or

(b) that directly or indirectly creates fractional interests in its rights or property and that issues securities as evidence of such fractional interests;

Section 44(6) Guarantor for Issuer

A guarantor for an issuer is deemed to be an issuer to the extent of his guarantee whether or not his obligation is noted on the security.

Corporations either private, or chartered as an agency of the government, which issue either stock or evidences of debt, or any combination of the two, fall directly within the definition of "issuer" as defined above. The scope of this definition is wide enough "to include any security issuing business entity, even a partnership or sole proprietor and will extend to other issuers,...s as joint ventures selling fractional interests in oil or gasoline leases. The guarantor of an issuer's debt security is held to all of the obligations of the issuer to the extent of the guarantee, but is relieved somewhat with the availability of any of the defences open to the issuer. Liability attaches whether the guarantee contra is disclosed on the face of the security or not and irrespective of the purchaser's knowledge of the obligation at the time the security was acquired.

Defences the Issuer may Raise

8-208. Effective signature of authenticating trustee, registrar, or transfer agent.

(1) A person placing his signature on a security as authenticating trustee, registrar, transfer agent or the like

warrants to a purchaser for value without notice of the particular defect that

(a) The security is genuine and in proper form; and

(b) His own participation in the issue of the security is within his capacity and within the scope of the authorization received by him from the issuer; and

(c) He has reasonable grounds to believe that the security is in the form and within the amount the issuer is authorized to issue.

(2) Unless otherwise agreed, a person by so placing his signature does not assume responsibility for the validity of the security in other respects.

Section 55(1) Warranties of Agents.--A person signing a security as authenticating trustee, registrar, transfer agent or other person entrusted by the issuer with the signing of the security, warrants to a purchaser for value without notice that

(a) The security is genuine;

(b) His acts in connection with the issue of the security are within his authority;and

(c) He has reasonable grounds for believing that the security is in the form and within the amount the issuer is authorized to issue.

(3) Limitation of Liability.--Unless otherwise agreed a person referred to in sub-section (1) does not assume any further liability for the validity of the security.

The public assumes that securities traded within the market

place are valid and therefore, great responsibility is placed upon issuers, their authenticating trustees, registrars and transfer agents, for the validity of securities in circulation. This responsibility is clearly delineated within the provisions set out above and by doing so enlarges the protection and "shelter" provisions for bona fide purchases, which in turn promotes greater confidence in the investor and a consequent increase in the liquidit of securities within the market place.

This situation is similar to that found operating with respect to commercial paper and "almost all defences available to the issuer are cut off by affording purchasers for value without notice of the specific defect approximately the same protection given a holder in due course and the rules relating to commercial paper" and in addition under Article 8 in the C.B.C.A. provisions, this protection extends in almost all cases to initial purchasers as well as later transferees. Once an issuer places his securities within the market place his manner of proceeding is now bound by the Code or the C.B.C.A. provisions both of which have eliminating many of the common law defences open to an issuer and the following discussion outlines the few defences left open to the issuer or his transfer agent.

8-202. Issuer's responsibility and defences; notice of defect or defence.

(1) Even against a purchaser for value and without notice, the terms of a security include those stated on security and those made part of the security by reference to another instrument, indenture or document or to a constitution, statute, ordinance, rule, regulation, order or the like to the extent that the terms so referred to do not conflict to the stated terms. Such a reference does not of itself charge a purchaser for value with notice of a defect going to the validity of security even though the security expressly states that a person accepting it admits

such notice.

(2) (a) A security other than one issued by a government or governmental agency or unit even though issued with a defect going to its validity is valid in the hands of a purchaser for value and without notice of the particular defect unless the defect involves the violation of constitutional provisions in which case the security is valid in the hands of a subsequent purchaser for value and without notice of a defect.

(b) The rule of sub-paragraph (a) applies to an issuer which is a government or governmental agency or unit only if either there has been substantial compliance with the legal requirements governing the issue or the issuer has received substantial consideration for the issue as a whole or the particular security and stated purpose of the issue is one for which the issuer has power to borrow money or issue the security.

(3) Except as otherwise provided in the case of certain unauthorized signatures on issue (section 8-205), lack of genuineness of a security is a complete defence even against a purchaser for value and without notice.

(4) All other defences of the issue including non-delivery and conditional delivery of the security are ineffective against a purchaser for value who has taken without notice of the particular defence.

(5) Nothing in this section shall be construed to effect the right of a party to a "when, as and if issued" or "when distributed" contract to cancel the contract in the event of a material change in the character of the security which is the subject of the contract or in the plan or arrangement pursuant to which security is to be issued or distributed.

Section 51 (1) Notice of defect.--Even against a purchaser for value and without notice of a defect going to the validity of a security, the terms of the security include those stated on the security and those incorporated therein by reference to another instrument, statute, rule, regulation or order to the extent that the terms so referenced do not conflict with the stated terms, but such a reference is not of itself notice to a purchaser for value of a defect going to the validity of the security, notwithstanding that the security expressly states that a person accepting it admits such notice.

(2) Purchaser for value.--A security is valid in the hands of a purchaser for value without notice of any defect going to its validity.

(3) Lack of genuineness.--Except as provided in section 53, the fact that a security is not genuine is a complete defence even against a purchaser for value without notice.

(4) Ineffective defences.--All other defences of an issuer, including non-delivery and conditional delivery of a security are ineffective against a purchaser for value without notice of a particular defence.

Where a security was made subject to the terms of another document, and its negotiability was challenged in the courts, a contrary decision was sometimes forthcoming as the courts would hold to the common law rule that the promise of payment must be "absolute on its face." Terms contained in underlying documents incorporated by reference were often related to rights in a collater security (as in the case of a trust indenture) and did not infringe upon the issuer's "unconditional promise to pay" provision within Article 8-202(l) and Section 51(l)(l) of the C.B.C.A. provides that the terms set forth in the security bind the holder as do those terms made prior to the security by reference thereto. In addition,

any terms within the incorporated document would conflict with those terms set out on the security are of no effect, and further, a mere reference does not of itself give notice of a defect going to the validity of a security.

The Defence of Invalidity

When the question of the validity of a security is raised a distinction must be made between a defect in the form of the security, which is not fatal, and a defect which arises out of a contravention of a statute, either federal or provincial, or of a by-law provision, or a contravention of a governmental body, for example, a securities commission.

The import of Article 8-202(c)(a) and Section 51(2) C.B.C.A. in effect, validate this security or rather, these provisions deny the issuer any defence based on the invalidity of the security once the security is in the hands of a purchaser for value without notice of the particular defect.

A security that was not genuine could not be enforced against an alleged issuer, in addition a counterfeit certificate would be valueless in the hands of any holder, and this position is maintained in Article 8-202(3) and Section 51(3) C.B.C.A. with the exceptions as outlined in Article 8-205 and Section 53(a) and (b of the C.B.C.A. These sections provide that an unauthorized signature placed on a security "prior to or in the course of issue," is ineffective against the issuer, but, where such a security is acquired by a purchaser for value without notice of the lack of authority, an estoppel is raised, on the basis of "apparent authority" and thereby blocks the issuer's ability to raise the defence of lack of authority. Seldom will a purchaser have knowledge of the authority of the signing party or parties, much less their names. Here the loss is born by the issuer, or the issuer's agent or authenticating trustee who in the circumstances is the party most

capable of preventing employee frauds. These exceptions will counter the holdings against some purchases for value from individuals with "apparent authority" as seen in the Reuben v. Great Finegold case (ff) and the Toronto Dominion Bank v. Consolidated Paper (ff).

Parallel with the rules prevailing in the commercial paper market, theft of endorsed securities from either the issuer or the agent's possession, or "the delivery of the security condition for effectiveness upon some subsequent event, such as payment therefor, will not provide the issue with an effective defence against a purchaser for value without notice of the particular defect. This is the general import of Article 8-202(4) and Section 51(4) of the C.B.C.A. provisions.

Staleness

With respect to staleness, a purchaser of an overdue, matured or called security is charged with notice of "...any defect in its issue or defence of the issuer...." Only after the lapse of two specific periods of time, in the first situation a collapse of one year and in the second situation a lapse of two years.

Where a security provides that after a stated event, either indicated on the security itself or incorporated by reference to some document at the head office, a holder will have the power to demand immediate performance of the obligation evidenced by the security (either payment of a sum of money, surrender for redemption or exchange) and upon such event happening, and provided the issuer is ready and willing to perform on such date, i.e. has the cash or securities on hand for payment or exchange, then the one-year period begins to run from such date that the issuer is ready and willing to perform.

However, if on the happening of the event, or the effective date, if the issuer was not prepared to perform then the purchaser c

holder is not bound with notice of any defect or defences unless he takes the security more than two years from that effective date or happening. This provides a clock for those issuers who are ready to perform their obligations (allows a certain date after which they may raise defences against stale securities) and this is a disadvantage to those issuers who are not prepared to perform their obligations as they lose the protection of the ability to raise the defence for an additional year. This is the general import of Article 8.203(1)(a) and (b) and Section 52(a) and (b) C.B.C.A.

Restriction on Transfer

Provision for the restriction on transfer of stock of a company has been provided for in both the federal and provincial Companies Acts. The code takes us a step further and the C.B.C.A. provisions follow this up by emphasizing that if a restriction is placed upon the transfer of a share, it must be "noted conspicuously" as set out in 8.204 and Section 45(8) of Article 8 of the C.B.C.A. respectively.

Unauthorized Completion or Alteration

The import of Article 8.206 and Section 54(1)(a)(b)(2) is that, as against a purchaser for value without notice of the unauthorized completion, that the issuer is prevented from raising the defence of material alteration or unauthorized completion of the security. Unauthorized or incorrect completions of securities can only occur with the negligence of the issuer or the dishonesty or negligence of an employee of the issuer or its agents. As with the rules relating to commercial paper, alterations of the instrumen where, whether or not material, do not invalidate the security in the hands of the innocent purchaser's value without notice of the defect. This same principle holds true with respect to the purchase for value without notice of the defect, i.e. a material alteration or unauthorized completion of the security.

Over-Issue

With respect to the over-issue situation, the provisions of Article 8-104(1)(a)(b)(200) and Section 48(1)(a)(b) and (2) and (3) is straightforward in its direction to the issuer upon an over-issue and attaches absolute liability for the same. The issuer may remedy the situation by either going into the market and acquiring an identifical security or if a security is "not so available" for purchase, then the issuer may pay the purchaser his purchase price plus interest from the date of his demand. Situation such as these will arise where the issuer has accepted for transfer a security which has been forged but for which the issuer or transfe agent issued a new certificate to the purchaser for value and subsequently was called upon to issue a new certificate to the register owner thereby creating the over-issue. In some situations it might be to the best interests of the company to pass a resolution and thereafter file an application for an increase in the number of authorized shares to cover the amount of the over-issue especially if going into the market at that time involves acquiring a not issue

Other Matters Concerning the Issuer

Due Diligence

It goes without saying that the issuer is entitled to expect the highest degree of good faith and due diligence from its authenticating trustee, transfer agent or registrar in a performance of the functions of such fiduciary relationships. "Good faith and due diligence"require the exercise of reasonable care and the observance of "reasonable commercial standards." (ff) These duties are set out in Article 8-406(1)(a)(b)(2) and Sections 76(1)(a)(b) and 76(2) of the C.B.C.A.

Attachment or Levy

The Code, and the investment securities transfer provisions of the C.B.C.A. for the purposes of attachment, treat the stock certificate or evidence of indebtedn as embodying title to the intangible equity in or show some action

against the issuer. Article 8-317 and Section 70 of the C.B.C.A. provide that no attempted attachment or levy upon a security by creditor of the holder or registered owner shall be effective unless the security is actually seized by the acting officer. These provisions again maintain the negotiability of the instrument, for to allow otherwise would be to destroy the freedom of the transferability otherwise afforded securities under the code and the C.B.C.A. transfer provisions.

Effective Registration

Upon a person presenting a security for transfer and upon that individual being registered in the books being maintained for that purpose, the issuer or its agent is entitled to treat the party so registered as the owner, until the security is properly presented for transfer, and as the party legally entitled to vote, to receive notices and otherwise to exercise all rights of power of ownership. The ownership may pass, but the purchaser may assert his status at will.

In a situation where the ownership has passed, but the certificate has not been presented for transfer and registration in the name of the new holder. Still, where the issuer sees a definite notice that the security has been transferred without actual presentation of the certificate, i.e. notice of an adverse claim, it may require further proof of continuing ownership from the registered owner before paying out to him dividends or issuing rights or other things of value.

Lost or Destroyed Certificates

Upon the loss of a security or one that has been apparently mislaid or wrongfully taken, the owner must notify the issuer within a reasonable period of time after he has become aware of such occurrence, failing this he will risk the loss of power to assert any

claim against the issuer for wrongful transfer of certificates to another and, once it has been transferred to a bona fide purchaser, of any claim for a new security to replace it. The obligations of the issuer were to issue a replacement certificate to the owner upon receipt of an indemnity bond and other , which has been normal corporate practice. Should the lost, or destroyed certificate turn up in the hands of a bona fide purchaser for value, the issuer may then look to the indemnity bond to protect itself from loss in the event the replacement certificate issued to the original owner also turns up in the hands of another bona fide purchaser. Provision is made for this situation in Article 8-405 and Section 75(1)(2)(a)(b)(c)(3)(4) of the C.B.C.A.

The Stockholder

Bona Fide Purchaser

The foregoing discussion considered controversies arising between the issuer and a holder of a security from a viewpoint of the issuer. Consideration is now given to the problems encountered by the stockholder both as transferor and transferee by the acquisition of a security in the post-issue sale.

The underlying concept to this discussion is that of the "bona fide purchaser" and the situations which will elevate one to that status on the one hand and which preclude a purchaser or rather deny a purchaser that status on the other hand. The protection afforded the bona fide purchaser is similar to the metaphorical "shield" which is often used to describe the successful establishmen of estoppel in other situations. A "bona fide purchaser" as set out in Article 8-302 and Section 44(2) of the C.B.C.A., is a purchaser for value in good faith and without notice of any adverse claim who takes delivery of security in bearer form or of one in registered form issued to him or endorsed to him or in blank.

The Uniform Commercial Code provisions as set out in Article 8 and the C.B.C.A. by its adoption of those provisions "makes a distinction between the purchaser for value from the issuer without notice of a particular defect going to the validity of the security, who then takes free of the issuer's defences, and a bona fide purchaser, i.e. one who takes by a formally perfect transfer for value from a prior holder, without notice of any adverse claims. Only a bona fide purchaser takes free of adverse claims that may be asserted by owners or others entitled to possession or ownership of the security. The latter definition includes the former. The protection extended by Article 8-301, 56(1) of the C.B.C.A. is granted to the bona fide purchaser of any type of security that needs a definition of Article 8-102(1), Section 44(2), whether or not the security was considered "negotiable under former case law. This completes the encircling protection of full"negotiability."

The key words in the definition as set out above of a "bona fide purchaser" is that such a purchaser must receive the security as well as in good faith and for value, it must also be acquired "without notice of any adverse claim." To digress for a moment, "adverse claim" as set out in Article 8-301(1) and Section 44(2) of the C.B.C.A. includes the claim that a transfer was or would be unauthorized or wrongful or that a particular adverse person is the owner of or has an interest in security. Article 8-304 and C.B.C.A. provision 57(1)(a) and (b) and 57(2) set out the factual situations upon whose occurrence the purchaser will be deemed to have notice of an adverse claim and they are briefly a) unambiguous notations of adverse claim on security itself; b) endorsements that are restrictive in nature; c) the purchaser's knowledge that a transfers by a fiduciary are for the fiduciary's individual benefit or otherwise breach of duty.

These factual situations as set out in the above noted provisions equally serve to give the purchaser a deemed notice and therefore may be raised as a bar to a request for transfer of the

security into the name of the presentor.

The grounds giving rise to the first and second factual situations are straightforward, in the former an endorsement "for collection" or "for surrender" and in the latter an endorsement that is clear and unambiguous to the fact that the security belongs to an individual other than the immediate transferor would serve immediately to put a purchaser on notice. The third situation however requires further clarification. Where the purchaser is receiving a security endorsed to him from a fiduciary (and this fiduciary can be an executive of an estate or a treasurer of a corporation) this of itself would not serve to put the purchaser on notice of any irregularities either as to the authority to execute the transfer or as to the application of the proceeds of the purchase. However, the situation will be viewed differently where the purchaser from all of the surrounding facts and circumstan should be aware that the proceeds of the sale are being applied in breach of the fiduciary's trust, for example, a lender, either institutional or individual, who has knowledge that the proceeds are being used or the security is being pledged either in the former to honor a personal debt or in the latter to collateralize a personal loan, each situation would give rise to a notice of an adverse claim These are by no means the only fact situations which may give rise to a notice of an adverse claim.

Staleness as Notice

There is a distinction here between staleness as a notice of an adverse claim under ARticle 8-305 and Section 58(a) and (b) of the C.B.C.A. and staleness as discussed earlier in respect to notice of defects in issue or defences available to the issuer (Article 8-203, Section 52(a) and (b) of the C.B.C.A.) The distinct lies in the theory that a purchaser taking a security with knowledge that the funds for the redemption of the same have been available for some time should be more on notice that there might be adverse

claims of ownership as opposed to a defect in the issue. We therefore, in such situation, where a purchaser acquires a security one year after the date for presentment or surrender or redemption or alternatively, six months after the moneys are available for such payment on presentation or surrender, then the purchaser is deemed to have notice of an adverse claim. This is another fact situation which would fall under the definition as set out before covering adverse claims, this specifically falling under "unambiguous notations of adverse claim on the security itself

The Importance of Delivery

A purchaser, prior to receipt of a security containing all the necessary endorsements, may be given notice of an adverse claim which will be binding upon him and bar him from obtaining the status of a bona fide purchaser. A delivery is not complete even though the security has been placed in the hands of a purchaser or his nominee if an endorsement is lacking upon the security. For even though the purchaser may be able to enforce the inscribing of the endorsement, any notice of an adverse claim being given to the purchaser before the endorsement is made will be binding upon him. Completion of the endorsements and delivery are therefore of the utmost importance to the purchaser, in order to determine his status and raise the shield of bona fides. Conversely, where the security is property endorsed but still in the hands of the vendor or transferor, will not constitute a transfer until actual delivery of the security is made to the purchaser. With respect to securities in bearer form, endorsement will not affect or alter the bare nature of the security, in addition, such an endorsement will not affect the holder's right to registration except where the wording of the endorsement is such that the purchaser may be held to have had notic of an adverse claim. This latter situation is considered and provid for in Article 8-310 and Section 63 of the C.B.C.A.

With the vast amount of security transfers affected today on the various stock exchanges and the over-the-counter sales,

under Article 8 and the C.B.C.A. provisions for transer, delivery is completed when: a) the buyer or his agent takes possession of the security; b) the buyer's broker takes possession of security endorsed especially to the buyer or issued in the buyer's name; c) the buyer's broker confirms the purchaser and identifies the security in his possession as belonging to the purchaser by book entry or otherwise; c) any third party acknowledges that a specific security is held by him for the purchaser. The bulk of these transfers are accomplished through the activities of the brokers for the respective parties and it is obvious by reading the provisions set out above that notice to the buyer's broker prior to the completion of one of the requirements of delivery as outlined above, will be noticed to the buyer and will therefore bar him from cheating the status of a bona fide purchaser and the attending shield. In these situations the purchaser would be able to demand a security lacking in any defect, and the broker because of his trar relationship with the buyer will be under an obligation to provide one thereby leaving the resolution of the defective security to the broker and the party from whom he received it.

Attention is drawn to the latter part of provision (c) of the above-noted sections which says "even though the transfer is made on endorsement of a fiduciary to the fiduciary himself or to his nominee," which absolves an issuer from liability for wrongful transfer. This emphasizes the fact that this rule is designed specifically for breach of fiduciaries and is in contrast to the rule established as to notice of adverse claim between a fiduciary and a subsequent purchaser as indicated in article 8 - 304 (2), section 57(2) C.B.C.A.

Discharging the Duty to Inquire into Adverse Claim

Where an issuer is presented with a security for transfer against which is lodged an "adverse claim" at that point, a duty is placed upon the issuer to inquire into the adverse claim. However,

this inquiry should not consume undue time (so as to cause the transferee unnecessary financial loss) nor should the issuer become a trier of fact in the matter between the individual who lodged the "adverse claim" and the individual presenting the security for registration of transfer. A clear, and expeditious manner of proceeding is set out under Article 8-403(2), section 73(2) C.B.C.A. which in effect allows the issuer to force the adverse claimant to take action. Briefly, the issuer gives the adverse claimant notice that it intends to transfer the security, unless within 30 days a court order is served upon it enjoining the transfer; or an indemnity bond, sufficient to protect the issuer from loss is filed with the issuer by the adverse claimant. This is not the only method of proceeding, and the issuer may use any reasonable means to discharge its obligation of inquiry (ff).

Notice of Lost or Stolen Securities

Earlier discussions concerned themselves with the manner in which notice of lost, stolen or destroyed securities was to be given to the issuer or transfer agents, or other necessary parties. The question has come up both within the common law and legislative enactments as to how long these notices should bind the issuer or said in another manner, when should the issuer or transfer agent be able to say in good faith and innocence that the notice was overlooked. Article 8 does not set a specific time limit but in its commentaries refers the reader to the case law. However, under section 73(4) of the C.B.C.A. a written notice of an adverse claim is effective only for 12 months unless renewed in writing and sent to the issuer. This would appear to be a compromise between conflicting cases arising out of the common law and it seems strange in any event that an issuer should be able to plead that it had in good faith "forgotten", "overlooked" a notice.

Liability and Limits of Liability

In balancing the scales on the side of the issuer, Article 8-404, section 74 C.B.C.A. provisions safeguard the issuer in situations where there has been compliance with the provisions of Article 8 or C.B.C.A. By this it is meant, an issuer will not be liable to the owner of a security or anyone else if it transfers, where: (a) the necessary endorsements were affixed and (b) there was no duty present to discharge or inquire into adverse claims. This essentially is the import of the above-indicated provisions and in addition, where an appropriate endorsement proves lacking the issuer will have a right over against the guarantor. Distinct from these situations, an issuer will only be held liable through its own negligence in overlooking notices it has received.

It is submitted, that compliance with the foregoing provisions by issuers or their agent will decrease the danger of losses for wrongful transfer, and the same provision place a duty upon the owner of a security who in most situations can effectively protect his interest, to give prompt notice to the issuer of its loss or theft. The provisions which must be satisfied in order to become a bona fide purchaser provide substantial obstacles to block a dishonest purchaser's attempts to acquire a bona fide status. Lastly, compliance with the article 8 provisions and C.B.C.A. provisions by the issuer should decrease the amount of paper work that was supported by overly cautious transfer agents in former times and equally, lessen the burden that was placed on the party presenting a security for transfer.

The Broker

Definition of Broker

In the vast majority of security transactions effected each day the broker is an integral working component of the

entire transaction, without whom sellers and buyers separated by many thousands of miles would not be able to achieve their desires. Article 8-303, section 44 (2) C.B.C.A., provide a definition for such an individual "As one who, while acting for another, engages either all or part of his time in the buying and selling of securities". However, a distinction is to be noted that when a broker is purchasing securities for himself, he is not "acting for another". In addition, where the broker holds securities for a customer in either street form, or in a named nominee, this does not affect the broker's status as agent for his customer.

Broker Warranties

The warranties that a broker undertakes to the issuer, purchaser, and also to his customer are set out in Article 8-306, section 59 C.B.C.A. Briefly, as a broker, his warranty is to the effect that the security is genuine and unaltered, that he has no knowledge of any impairment of validity, and that it is effective and rightful. In the situation where a purchaser declines delivery due to a defect in the security or subsequent to accepting delivery commences an action on the warranty, the broker must assume the liability with the right over against his customer (save and except where his customer has disappeared or is insolvent). Additional duties include obtaining completed endorsements, and assuring that delivery of the security is completed. In many situations, due to the broker's personal knowledge of the seller or buyer they will be called upon to give guarantees of signatures and again, the caution concerning guarantee on endorsement mentioned earlier, should be brought to the broker's attention when advice of counsel is sought.

Notice of Adverse Claim

As has been mentioned earlier a purchaser cannot achieve the status of a bona fide purchaser if notice of an adverse claim is brought to this attention prior to accepting

delivery of a security complete in all details. Article 8-313, section 66 of C.B.C.A., delineate the situations where delivery may be constructive, a review of these provisions will amplify the concept of "constructive delivery" and clarify the situations in the common law that are cleaned up. They are as follows:

(1) Delivery to a purchaser occurs when

(a) he or a person designated by him acquires possession of a security; or

(b) his broker acquires possession of a security specially endorsed to or issued in the name of the purchaser; or

(c) his broker sends him confirmation of the purchase and also by book entry or otherwise identifies a specific security in the broker's possession as belonging to the purchaser; or

(d) with respect to an identified security to be delivered while still in the possession of a third person when that person acknowledges that he holds for the purchaser; or

(e) appropriate entries on the books of a clearing corporation are made under section 8-320.

(2) The purchaser is the owner of a security held for him by his broker, but is not the holder of subjects specified in subparagraphs (b), (c) and (e) of subsection (1). Where a security is part of a fungible bulk the purchaser is the owner of a proportionate property interest in the fungible bulk.

(3) Notice of an adverse claim received by the broker or by the purchaser after the broker takes delivery as a holder for value is not effective either as to the broker or as to the purchaser. However, as between the broker and the purchaser the purchaser may demand delivery of an equivalent security as to which no notice of an adverse claim has been received. These last two provisions are novel in that the former is meant to protect the registered owner from loss as a result of the broker either going bankrupt, or having tax liens placed against him, whilst he is holding securities for the owner as agent only and such securities form part of a fungible bulk of similar securities. With respect to the latter provision, initially it sets out the time after which a notice of adverse claim is against the purchaser and secondly as the broker is in a better position to do so, the purchaser may demand that a clean security be delivered to him. Against, as discussed earlier, any notice which the broker has received via a "circular" or other written notice received either from the registered owner or issuer, or other recognized authority will continue as notice to the broker of an adverse claim the only exception being the lapse of one year since the last written notice without a renewal of the same.

Banks, and Trust Companies

In General

While there are various provisions throughout Article 8 and generally throughout the Uniform Commercial Code relating to banks, characterizing their status, describing their function, setting out tests of good faith, with respect to the C.B.C.A.

provisions there is no one provision that deals specifically with banks or trust companies, but, it is submitted that the activities of either could well come under the fraud definitions and scope of various provisions within the C.B.C.A. While the following will not be exhaustive of the many functions that could or will come under the C.B.C.A. provisions an attempt will be made to highlight those essential functions that a bank or trust company might perform as agent for an issuer, in the of a broker, or in their role as money lenders. Where a bank or trust company issues shares to the public it certainly will come under the definition of issuer and thereby be bound with the obligations and duties. The protections afforded a bona fide purchaser will certainly extend to the bank or a trust company that acquires bonds or other forms of security for its own investment portfolios.

At common law when a bank accepted a security and pledge as collateral security for a loan to the owner, (the security certificate then being endorsed in blank or specially endorsed) and the security later turned out to be defective either because of an unauthorized signature or a forgery, and even where there was no notice of this the bank was left holding the bag. It would appear that under the new provisions specifically sections 53, 54, 55, and 56, where the facts support their application, these provisions would tend to elevate the bank to the position of a bona fide purchaser for value without notice. Surely, in the situation where an employee of an issuer, or transfer agent, having access to the share certificate pilfers one forges a signature and passes it off and it then passes from hand to hand in the marketplace finally coming to rest with the bank they would be cloaked with the same trappings as that of a bona fide purchaser for value without notice. It is recognized, however, that there are several arguments supporting the contrary position.

Securities in Control of the Fiduciary

In the day to day business of a bank there are numerous transactions completed between the bank and a fiduciary of either a trust, an estate, or some other controlling document. While the bank must exercise some care in ascertaining that the individual has in fact the authority to endorse a security for transfer, upon satisfying itself it should not look at every endorsement as constituting a breach of the fiduciary's trust. However, as mentioned earlier with respect to issuers and transfer agents any knowledge acquired that the proceeds of a transfer are to be applied to the personal benefit of the fiduciary will put the bank on notice and may at a later point substantiate is liability for wrongful transfer. For example, a bank extending a loan to an individual trustee upon the pledge of securities registered in the name of the trust.

Notice of Adverse Claims

The bank is in the same position as the issuer, transfer agent, broker or other individual who regularly receives circulars listing securities, bonds which have been lost , stolen or destroyed and receipt of such circular being notice under the provisions outlined above. Therefore whether a bank is acquiring bonds for its own portfolio or receiving them as collateral security on a loan it is extending to the owner, a review of the files it maintains for such notices would prove a wise and cautionary rule of thumb. This would be so even in the situation where a year has elapsed since the bank received a written notice of the loss.

Bank as Broker

When a bank acquires stock for a customer and holds the same as collateral until such time as the principal has been repaid, there is little doubt that the bank acting in this role would be characterized as a broker and would come under section 44(2) "broker". It would therefore come under the warranty requirements of section 59 and upon receipt of "circulars and notices" by virtue of section 66 its customer for whom it acquired the security would also be bound with notice. The discussion contained in earlier portions of this paper concerning these two concepts applies equally to the bank, of course only in a situation where the bank actually acts as an agent for its customer.

Bank as Registrar, Authenticating Trustee, or Transfer Agent

Where a bank acts in any of the above capacities it is bound with all of the obligations and duties of the issuer and will be held liable for all improper or wrongful transfers or delays in transfers as discussed earlier. Those duties and obligations accepted by a bank upon agreeing to act as transfer agent for a principal are set out in Article 8-406, section 76 C.B.C.A., as follows:

> (1) Where a person acts as authenticating trustee, transfer agent, registrar or other agent for an issuer in the registration of transfers of his securities or in the issue of new securities or in the cancellation of surrendered securities
>
> > (a) he is under a duty to the issuer to exercise good faith and due diligence in performing his functions; and

(b) he has with regard to the particular functions he performs the same obligations to the holder or owner of the security and has the same rights and privileges as the issuer has in regard to those functions.

(2) Notice to an authenticating trustee, transfer agent, registrar or other such agent is notice to the issuer with respect to the functions performed by the agent.

In addition to setting up proper procedures to reduce the impact of losses occurring due to the negligence of a bank's employees, a bank should insert adequate exculpatory clauses within a contract with its customer, and where this cannot be negotiated stress is then placed on providing adequate procedures to prevent such losses. In addition, as banks will be called upon to guarantee signatures, counsel when advising a bank should stress the difference between this procedure and that of in guaranteeing endorsements which a bank only in rare situations should acquiesce in doing.

Bona Fides: Its Advantages

Upon obtaining the status of a bona fide purchaser all of the defences open to the issuer are blocked with the exception of counterfeit certificates, over-issue and unauthorized signatures. The shield of "bona fides" blocks an owner or prior holder from asserting any claims to the security, whether or not a new or re-issued security has been issued to the purchaser. The only possible exception to this protection, would be where the prior owner alleges that his signature was forged and he has not done anything to estop himself from asserting the ineffectiveness of the signature, in which case, he may replevy

the security from the holder, even though he be a bona fide purchaser, until such time as the holder or bona fide purchaser obtains a new, reissued or re-registered from the issuer. Once the bona fide purchaser is in receipt of a new re-issued or re-registered security, the former owner or holder, must assert his claims against the issuer alone for wrongful transfer.

The Selling Stockholder

The vendor, transferor, or selling stockbroker warrants to the transferee, purchaser, the following as set out in Article 8-306(2), Section 59(2) of the C.B.C.A.,

a) his transfer is effectful and rightful; and

b) his security is genuine and has not been materially altered; and

c) he knows no fact which might impair the validity of the security.

Contrary to that endorsement made by the drawer of a cheque and other form of commercial paper, the transferor, by his endorsement does not warrant that a debt security will be paid and this in fact is set out in Article 8-308(4) and Section 61(8) of the C.B.C.A. provisions. The warranties as set out above encompass almost all fact situations which may arise giving a purchaser a claim against the transferor where the transfer and registration of a security was refused.

An owner, or holder, upon agreeing to sell his security has an obligation placed upon him by Article 8-314 and Section 67(1) (a)(b), Section 2 and 3 to deliver a security properly endorsed so that the purchaser, transferee, may with minimal difficulty obtain a transfer and registration of the security into either his name or

his nominees. Provision is made within the above noted sections for the acknowledgement of delivery when the sale and purchase is made through brokers upon a recognized exchange. Under Article 8-316 and s. 69(1) and 69(2) of the C.B.C.A. a transferee, purchaser, may demand that his transferor provide sufficient proof of his authority to transfer, or any further documentation that the transferee is called upon to produce by the transfer agent in order to secure registration. A transferor, seller, or broker, is at liberty to deliver any security from a particular issue and class of securities unless otherwise requested by the purchaser to deliver a specific security from that issue and class held by the seller, transferor. In addition to this, where a purchaser buys a security which is part of a fungible bulk of securities, that purchaser is the owner of a proportionate interest in the fungible bulk which is provided for in Article 8-313 (2) and s. 66(3) of the C.B.C.A.

A seller upon completing the above applications may, on default of the purchaser, commence an action claiming the purchase price of the securities accepted by the purchaser. Where the purchaser does not accept delivery, the seller's remedies are damages measured by contract law with the exception of securities for which there are no ready markets (private companies) or where resale would be unreasonable (compliance with the Securities Act regulation prior to offering for sale to the public).

Endorsement

No endorsement is required on a bearer's security, i.e., one that runs to bear according to its terms and not by

reason of any endorsement. Where an endorsement is found upon a bearer's security this may constitute notice of an adverse claim. A security in registered form specifies a person entitled to it and states that its transfer may be registered on the books of the issuer. Normally, upon selling on a stock exchange all transactions are done through brokers, the selling stockholder endorses the form and forwards this to his broker who in turn either forwards this endorsed certificate to the purchaser's broker or another security suitably endorsed is delivered to the purchaser's broker. This type of endorsement or one "to bear" is a simple " blank " endorsement (ff).

Where the form is filled in with the name of the transferee or the name of an individual who is to effect the transfer, or both, under Article 8-308 (2) and s. 61(6) of the C.B.C.A., the endorsement is "special" in form. An endorsement in blank may be converted into a special endorsement by filling in the blanks and conversely a special endorsement may be changed to a blank endorsement by adding the appropriate words of transfer in blank and an appropriate endorsement below that of his transferor.

An individual may also endorse upon a security that the transfer is for an amount less than all of the number of securities represented by the stock certificate. The specific amount of shares to be transferred out of the whole amount indicated on the stock certificate is filled in the appropriate blank on the form. (ff) The above outlined endorsements need not be made on the reverse side of the stock certificate, but may be executed upon a separate document sometimes referred to as a "stock power" which bears similar phraseology to the form found on the reverse side of a stock certificate.

Unauthorized Endorsement

An unauthorized endorsement will render a transfer ineffective. Subsequently, the unauthorized signature may be ratified by the issuer or the owner or holder because of certain behavior or conduct concerning the security itself may be estopped from raising the lack of authority. The true owner in two situation as set out in article 8-311 and s. 64(1)(a) and (b) and 64(2) of the C.B.C.A. bring an action (a) against the issuer if it has wrongfully transferred the security to a bona fide purchaser, or (b) against any holder other than a bona fide purchaser who, without notice of the true owner's "adverse" claim, has presented the security bearing the forged signature to the issuer or its transfer agent and received a new, reissued or reregistered security. This is a common sense as well as a practical approach for in most instances an individual deals through a broker on the exchange and seldom handles a security until it is delivered to him registered in his name, to charge him with notice of or reliance upon a forged signature would create an unusual hardship for the average everyday purchaser and certainly would tend to slow the movement of the marketplace. An issuer in this situation faces a double jeopardy, in that he may be called upon to recompense the true owner for an innocent but wrongful transfer of his security, and secondly where a bona fide purchaser appears having acquired the new or reissued security without notice of any defects.

Who is an Appropriate Party to Endorse?

Following the discussion regarding unauthorized endorsements a natural question which arises and which is of the utmost importance regarding the rights and obligations of those parties presenting securities for transfer, is who is an "appropriate" party to endorse a security certificate.

Those "appropriate" individuals are to be found in the broad definition set out in Article 308 and s. 61(1) (a) to (g) of the C.B.C.A. provisions. For example, those "appropriate" individuals are defined in relation to fiduciary relationships, parties without capacity to sign, joint ownership arrangements and situations where the beneficial owner is not or cannot be the individual who is to endorse. As any discussion of these provisions is really an integral part of the discussion on transfers, attention will be more fully focused on these provisions within that discussion.

Transfers

General

With the number of acquisitions and transfer of securities increasing daily and yearly, both on recognized exchanges, over the counter sales, and transfers within closely held corporations, representing the transfer of millions of dollars, the law has been called upon to provide clear, efficient and effective means of protecting all parties to such transfers without unnecessary expenditures of time or money. As can be seen by the foregoing discussion on common law "consistent inconsistencies" indicating a different right of development than that which we are expressing within the securities marketplace an unnecessary result being the lack of rules developed by the common law to guide the various parties concerned with a transfer as to their respective rights and obligations. In addition, the marketplace, both nationally and internationally has demanded procedures that facilitate the transfer of securities while affording the issuer, and its transfer agent, the greatest possible protection against liability for wrongful transfer. With the move into the computer age it is necessary to speed up the conservative transfer agent from the ingrained habit of following complex procedures, which were established to ensure the rightful-

ness of the transfer and thereby protect themselves as well as their principals but, in many cases, needlessly complicating a transfer beyond reasonable limits of caution. The limits to which an issuer, or its transfer agent may go, before effecting a transfer are now clearly defined within Article 8 and by their adoption within the C.B.C.A. provisions. They are clear and well ordered, and in fact, where an issuer or transfer agent unduly delays a transfer they will be liable to the transferee for any loss thereby suffered. Simply put, Article 8's approach to easing transfer procedures is to limit the issuer's demand for proofs of the appropriateness of transfer, guarantees of signatures and tax waivers to certain documents only. An issuer where given notice of an adverse claim has a duty to investigate and upon complying may affect the transfer, and in the absence of any adverse claim, upon receipt of such proofs, transfer the security. Where the issuer has a security presented for transfer with documentation in good order, and it turns out later that the transfer was wrongful, the issuer or its transfer agent will be protected from liability either directly or by reason of a right over against the signature guarantors or others. The general rule to be followed by issuers, or transfer agents is set out in Article 8-401 and s. 71(1) (a) to (e) and s. 71(2) of the C.B.C.A. provisions and provides as follows:

> (1) Where a security in registered form is presented to the issuer with a request to register transfer, the issuer is under a duty to register the transfer as requested if
>
> > (a) the security is endorsed by the appropriate person or persons (Article 8-308, s. 61 C.B.C.A.); and

Proofs the Issuer May Require

Proof of Appropriate Endorsement

As mentioned earlier, Article 8-308 and s. 61 of the C.B.C.A. provisions define with great clarity who an appropriate person is in the varying relationships and within the varying circumstances that occur and from which a request for transfer arises. Any discussion of this section would only tend to cloud the import of it as the provisions themselves are clear and to the point and are as follows:

> (3) "An appropriate person" in subsection (1) means
>
> > (a) the person specified by the security or by a special endorsement to be entitled to the security; or
> >
> > (b) where the person so specified is described as a fiduciary but is no longer serving in the described capacity, - either that person or his successor; or
> >
> > (c) where the security or endorsement so specifies more than one person as fiduciaries and one or more are no longer serving in the described capacity, - the remaining fiduciary or fiduciaries, whether or not a successor has been appointed or qualified; or
> >
> > (d) where the person so specified is an individual and is without capacity to act by virtue of death, incompetence, infancy or otherwise - his executor, a minister, guardian or like fiduciary; or

(b) reasonable assurance is given that those endorsements are genuine and effective (Article 8-402, s. 72 of C.B.C.A. provisions); and

(c) the issuer has no duty to inquire into adverse claims or has discharged any such duty (Article 8-403, s. 73 C.B.C.A.); and

(d) any applicable law relating to the collection of taxes has been complied with; and

(e) the transfer is in fact rightful or is to a bona fide purchaser.

(2) Where an issuer is under a duty to register a transfer of a security the issuer is liable to a holder presenting it for registration or his principal for loss resulting from any unreasonable delay in registration or from failure or refusal to register the transfer.

These provisions are not mandatory and an issuer may waive any one or more of them where it has reasonable faith in the integrity of the individual presenting the security for transfer. As stated above, this is the general rule and the following discussion of the various provisions within this section of Article 8 and the C.B.C.A. provisions, serve to clarify and qualify the amount of documentation which may be requested and what documentation is suitable to allow the issuer or transfer agent to effect the transfer without fear of liability arising at a later time.

(e) Where the security or endorsement so specifies more than one person as tenants by the entirety or with a right of survivorship and by reason of death or cannot sign , - survivor or survivors; or

(f) a person having power to sign under applicable law or controlling instrument; or

(g) to the extent that any of the foregoing persons may act through an agent, - his authorized agent.

Where a security is endorsed by a decedent just prior to his death, or by an authorized agent or fiduciary whose authority is later revoked, Article 8-308(6) and s. 61(2) provide that the endorsement is appropriate and effective provided it was appropriate at the time of signing, irrespective of the subsequent change in circumstances.

Assurance that the Endorsement is Effective

The provisions set out in the previous discussion define "who" should sign the security but do not define the documentary proofs that an issuer or transfer agent may require of the "authority" of such person to sign. Under the common law, an issuer in some situation was liable for transfer based on an unauthorized, forged or otherwise inappropriate signature, and therefore developed the practice of requiring excessive documentary material to prove the effectiveness of a signature. By the article provisions and the C.B.C.A. provision an issuer is still held responsible for such transfers but may only require the following assurances:

(1) The issuer may require the following assurance that each necessary endorsement (Article 8-308, s. 61 C.B.C.A.) is genuine and effective.

(a) in all cases, a guarantee of the signature (subsection (1) of Article 8-312, subsection (1) of s. 65 of the C.B.C.A.) of the person endorsing; and

(b) where the endorsement is by an agent, appropriate assurance of the authority to sign;

(c) where the endorsement is by a fiduciary, appropriate evidence of appointment or encumbancy;

(d) where there is more than one fiduciary, reasonable assurance that all who are required to sign have done so;

(e) where the endorsement is by a person not covered by any of the foregoing, assurance appropriate to the case corresponding as nearly as may be to the foregoing.

Signature Guarantees

It is by use of the signature guarantee that an issuer will be able to indemnify himself should the endorsement be later held to be unauthorized. This is done by requiring that a guarantor, guarantee the signature at the time of presentation. A guarantor may be either a broker, a bank, responsible employees of either, who have a personal knowledge of the integrity and identity of the

endorser. Article 8-312 (1), s. 65(1)(2), C.B.C.A. provisions define the warranties that a guarantor of signature undertakes upon guaranteeing a signature and are as follows:

> (1) Any person guaranteeing a signature of an endorser of a security warns at the time of signing
>
> (a) the signature was genuine; and
>
> (b) the signer was an appropriate person to endorse (Article 8-308, s. 61 C.B.C.A.); and
>
> (c) the signer had legal capacity to sign.

But the guarantor does not otherwise want the rightfulness of the particular transfer.

There is a distinction that must be noted here between the guarantor of signature, who warrants only that the signature is genuine, i.e., not forged and that that parties signing is appropriate, under subsection 8-308(3), s. 61(1) C.B.C.A. Where a guarantor provides a guarantee under Article 8-312(2) and s. 65(3) of the C.B.C.A. it is a guarantee of an endorsement (as opposed to the guarantee of signature) that in addition to the warranty of subsection (1), a further guarantee that the transfer will be rightful. There is an immense difference between them and the latter guarantee should only be entered into with the utmost caution and awareness of the situation.

Evidence of Appointment or Encumbancy

The discussion has covered to this point for the guidance of the issuer, who is an appropriate person; what proofs or assurances the issuer may require to show the

endorsement is effective and as a corollary to this the provisions outlining signature guarantees, in addition to which the issuer may require "evidence of appointment or encumbency". Although the signature guarantee goes to "appropriateness" as well as genuineness, the issuer is entitled to demand proof of appointment or encumbency to satisfy itself. Article 8-402(3), s. 72(4)(5)(6) sets out the documentary proof that the issuer may require of the presenting party:

> (3) "Appropriate evidence of appointment or encumbency" in subsection (1) means
>
> > (a) in the case of a fiduciary appointed or qualified by a court, a certificate issued by or under the direction or supervision of that court or an officer thereof and dated within 60 days before the date of presentation for transfer; or
> >
> > (b) in any other case, a copy of a document showing the appointment or a certificate issued by or on behalf of a person reasonably believed by the issuer to be responsible or, in the absence of such a document or certificate, other evidence reasonably deemed by the issuer to be appropriate. The issuer may adopt standards with respect to such evidence provided such standards are not manifestly unreasonable. The issuer is not charged with notice of the contents of any document obtained pursuant to this paragraph (b) except to the extent that the contents relate directly to the appointment or encumbency.

An example of where it might not be possible to obtain such a court order or certificate is that of an inter vivos trust,

in which case a written affidavit of the trustee, confirmed by a bank or broker, should be sufficient. In a situation where a donor transfers shares into a trustee's name, the named trustee's endorsement will be effective until such time as the issuer receives written notice that the trustee is no longer acting in such capacity (ff).

Some examples of which an issuer may require proofs, i.e., documents evidencing appointment in relation to an executorship or trust, a certified copy of a court order appointing a guardian or trustee, or a certified copy of a resolution of a corporation's board of directors authorizing a certain officer as a party to sign, each of which must be received and executed within 60 days of the date on which the security is presented for transfer.

There is nothing to prevent an overly cautious issuer or transfer agent from requiring further documentary evidence of appointment or encumbency, however, Article 8 and the C.B.C.A. provisions provide interesting methods for this manner of proceeding. Under Article 8-401(2), s. 71(2) of C.B.C.A. , where the issuer causes undue delay and the transferee suffers financial loss the issuer will be liable for that amount. In addition, under Article 8-402(4), s. 72(7) of C.B.C.A. provides that where an issuer or transfer agent demands additional documentary evidence i.e., trust indenture, copy of the will, which documentary evidence does not relate solely to the question of "appropriate evidence of appointment or encumbency", then the issuer will be deemed to have notice of all matters contained therein including any notice of an adverse claim or information which would put the issuer on notice.

Notice of Adverse Claims

As mentioned earlier, an issuer has a duty placed upon him to investigate adverse claims, both those formally brought to his attention by stockholders who has had his share certificate

either destroyed or stolen or lost it and that situation of where an issuer by demanding excessive documentary proof of appointment, will be deemed to have notice of a situation giving rise to an adverse claim. Therefore, a transfer will be wrongful if either of the above mentioned two situations exist, and the issuer proceeds to register the transfer. With respect to the first situation outlined above , the stockholder in order to protect his interest must provide the issuer or its agent notice in writing of his loss, (a) "at a time and in a manner which affords the issuer a reasonable opportunity to act on it", (b) reasonably identifies the claimant, the registered owner and the security, and (c) provides an address where the claimant can be reached, upon the stockholder so doing then the issuer is placed on notice. (ff) Notice from excessive documentation has been discussed earlier, and there is one further manner in which an issuer may receive notice and that is through standard publications of securities commissions, or other appropriate bodies, which give notice of a security either being stolen, lost , or destroyed, and upon receiving such publication, "circular", the issuer should make appropriate notations within its records so that if the questionable security is presented for transfer at a later date, its "taintedness" will not be overlooked and appropriate steps taken to discharge the issuer's duty of inquiry.

The Fiduciary Breach

Prior to the enactment of Article 8 and its adoption by the C.B.C.A., issuers were most insistent upon receiving adequate proof as to the rightfulness by a fiduciary to effect a transfer and that the transfer was not in breach of the terms of the controlling instrument or deed of trust. The

provisions which are to guide the issuer (Article 8-403(3)) and discharging his only duties are (a) to record with reasonable diligence any notices of adverse claim, i.e., stop orders or other notices giving rise to suspicion or knowledge that the transfer is not rightful , and (b) to refrain from asking for more than evidence of appointment or encumbency. In addition the above noted provisions may be summarized as follows:

> (a) once the issuer has registered a security in a fiduciary's name it may assume that the fiduciary's status continues unchanged until it receives written notice to the contrary;
>
> (b) the issuer need not inquire whether a transfer by a fiduciary complies with a controlling instrument or even with the laws of the province having jurisdiction over the fiduciary relationship. It is not even liable if such government law would have "required court approval" of the transfer; and
>
> (c) the issuer is not charged with notice of any other extraneous matters, including public or court records or files - even in its possession -- unless there is actual notice.

C.B.C.A. Provisions to Pertaining to Form

Within Part 6 of the C.B.C.A., of the 32 sections dealing with security certificates, registers and tranfers, there are three sections which are not drawn from the American Uniform Commercial Code, article 8. Two of these three sections, section 4 and 46 of the C.B.C.A. will be discussed briefly below, as these two sections set out requirements which are drawn from the former Canada Corporations Act and should therefore be familiar to corporate practitioners.

Briefly, s. 45 delineates the rights of the shareholder with respect to his entitlement to a security certificate(ff); the assessable fee for the certificate(ff); corporations obligation to joint holders of certificates(ff); rules relating to certificates(ff), manual signatures(f f), continuation of signature(ff); contents of the share certificate, i.e. name of the corporation certain phraseology complying with statute requirements, and the name of the shareholder and the number and class of shares that the certificate represented(ff). Subsection 8 of s. 45 has been ingrafted and was mentioned earlier is drawn from article 8-204 and article 8-103. Other subsections of section 45 pertain to the particulars of the class(ff), duties of the corporation to furnish sufficient information concerning the various class and series of shares issued by the corporation(ff) and finally provisic relating to fractional shares(ff), script certificates(ff) and the holders thereof(ff).

Section 46 of the C.B.C.A. sets out the requirements for securities records(ff), there contents, ability of the corporation to maintain central and branch registers(ff), location of securties registers(ff) the effect of registration within the securities register(ff) and provision for the destruction of certificates(ff), i.e. this last mentioned provision sets a time limit upon the elapse of which the company is at liberty

to destroy the security certificates as possession.

The third and remaining section of the C.B.C.A. to be discussed is s. 47 which was discussed earlier with respect to su b section 1 which was drawn from the U.C.C. article 8. The remaining subsections, (2), (9) are drawn from the English Companies Act, (ff) or rather, are drawn from recommendations made within the Jenkins Report(ff) concerning certain oppressive situations which had developed within the common law relating to personal representatives and there precarious position, (lack of clear authority, either common law or legislative) with respect to oppressive directors. The subsections of s. 47 delineate the circumstances under which the corporation whose articles restrict the right to transfer its securities shall recognize and treat a person as the registered security holder and who there after may add in all respects and with the same capacitys as the original registered shareholder. Subsection 2 describes the various individuals who may fall into this group(ff), for example an executor, or guardian, a liquidator or a trustee in bankruptcy. While the various individuals set out in subsection 2 would appear to be definitive of who falls into the group, subsection 3(ff) clearly indicates that the Act also takes into account any other individual to whom the ownership of securities devolves by operation of law and accords him the same rights and privileges. Subsection 4 states that a corporation need not inquire into nor see to the performance of any duty owed to the third person by either the registered holder or the individual that it recognizes as the registered holder by virtue of these provisions. Essentially that means the companies not bound to indemnify any individual for a breach of fiduciary duty by any trustee or other fiduciary. Subsection 5 allows for an infant to hold securities and saves the corporation harmless from any later repudiation. Subsection 6 is straight forward and upon receipt of suitable documentation

of the death of one joint holder by another the corporation may take this into account and act accordingly. Subsection 7 8 and 9 deal with the transmission of securities and essentially set out the requirements which must be satisfied prior to a corporation effecting a change upon its register into the name of the individual making application for such change.

While this has not been a serious problem within Canadian common law jurisdictions, the Jenkins Report felt that some legislative direction must be given to directors so as not to allow unscrupulous directors to oppress minority shareholders. An example, illustrative of the situations in which an action under s. 210 of the English Companies Act(ff) would be appropriately raised to thwart any attempt by directors to oppress shareholders, would be, a situation "in which the directors, having power to do so under the articles, refuse to register personal representative in respect of shares devolving upon them in that capacity, and by this expedient (coupled with the absorbtion of profits in payment of the directors remuneration) force the personal representatives to sell their shares to the directors at an inadequate price." therefore, s. 47 and more specifically subsections (2) to (9), provide the authority, mechanics, and requirements that must be met by a fiduciary to have himself registered on the books of the company and thereby be in a position to properly advance the best interests of the individual, estate, or entity, to whom he owes his obligation and duties.

Certificate Lists Transfer Systems

Continuing lies in the volume of trading in stocks and bonds in Toronto is produced and concerned about the adequacies of present systems and procedures. It has been estimated that there are 75 to 100 (ff) distinct times that a certificate is handled from the initial sale to the eventual receipt by the purchaser of the certificate registered in his name. (ff) The entire settlement process has been described as follows:

"Removement of the certificate from customer through the broker through the transfer agent and back requires number of people doing little more than just logging it in, reveiwing it, logging it out and sending it on to the next person.

Involved in this paper pushing process at the securities firm are the branch office, the receiving department, the transfer analysist, the transfer department and the delivery department . . . Added to this are the numerous documents that each of these movements must generate so that the firms general ledger and related ledgers correctly reflect the location and movement of the certificates and the status of the firms and the customers accounts.

Then the certificate has to be packaged and carried to the transfer agent. At the transfer agent, the certificate is logged in, examined and logged out a total of almost 7 more times and the certificate still has to go to the registrar. Handling the certificate at the transfer agent are the window clerk, the transfer analysist, the examiner who looks for lost, stolen or estopped ordered certificates, and the cage clerk where the new certificates are held. Then it goes to the typing department, then to proofing and balancing, and then to cancelling and sorting for routing to the registrar.

Once carried to the registrar, he engages in another logging in, reviewing for lost, stolen or estopped order certificates, proofing and balancing. . . . (T)hen the certificate must be carried back to the transfer agent for preparation of the transfered journal and matching the new certificate with the old window ticket. From here it is back to the brokerage house for at least another two logging ins, and logging outs - by the receiving department of the cage and then by either the vault if the firm keeps the stock, or the delivery - mail room if it is to be sent out to a broker, bank or individual.(ff)

It can be readily appreciated that the burden placed upon the existing mechanism for effecting these transfers is awesome; but of even more significance are the restrictive consequences this shuttling of

paper from a, to b, to c, brings about in creating a bottleneck, to the smooth function of the exchanges, to say nothing of the increased potential for loss, theft, forgery, and general decline in business efficiency which occurs during the journey of the certificate from vendor to purchaser.

That a review and revision of this antiquated system is long overdue in Canada goes without saying, and attention has been paid by both the Federal goverment and some provincial governments(ff), but this but begging the question, is the time right to make a change away from the physical transfer of investment paper. Obviously the answer cannot be a flat out yes or a flat out no and discussion must therefore be directed first, towards analysis of the position of our exchanges and their procedures for transfer within the practical context and secondly a discussion of changes that will necessarily have to be made in the existing statutes to accommodate a new system for processing securities transactions without the necessary share certificate.

A security transaction, distilled to its essential elements reveals a problem in legistics, i.e., bringing the money, documents and instructions for settlement, together having the greatest consideration for time and space. As indicated above the share certificate is an element in the transfer process. Transfer within the Canadian and American exchanges is facilitated by endorsement over to a purchaser over endorsement in blank on the reverse side of the certificate. Practice in England is somewhat more cumbersome in that a second document, an instrument of transfer, properly executed must accompany the share certificate, thereby doubling the necessary paper work.

The cost of maintaining the present system; costs that is in number of people necessary to move the paper from vendor to purchaser, not to mention transfer agents, clearing houses, clearing divisions of stock exchanges netting out daily transactions all of which create a tremendous pressure on the system and do not even take into consideration the additional expense

incurred when break downs in the system cause delays to the overall functioning of the exchanges.

What then are the alternatives to the use of the share certificate and the transfer process? There are many alternatives, machine readable certificates as the share certificate is essentially a carrier of information; uniform numbering schemes, which have already been implemented by several banks in the United States (ff) but in the interests of bereavity this discussion will be directed to the central depository, as presently operating in New York state(ff) and tentatively scheduled to commence functioning in Canada in the near future(ff) The first two mentioned examples of both of being alternatives to the share certificate problem, in fact retain the share certificate in a new form whereas the direction of this discussion is towards the reduction of paper movement within the transfer process or in other words the immobilization of the certificate The central depository system has emerged as a concrete method of reducing the movement of the share certificate by making "appropriate book entries", its basic concept of operation is quite simple:

> "Brokerage firms maintain shares of eligible securities on deposit in their C.D.S. accounts. These accounts are credited with the number of shares deposited, and stock certificates representing the shares are registered in the name of the common nominee, Block and Company, to standardize the administrative and bookkeeping procedures in which they may subsequently become involved. C.D.S. does not acquire any beneficial interest in the shares.
>
> To make delivery, the selling brokerage firm instructs C.D.S. to debit to its account, by, say, 500 shares of XYZ corporation and credit the buying brokers C.D.S. account by the same number of shares. Title to the shares is thus transfered by a computerized bookkeeping entry while the certificates themselves remain immobilized in the C.D.S. vault. At the same time, the offsetting changes in the buying and selling members daily cash balances are made by the electronic bookkeeping entry. (ff)

The payment of dividends, notice of meetings, and distribution of proxy materials may be handled through the essential depository system under the following method. All dividend payments for eligible securities on deposit are made to the depository, who in turn allocates these funds amongst the various brockerage firms on whose behalf the specific securities are deposited, who in turn credit their clients' accounts directly or forward a cheque drawn for the appropriate amount to the client. The same procedure may be followed with notice of meetings, proxy materials. The federal government had anticipated this need and commissioned a study, following which it incorporated the Canadian Depository for Securities Limited, which was tentatively scheduled to commence operations in mid-1972 and which has not at this date opened its doors for the acceptance of deposits. Under the Canadian Depository for Securities Limited, member organizations will include banks, insurance companies, trust companies, investment companies, mutual funds, brokers, and investment dealers. Initially, only shares will be deposited, for deposit orders with bonds and debentures to be come eligible at a later date. Eligible securities will include those from several stock exchanges as well as unlisted securities.

The Canadian Depository will differ somewhat from the American Central Certificates and Service in that it will consolidate most of the shares of a given company into a large denominational certificates, called "jumble" certificate, held in the depository's name. Any transfers will continue to be involved in the registration of the transfer into the depository's name. The remainder of the securities of a given company will also be held in the name of the Depository, but as a "working supply" to meet the need for withdrawals from the system. (ff). As this system

will operate across Canada, specific changes in the legislation of the ten provinces as well as in the federal jurisdiction will be necessary, though to date, Ontario is the only jurisdiction acknowledging this new concept. In Ontario there is the Business Corporations Act, there is provision made for the "appropriate entries on the books of the clearing corporation". By clearing corporation it is meant the depository (ff). There has possibly been legislative provision for the immobilization of the certificate in the depository in the Ontario Business Corporations Act (ff) which in and of itself is "legislative recognition that the certificate is not the sine qua non for transfer of securities." (ff) Essentially, the Canadian system would operate in this manner:

> When transfers are made wholly within the system, no physical move in the certificages is necessary. A transfer is made on the depository accounts, i.e., the depository records that it is holding X shares for broker P instead of the broker V. This transfer process could complete an order from the T.S.E.'s clearing house or daily letting out buy and sell orders among number brokers cleared off (not to be confused with the depository clearing corporation). The order would indicate that the broker V owes X shares to broker P. The differences from the present system is that V does not have to handle the share certificates physically but his account with the depository should be debited.
>
> It is important to know that such a transfer takes place through the depository between two members of the depository, since the shares are registered in the depositor's name and the latter is merely holding the shares for a different member after the transfer. To the extent that it will be used, the depository cuts down the importance of investment paper by locking it up in the clearing corporation. The certificate continues to exist, however, in one form or another (jumble certificate or work and supply) in the custody of the depository.

> Withdrawals of certificates from a depository will normally be affected from certificates in the "work and supply". Thus when customer A of a member broker wishes to have physical possession of certificates or when a member sells shares to a non-member B, an appropriate certificate will be received by the transfer agent from the depository out of the "work and supply". The transfer agent will then issue a new certificate to A and B. There are two underlying principles: (1) that institutions who deal substantially ordinary investors will be content to have their certificates held initially in "street form" and member broker and ultimately in the depository's name and will not insist on taking possession of certificates registered in their own names and perhaps lodging them in a bank for safekeeping.

The depository concept has grown out of the fact that a certificate is a symbol and information carrier for an intangible interest.

> In North America, the route idea of a central depository was to take advantage of the fact that many certificates spend most of their lifetime dormant in safekeeping, and one important place for safekeeping is the broker's office. When the certificates of both buyer and seller are lodged in a depository, the locus and record keeping is centralized, and if the non-ownership is in the depository, no physical delivery is required and no alteration in the records of the transfer agent.

Ian Baxter, in his article "New Mechanics for Security Transactions", sets out several examples of depositories operating on a nominal ownership basis following by examples of depositories operating on a real ownership basis with the pros and cons of both. With respect to the depository operating on a nominal ownership basis Mr. Baxter had this to say:

Consider self-registrable securities from X to Y, both of whom use brokers and the same depository. Before the sale, the securities are in the name of the depository held for the account of X's broker. The transferrage records the depository as owner, and dividends, etc., are transmitted to the depository for distribution. The depository is concerned with which broker's account it is holding for, and not with the broker's customers. It is in the broker's back offices that we find records of real as opposed to nominal ownership. In order that dividends and notices can be finally distributed. There is no delivery of a certificate in the X Y sale and change of ownership is symbolized by altering the computorized records of a depository. In principle this is the same as a change in ownership which depends on altering stock and bond registers, except that the changes are recorded by the depository and not by the transfer agents, and the recorded changes relate to brokers' accounts and not to real owners. So, in transactions of the type of X Y (i.e., employing brokers in the central depository), the certificate has vanished from the scene. But such transactions are not the only ones where the certificate merely moves from safekeeping to safekeeping, since banks and other financial institutions provide safekeeping services. In addition, every investor has a safekeeping problem, because the certificate is active exceptionally and dormant normally, and so many investors might wish to have their certificates lodged with a central depository having adequate, safe and convenient facilities. If this were to happen, the certificate would become _rai avis_ in the settlement of securities transactions. Is the central depository concept capable of further development towards this end? One way, already planned in practice, is to extend the range of users of the depository beyond bankers, to include banks and financial institutions. The result of this will be to produce considerable "freezing" of the movement of securities, vis-a-vis the transfer agents, and an elimination to the same extent of the certificate, replacing it by data files kept in computors or otherwise. Most of the ownership data regarding security transactions would then be kept in a three-

tier recording system, namely: (1) transfer agents, who would record the depository as owner of stocks deposited with it;

(2) the central depository, which maintains accounts for depositing brokers and financial institutions, and records securities as held for the depositors, who, in the proponents of cases, are agents for the real owners;

(3) brokers and financial institutions who keep data on the real owners and pay out dividends to them.

Transactions within this system would be "certificateless". There is, however, in toto a great deal of record keeping and passing of documents and data when the work of the three tiers is added together.

Although a depository for brokers and institutions produces a large degree of certificate elimination, it has the characteristics that the records of the transfer agent and the depository were usually only showing only nominal owners, and one must refer to the records of brokers and financial institutions for data on real owners. Could we have a central depository that would hold securities account on a real ownership and not on a nominal ownership basis? If A is X's broker, then, under the porposed Canadian depository, X's securities will be lodged with the depository, in street names, to the account of A. However, if a depository were operating on a real ownership basis, A would open an account for X at the depository (if X did not already have one) and would lodge the securities in X's account. This would produce some significant differences in the system.

(1) The number of accounts would increase, if such deposits became popular among investors. On the other hand, the average volume of securities held in an account and the average rate of account activity would decrease. The total volume in account activity would be spread over a number of real ownership accounts greater than the previous number of nominal ownership accounts. The number of accounts could still be restricted and controlled, if so

desired, by providing that only a broker or financial institution may open and operate an account on behalf of a real owner. A change to a real ownership basis would increase the number of accounts to be maintained by the depository. But the holding of a large number of individual accounts in a data processing system is not uncommon, for example, in the deposit account systems of the major banks. In addition, real ownership data has to be kept by brokers and others with reference to their customers and, so, putting a depository on a real ownership basis would involve transfer of recording functions and a re-organization from the three-tier system with more record keeping and accounting at depository level and less at broker and financial institution level.

(2) Dividends, proxy notices, and the like could be distributed by the depository directly to the real owners of the securities. In many cases this would involve payments into a bank account which work could be automated by having communication links between the depository computor and the data processing systems of the banks and trust companies.

(3) A depository operating on a nominal ownership basis does not earmark securities to the real owners and (analogous to deposit banking) has an obligation to deliver equivalent securities to the depositor, who will usually be the real owners broker. As far as such a depository is concerned, 100 shares of R corporation belong to X and deposited by broker A are indistinguishable from 100 shares of R corporation belonging to Y and also deposited by broker A. So the broker is holding his customers' securities in an unearmarked mass in street names in his depository account. In the event of the broker's bankruptcy this lack of earmarking might produce some interesting questions which would not arise in a case of a depository operating on a real ownership account basis.

(4) A system which increases the immobility of certificates will reduce the work of the transfer agents. If a depository is used in a large majority of transactions, the transfer agents will have a small amount of transfer work to do. In the case of a depository operating on a real ownership basis, a depository will have a list of all the shareholders that R corporation whose certificates have been lodged with the depository, and will send dividend payments to them. The transfer agents of R corporation will show the depository as owner of the certificates lodged with it, and will show real owners only where the depository has not been used. Probably, there will not be a complete list of real owners of the stock of R corporation at either transfers or depository level, but, if the depository is popular, it will be nearer to having a complete list. It may be that a complete list of the real stockholders of R can only be assembled by extracting information from the records of each of the three tiers, i.e., transfer agent, depository, broker. This raises the question whether, in a real ownership account system, there would be need of both a depository tier and the transfer tier. If they are each compultorized, they can be amalgamated into a combined system by establishing appropriate communication links (which can be automatic in operation) between the computors of the transfer agents and the depository. If so, the automated transfer agent/depository system could assemble an up to date list of the real stockholders of R corporation and it could send out dividends and notices. The back office functions of brokers and others would be reduced accordingly.

So a change from a nominal ownership account basis to a real ownership basis, and a combining of all systems between the depository and the transfer agents, could be a future development of the central depository concept.

Major components of the central depository system have advocated its absorption of all of the various functions connected with the settlement process (which include

payment and change of ownership) their practical argument being, that this would bring together all the data and instructions relating to the various functions of the settlement process within the same computorized system, "so that that system would have "before its eyes" at one and the same time all the information needed to settle the transaction". Again, the major components are motivated in their advocacy of a central depositor as a step towards a more smoothly functioning securities transfer process in view of the disjointed and highly compartmentalized procedures and steps which are necessary in the presently existing system.

The main present function of the registrable certificate is to symbolize acquisition by the transferee of an interest in property and to provide identifying particulars of the type and quantity of the securities. The transfers certificate, when endorsed and delivered to the transferee, enables the latter to register his interest with the transfer agent. A certificate issued in name of the transferee symbolizes that he is the owner of an interest in the securities. There is no reason why there should only be one lawful way of achieving the objective of symbolizing termination of the seller's interest in the securities and the creation in lieu of an interest in the buyer, and both the Uniform Commercial Code and the Ontario Business Corporations Act admit alternate routes through the transfer procedures of a depository. Even if the concept of a central depository system were fully accepted today there would still arise certain transactions that would be completed by physical delivery of investment paper such as bearer securities, foreign securities, and transfers otherwise than through those of the system. In view of the technical possibilities of electronic carriage of information, it would seem desirable to have fairly open ended provisions that would make possible both existing modes of transferring title and others that might arise in the future. Article 8-320 of the Uniform Commercial Code provides that "in addition to other methods, a transfer or pledge of a security or any interest

therein may be effected by the making of appropriate entries in the books of the clearing corporation."

The Ontario Business Corporations Act, by virtue of s. 91 have adopted en toto Article 8-320 which set out the mechanics for a transfer or pledge within a central depository system.

To balance the scale somewhat, there are disadvantages to the central depository concept, such as ending direct relationship between the corporate issuer and its stockholders. The corporate issuer would be concerned with fewer record stockholders but would know much less than it does today concerning identity of the beneficial owners of its shares. The beneficial owners would find his rights as stockholder, already attenuated, even further deluted. Where a stockholder chooses to register his shares in the name of a nominee, he takes the risk attended on such an arrangement such risk, being the loss of his right to vote at stockholders' meetings. The individual public stockholder, member of a vanishing breed in these days of institutionalized share ownership, would be of less consequence in corporate affairs than at present. Therefore, transfer by a central depository systems could sound the death knell for the concept of shareholders' democracy, such as we know it today. There is also the question as to whether the mutual funds could use this system for their portfolio's securities. There is also the position of the secured lendor, and with respect to his position, upon taking a share certificate as collateral security on a loan, this type of transaction must be taken into account and appropriate provision made for it within the depository as well as within the enabling provisions. Many corporations, particularly those with few shareholders, will prefer to use certificates and will not find a costly computorized system worthwhile.