NEGOTIABLE SHARE CERTIFICATES FOR PHILIPPINE CORPORATIONS

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Much of the industrial and commercial development of the last few centuries would not have been possible but for the corporation.[1] Proving of immense value as a tool employed by individual investors in the conduct of business, the corporate mechanism has attained the stature of an institution.[2] The Gargantuan proportions achieved by these combinations have often raised grave issues as to desirability of enormous concentrations of economic power.[3] Be that as it may, the place of corporations in the modern business is secure, with their amassed capital promoting almost every enterprise of note.[4]

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[1] Quoting from Justice Stone in California v. Tashiro, 278 U. S. 123, 49 Sup. Ct. 47, 49, 73 L. Ed. 214:

"It would be difficult to select any single agency of more universal use or more generally recognized as a usual and appropriate means of carrying on commerce and trade than the business corporation."

See also Hale v. Henkel, 201 U. S. 43, 26 Sup. Ct. 570, 50 L. Ed. 652; In re Steinberg's Estate, 274 N. Y. S. 914, 919, 153 Misc. 339; Louis K. Ligett Co. v. Lee, 288 U. S. 517, 564, 53 S. Ct. 481, 77 L. Ed. 929, 85 A. L. R. 699.

[2] Corporations have ceased to be merely legal devices through which the private business transactions of individuals may be carried on. Though still much used for this purpose, the corporate form has acquired a larger significance. The corporation has, in fact, become both a method of property tenure and a means of organizing economic life. Grown to tremendous proportions, there may be said to have evolved a "corporate system"—as there was once a feudal system—which has attracted to itself a combination of attributes and powers, and has attained a degree of prominence entitling it to be dealt with as a major social institution. BERLE AND MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1933), 1.

[3] In the United States, the size factor was dramatically brought home by a TNEC table comparing the total valuation of all the property in each state with the total reported assets of each of the 30 billion-dollar corporations. Only 10 states had property within their respective borders valued at more than the assets of Metropolitan Life Insurance Co. ($4.23 billion in 1935) or American Telephone and Telegraph Co. ($3.99 billion). At the other end of the scale, fully 18 states ranked below the smallest of the 30 corporations.

Loss, Securities Regulation, p. 13, citing TNEC Monograph No. 30, Survey of Shareholdings in 1,710 Corporations with Securities Listed on a National Securities Exchange (1941); also Stokes, Financial Trends of Large Manufacturing Corporations, 27 Survey of Current Business.

[4] Justice Field in San Mateo County v. Southern Pacific R. Co. (Railroad Tax Cases), 13 Fed. 722, 743:

"And, as a matter of fact, nearly all enterprises in this state, requiring for their execution an expenditure of large capital, are undertaken by corporations. They

Though dwarfed by the huge and intricate corporate organizations in the United States, the Philippine business corporation has in its own right grown at a remarkable pace.[5] Moreover, the future augurs a more predominant position for the corporation in Philippine commercial life. The effort at industrialization and an expanded economy call for the utmost utilization of individual finances available for investment, requiring the assembling of capital best brought about through its medium.

As the demands of modern commerce compel the continuing development of the corporate form of organization, so should corporation law grow. Law serves its function best when it anticipates and provides, encourages or prevents. Little justification appears for preserving on the statute books outworn concepts which stifle the corporate agency, hindering its utility for economic progress. Quite fortunately, reexamination has for some time been the fashion in Philippine legal circles.[6]

Few aspects of Philippine corporation law deserve as much scrutiny as the rules governing share certificates and their transmission from person to person. Stock transferability is recognized as one of the great advantages of the corporation over other forms of business organization. The facility with which these units of interest are bought and sold contribute vastly to encourage capitalization. Stocks are among the most liquidable of investments. Assuming a public market, they may be realized upon promptly. Furthermore, they find ready acceptance as security for loans. This feasibility of easy acquisition and disposal—of putting money to work and calling it back almost at will—renders investment in corporate stock convenient to investors of varied means.[7]

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engage in commerce; they build and sail ships; they cover our navigable streams with steamers; they construct houses; they bring the products of earth and sea to market; they light our streets and buildings; they open and work mines; they carry water to our cities; they erect railroads, and cross mountains and deserts with them; they erect churches, colleges, lyceums, and theaters; they set up manufactories and keep the spindle and shuttle in motion; they establish banks for savings; they insure against accidents on land and sea; they give policies on life; they make money exchanges with all parts of the world; they publish newspapers and books, and send news by lightning across the continent and under the ocean."

BERLE AND MEANS, *op. cit.*, Chapters I to III, deals with the corporate system in transition.

[5] Six thousand eight hundred sixty corporations were registered at the Securities and Exchange Commission during the post-war period from May, 1946 to December, 1954.

[6] Notably, the proposed revision of Philippine commercial laws.

[7] It is not alone the capitalist and banker that purchases and holds stock in corporations. The surplus wealth of the people at large is being invested in corporate stocks and bonds. In the course of time all these securities pass into the hands of

The desirability of stock as a form of investment is substantially derogated from by statutory and judicial formulations leaving indefinite the rights of a certificate transferee. Sound corporate policy dictates the encouragement of investments through the elimination of uncertainties and risks.

Similar considerations of liquidity and stockholder security, as well as a compelling necessity for uniformity of state laws, impelled the adoption of model legislation in the United States. But more about this later.

Philippine statutory provisions governing stock transfers consist of Sections 35 and 52 of the Philippine Corporation Law, which sections [8] are substantially as contained in the original Act 1459, effective April 1, 1906. Yet age alone is an insufficient argument for revision; amendment must seek justification in the desirability and possibility of reform. If the extant law, with the modifications brought about through the judicial process, gives evidence of equal or superior adaptability for the desired purposes, there is no sense in change. Alteration is not for alteration's sake alone.

A brief foreword: The expanse of the field negatives a minute inquiry into every detail of the law on stock transfers. What follows is an effort at analysis, comparison, and evaluation on a broad scale of the Philippine and American experience relative to share certificate transmissibility, with the hope of advancing a modest contribution to the process of selective assimilation in law.

With these observations, we proceed to a review of the fundamental concepts underlying stock transfers.

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investors, bona fide holders. It would hardly be an exaggeration to say that the law governing stocks and bonds, in the magnitude of the interests, the number of persons affected, and the variety of legal principles involved, is more important than all other branches of law combined. Even real estate, so far as the cities are concerned, is being absorbed by corporations, which issue stock to represent it. In the great moneyed centers, stock constitutes the chief basis of credit, as collateral for loans at banks and trust companies. Hundreds of millions of dollars are loaned with no other security than certificates of stock transferred in blank with no registry whatsoever on the corporate books. Hence it is with reason that the constant tendency of the courts is to protect the bona fide purchasers of certificates of stock. It is fitting, in these days of the formative period of the law governing corporations and stock, that the principles governing the transfer of certificates should favor the protection and security of the investing public, and should be against secret liens, attachments, claims, and negligence of both the corporation and third persons. COOK, CORPORATIONS (8th Edition), § 444 at 1438. Also BERLE AND PEDERSON, LIQUID CLAIMS AND NATIONAL WEALTH (1934).

[8] Except for a paragraph appended to § 52 by Act 3741.

I

Two distinct aspects divide the law relative to stock transfers. One treats of the rights and duties of the corporation with reference to registration, the issue of new certificates, and the entry of stock transactions on the books of the corporation.[9] This process of registration fixes the rights of the shareowner as such vis-a-vis the corporation; i.e., it establishes him as a shareholder of record with the corresponding duties and privileges.[10] Except insofar as a discussion thereof may bear on the topic detailed below, the legal consequences flowing from recording upon the stock books are alien to this paper.

A second aspect of the law on stock transfers delimits the area of research and discussion. This involves the share certificate as evidence of title and treats of the methods of assignment of the shares as between seller and buyer, pledgor and pledgee. With this field of stock certificate transfer from person to person, sprout problems of negotiability or quasi-negotiability.

That the certificate is not essential to the complete ownership of the stock or to the creation of a stockholder relationship is basic in Philippine law,[11] but its value as documentary evidence of owner-

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[9] BALLANTINE, LAW OF CORPORATIONS (1946), § 320; 12 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, § 5463.

[10] In connection with recording on the corporate books, the word "transfer" is generally employed to indicate entry of transfer on the records, involving the successive stages of surrender of the outstanding certificate for cancellation and issuance by the corporation of a new certificate. Or, as embodied in the phrase "transfer on the books," the word may refer to a formal instrument of transfer of title executed in a corporate transfer book containing blank forms of transfer. See BALLANTINE, *op. cit.*, § 321. In neither of these senses is "transfer" employed here. Where pertinent, the word "registration" or "recording" will be employed to designate the foregoing processes.

In another sense, "transfer" may indicate the assignment or transfer of legal title to the shares from person to person. Compare § 22 of the Uniform Stock Transfer Act where "transfer" means "transfer of legal title." "Transfer," as employed here, must be taken as so defined.

Note, further, that in the following discussion the interests of a pledgee often correspond to those of a purchaser of a share certificate; in such cases, "transferee" may occasionally be used to indicate both, quite loosely.

[11] 2 TOLENTINO, COMMENTARIES AND JURISPRUDENCE ON THE COMMERCIAL LAWS OF THE PHILIPPINES (6th Ed., 1951), p. 727; SALONGA, PHILIPPINE LAW ON PRIVATE CORPORATIONS (1952), p. 380.

For the original American doctrine: Winslow v. Fletcher, 53 Conn. 390, 4 Atl. 250; Hawley v. Upton, 102 U. S. 314, 26 L. Ed. 179; De Laoch v. Bennett, 156 Ga. 633, 129 S. E. 592, citing R. C. L.; Illinois-Indiana Fair Ass'n v. Phillips, 323 Ill. 368, 159 N. E.815, 59 A. L. R. 591; Butler University v. Scoonover, 114 Ind. 381, 16 N. E. 642, 5 Am. St. Rep. 627; Re Calber, 145 Iowa 1, 123 N. W. 743, 25 L. R. A. (N.S.) 384; Chester Glass Co. v. Dewey, 16 Mass. 94, 8 Am. Dec. 128; Randall

ship and as an instrument for the transfer of title to shares of stock was very early recognized.[12]

Notwithstanding Section 35 of the Philippine Corporation Law providing for the transfer of shares by delivery of the stock certificate indorsed by the owner or his agent,[13] it is indisputable that certificates of stock issued by authority of this statute are not choses in action.[14] The Negotiable Instruments Law does not comprehend share certificates within its purview.[15]

With the absence of the characteristic of negotiability, even a bona fide transferee of such certificates acquires no better title to the shares than his transferor had.[16] He falls heir to the equities

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Printing Co. v. Sanitas Mineral Water Co., 120 Minn. 268, 139 N. W. 606, 43 L. R. A. (N. S.) 706; Holland v. Duluth Iron Min. & Development Co., 65 Minn. 324, 68 N. W. 50, 60 Am. St. Rep. 480; Yeman v. Galveston City Co., 106 Tex. 389, 167 S. W. 710, Ann. Cas. 1917E, 191; Lipscomb v. Condon, 56 W. Va. 416, 49 S. E. 392, 67 L. R. A. 670, 107 Am. St. Rep. 938. See BALLANTINE, *op. cit.*, at § 198.

[12] TOLENTINO, *op. cit.*, at 728.

[13] § 35 of Act 1459 reads in part:

"... Shares of stock so issued are personal property and may be transferred by delivery of the certificate indorsed by the owner or his attorney in fact or other person legally authorized to make the transfer. No transfer, however, shall be valid, except as between the parties, until the transfer is entered and noted upon the books of the corporation so as to show the names of the parties to the transaction, the date of the transfer, the number of the certificate, and the number of shares transferred."

[14] Santamaria v. Hongkong and Shanghai Banking Corporation, G. R. L-2808, August 31, 1951; Eastern Investment Co. v. Yap (CA), 20 O. G. (11th Supp.), 224. TOLENTINO, *op. cit.*, at 728. SALONGA, *op. cit.*, at 381.

For comparable American rulings as to the nature of share certificates: National Safe Deposit, Savings & Trust Co. v. Hibbs, 229 U. S. 391, 57 L. Ed. 1241, 33 Sup. Ct. 818, aff'g. 32 App. Cas. (D.C.) 459; Hammond v. Hastings, 134 U. S. 401, 33 L. Ed. 960, 10 Sup. Ct. 727; Weniger v. Success Min. Co., 227 Fed. 548; National City Bank of Chicago v. Wagner, 216 Fed. 473; O'Neil v. Wolcott Min. Co., 174 Fed. 527, 27 L. R. A. (N.W.) 200; Church v. Citizens' St. R. Co., 78 Fed. 526; Bangor Elec. Light & Power Co. v. Robinson, 52 Fed. 520; Matthews v. Massachusetts Nat'l Bank, Holmes 396, Fed. Cas. No. 9, 286; Powell v. Maryland Trust Co., 125 F. (2d) 260; see FLETCHER, *op. cit.*, at § 5475; COOK, *op. cit.*, § 412.

[15] Eastern Investment Co. v. Yap, *supra* note 14; FRANCISCO, COMMENTARIES ON THE NEGOTIABLE INSTRUMENTS LAW (3rd Ed., 1949), p. 12 See § 1, Act 2031.

Are share certificates subject to the Civil Code provisions on Sales? (Articles 1458 to 1637, R. A. 386). Are they "goods" or "documents of title to goods"? There is no pertinent ruling by the Philippine Supreme Court.

Article 1636 of the Civil Code (on definitions) stems from § 76 of the Uniform Sales Act. American courts, construing § 76, indicate a negative response in Smith v. Lingelbach, 177 Wis. 170, 187 N.W. 1007 (1922); cf., Millard v. Green, 94 Conn. 597, 110 Atl. 177; Laundry & Cleaning Co. v. Whitmore, 92 Ohio St. 44, 110 N.E. 518; contra, Postel v. Hagist, 251 Ill. App. 454, 466. See Kaufman, "Are Sales of Corporate Stock Subject to the Uniform Sales Act?" 10 N.Y.U.L. Q. 157, (1932).

[16] TOLENTINO, *op. cit.*, at 728. FLETCHER, *op. cit.*, at § 5475 and cases cited.

existing on the stock against the transferor in favor of the corporation or of third persons, irrespective of his lack of knowledge thereof.[17] Thus, transmission of a share certificate by one without title or authority to transfer the same, gives the transferee no title to the shares as against the true owner.[18]

II

Recognition of mercantile necessity for according to stock certificates some of the attributes of commercial paper, in view of extensive dealings in certificates and their widespread use as collateral security, led to the development of the doctrine of share certificate quasi-negotiability at common law.[19] Judicial decisions have effected a similar result in Philippine corporate jurisprudence.[20] Courts have, ostensibly through construction and interpretation, brought about considerable amelioration in the position of a stock purchaser or pledgee. Nevertheless, it is proposed to be demonstrated that the transferee of a share certifirate must, under present law, remain in large part insecure as to his stock investment.

The departure from the rule of strict non-negotiability rests on the propriety of according protection to an innocent transferee where negligence or fault is attributable to the owner of the stock. When

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[17] Eastern Investment Co. v. Yap, *supra* note 14. TOLENTINO, *op. cit.*, at 728. FLETCHER, *op. cit.*, at 5475 and cases cited.

[18] TOLENTINO, *op. cit.*, at 728. FLETCHER, *op. cit.*, at § 5542 and cases cited.

[19] As cited in Masury v. Arkansas National Bank, 93 Fed, Rep. 603 (1899):

"It is a well-known fact that stock certificates frequently circulate in places far remote from the home of the corporation by which they were issued, that in all commercial centers they are commonly transferred from hand to hand like negotiable paper, and that they are hypothecated for temporary loans by a simple indorsement and delivery thereof, the latter being perhaps the most common use to which such securities are put. In the great majority of cases when stock is merely pledged for a loan, no record of transfer is made on the books of the corporation, and in the judgment of laymen the making of such a record seems to be a needless formality. The trend of modern decisions has been to encourage the free circulation of stock certificates in the mode last indicated, on the theory that they are a valuable aid to commercial transactions, and that the public interest is best subserved by removing all restrictions against their circulation, and by placing them as nearly as possible on the plane of commercial paper."

Also, National Safe Deposit Savings & Trust Co. v. Hibbs, 229 U.S. 391, 33 Sup. Ct. 818, 57 L. ed. 1241; O'Neil v. Wolcott Min. Co., 174 Fed. 527, 532, 27 L.R.A. 200; Nat'l City Bank v. Wagner, 216 Fed. 473; Powers v. Pacific Diesel Co., 206 Cal. 334, 274 Pac. 512, 73 A.L.R. 1398, 1405; Howison v. Mechanics' Sav. Bank, 88 N.H. 31, 183 Atl. 697; see BALLANTINE, PURCHASE FOR VALUE AND ESTOPPEL, 6 MINN. L. REV. 87, 92; FLETCHER, *op. cit.*, at §§ 5477, 5562.

[20] Bachrach Motor Co. v. Lacson Ledesma, 64 Phil. 681; Santamaria v. Hongkong and Shanghai Bank, *supra* note 14. TOLENTINO, *op. cit.*, at 729; SALONGA, *op. cit.*, at 439.

the owner of the shares places the certificates indorsed in blank in the hands of another, such possessor, although acting wrongfully, might therefore pass good title by sale or pledge to one who reasonably relied upon such evidence and appearance of title or power of disposition, and who took in good faith [21] and for value.[22]

Because stock certificates when so treated partake of some of the attributes of negotiability in passing from hand to hand, they are frequently denominated quasi-negotiable.[23] But the true basis of the rule is estoppel [24] and the sanction therefor may be found in the maxim that where one of the innocent parties must suffer by reason of a wrongful or unauthorized act, the loss should fall on him who first trusted the wrongdoer and put in his hands the means of inflicting such loss.[25]

Where the owner has intentionally or through negligence clothed another with apparent title to the shares, or apparent authority to dispose thereof, estoppel may arise. The normal situation calling for application of the doctrine commences with the owner delivering the certificate to a third person, with a power of attorney or indorsement in blank, but upon an understanding not to transfer. As against third person dealing in good faith with the misappropriating party, the true owner is precluded from asserting title.[26]

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[21] Santamaria v. Hongkong & Shanghai Bank, *supra* note 14. Title will not vest on transferees with actual notice that the apparent title or authority is defective; nor when attendant circumstances, such as the form or terms of the indorsement, are sufficient to put them upon inquiry. FLETCHER, *op. cit.*, at § 5563, and cases cited.

[22] Santamaria v. Hongkong & Shanghai Bank, *supra note* 14. Compare: National Safe Deposits, Savings & Trust Co., v. Hibbs, 229 U.S. 391, 57 L. Ed. 1241, 33 Sup. Ct. 818 affg. 32 App. Cas. (D.C.) 459; Cowdrey v. Vanderburgh., 101 U.S. 572, 25 L. Ed. 923; Johnson v. Bixby, 252 Fed. 103; National Bank of Chicago v. Wagner, 216 Fed. 473, Wolf v. American Trust & Savings Bank, 214 Fed. 761; O'Neil v. Wolcott Min. Co., 174 Fed. 527, 27 L.R.A. (N.S.) 200; Elliot v. E.C. Miller & Co., 158 Fed. 868; Fulton Nat. Bank v. Moody, 51 Ga. App. 179, 179 S.E. 831, ann. in 49 HARV. L. REV. 161.

[23] Bachrach Motor Co. v. Ledesma, *supra* note 14. The terminology is not unjustified; in the situation above outlined, the transferee does obtain better title than the wrongful transferor. A certificate indorsed in blank is easily assignable. Another aspect of "quasi-negotiability" discourages hidden liens (*infra*).

[24] *Cf.*, Article 1438, R. A. 386.

[25] Santamaria v. Hongkong & Shanghai Bank, *supra* note 14. SALONGA, *op. cit.*, [illegible]382. Compare FLETCHER, *op. cit.*, # 5542, and cases cited; COOK, *op. cit.*, at § 416; Annotation: 29 L. R. A. (N.S.) 254. Of course, the misappropriator should in any event respond for damages. The discussion here, however, assumes the usual situation where the wrong doer proves elusive or is unable to make reparation.

The essential elements of the estoppel of the true owner against the bona fide purchaser are:

(1) Some voluntary act on his part calculated to clothe the possessor of the

The investor's interest lies primarily in determining what risks and liabilities he incurs in purchasing or otherwise dealing in stock certificates. It behooves him to minimize the instances when some undisclosed forgery, theft, breach of trust, any other fact, equitable right affecting former owners, or proceeding involving the stock can intervene to defeat or detract from his rights as shareholder. From this viewpoint, the estoppel rule adopted in the Philippines proves inadequate in a number of particulars.

The doctrine, in truth, has to date received little elaboration from the local appellate courts. However, the logical derivations of the acquired approach are easy to perceive; better then to measure its failings by resort in part to American case law built upon the foundation of this rule.[27]

Of course, if forgery has been made, no purchaser or pledgee can seek shelter beneath his good faith to defeat the owner's rights to the stock. A's title to a certificate—placed in the hands of B but without indorsement—is not subordinated by transfer from B to C, a purchaser for value without notice of irregularities, following false indorsement by B of the certificate in simulation of A's signature. Forgery cannot be the source of title to promissory notes and bills of exchange; much less to non-negotiable certificates of stock.[28]

Even short of forgery, the bona fide transferee of a stock certificate cannot rest assured of good title subsequent to unauthorized transfer, for the estoppel doctrine reaches its limitations when the owner of the certificate has neither entrusted the wrongdoer with the possession thereof nor clothed him with evidence of title.[29] Wrongful transfer by a thief of an indorsed certificate will not pass good title to a bona fide transferee,[30] and it is immaterial that the thief, being a servant, clerk, or otherwise, had easy access to the

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certificate with the customary evidence of title or authority and induce others to rely upon it;

(2) Reliance upon the customary evidence or appearance of title or authority by a purchaser or pledgee in good faith and for value.

Most courts take judicial notice of what is regarded as customary evidence of title or authority to transfer shares as a matter of common knowledge.

BALLANTINE, *op.-cit.*, at § 757.

[27] Frequent recourse will be had to decisions by American courts, but with awareness that they are only of persuasive force in this jurisdiction.

[28] See FLETCHER, *op. cit.*, at § 5542, and cases cited. But see the effect of registration on the corporate books in connection with forgery under Art. 8 of the Uniform Commercial Code, *infra*.

[29] *Ibid.*

[30] Bangor Electric Light & Power Co. v. Robinson, 52 Fed. 520. See FLETCHER, *op. cit.*, at § 5562; BALLANTINE, *op. cit.*, at § 330.

certificate.[31] Similarly, title will not accrue to the transferee upon acquisition from a finder of a lost certificate, though properly indorsed by the registered owner.[32]

Transactions in shares of stock carry with them such other risks as appertain to an ordinary contract involving personalty.[33] Where the investor deals in stock through an intermediary, the law of agency is not to be disregarded.[34] Conceivably, the principal's inability to enter into the agency relationship— consequent to his insanity,[35] minority,[36] or other incapacity [37]—may vitiate the certificate in the hands of a bona fide transferee. These and other defects in legal representation [38] may render the contract unenforceable.[39]

Consequently, these latent imperfections may infect title to stock obtained through an intermediary. Possession of an untarnished

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[31] *Ibid.* Also: Hudson Trust Co. v. American Linseed Co., 232 N.Y. 350, 134 N.E. 178, noted in 31 Yale L. J. 773; Know v. Eden Musee American Co., 148 N.Y. 441, 454, 42 N.E. 988, 31 L.R.A. 779, 51 Am. St. Rep. 700.

[32] BALLANTINE, *op. cit.*, at § 330, and cases cited. Also: Note, 52 A.L.R. 947, 949.

[33] FLETCHER, *op. cit.*, at § 5566, and cases cited.

[34] Pacific Commercial Co. v. Yatco, 68 Phil. 398, attempts to distinguish an agent from a "broker", as follows:

"The commission agent is one engaged in the purchase or sale for another of personal property which, for this purpose, is placed in his possession and at his disposal. He maintains a relation not only with his principal and the purchasers of vendors, but also with the property which is the subject matter of the transaction. On the other hand, a broker has no relation with the thing he buys or sale. He is merely an intermediary between the purchaser and the vendor. He acquires neither the custody nor the possession of the thing he sells. His only office is to bring together the parties to the transaction."

But the stockbroker, who ordinarily is charged with the custody of the certificate in indorsed form while acting as a bridge between seller and buyer, is properly an agent rather than a "broker", as above distinguished. Compare the American view, *infra*.

[35] Article 1327, R.A. 386. Compare MECHEM, OUTLINES OF THE LAW OF AGENCY (3rd Ed.), at § 59.

[36] Article 1327, R.A. 386. As to the legal effect of contracts by minors: Bambalan v. Maramba, 51 Phil. 417; Young v. Tecson, 39 O.G. 953; both illustrating the general rule on voidability. But *cf.* Mercado v. Espiritu, 37 Phil. 215, which holds: The sale of real estate, effected by minors who have already passed the age of puberty and adolescence and are near the adult age when they pretend to have already reached their majority, while in fact they have not, is valid, and they cannot be permitted afterwards to excuse themselves from compliance with obligations assumed by them or to seek their annulment. Also, Suan & Chiaco v. Alcantara, 47 O.G. 4561. I PADILLA, CIVIL CODE ANNOTATED (1953), pp. 70 to 73.

[37] Article 1327, R.A. 386.

[38] See PADILLA, *op. cit. supra* note 36, at p. 435, citing scattered provisions of the new Civil Code.

[39] Article 1317, R.A. 386. *Cf.*, Salunga v. Evangelista, 20 Phil. 273; Ibañez v. Rodriguez 47 Phil. 554. But query: Since an agency defective for want of capacity

certificate falls short of supplanting the necessity for seeking assurance from the record owner.

These precautions may not be adequate in every instance. Envisage this situation: Without circumstances indicating estoppel on the part of the true owner A, B obtains possession of a stock certificate and effects an unauthorized transfer to C, a bona fide purchaser for value. C surrenders the certificate to the issuing corporation and obtains another certificate in his name, thereby becoming an apparent shareholder on the books of the corporation. Thereafter C indorses the new certificate to D, also in good faith.

Observe the conflicting claims to the stock. Where no share over-issue follows, the solution is readily achieved. Evidently, since no negligence or wrong may be imputed to him, A should be sustained in his claim to the shares. On the other hand D's interests are commensurately upheld through enforcement of the estoppel doctrine against the corporation. Having bought in reliance upon the certificate of title issued by the corporation, D is asserted to have a right against the company on its representation to have himself recognized as shareholder or, at his discretion, for damages.[40] Where recognition of both A and D as stockholders results in an over-issue of shares, the answer is less assured. Recorded Philippine decisions throw no light on the disposition of this controversy. American authorities are in disagreement.[41] Ballantine,[42] Stevens,[43] Morawetz,[44] and Clark,[45] on the basis of the position taken by the federal courts,[46] indicate that the original owner A retains title to the stock. But Cook,[47] Fletcher,[48] and Christy,[49] relegate A to recovery of dam-

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is merely voidable (Art. 1390, R.A. 386) and therefore effective till annulled, is not a transfer pursuant to such agency before annulment upon "legal representation"?

Should the result differ if the principal is undisclosed under Article 1883, R.A. 386?

[40] BALLANTINE, *op. cit.*, at § 331, and cases cited.

[41] See note, 23 MINN. L. REV., 484, 499.

[42] BALLANTINE, *op. cit.*, at § 331.

[43] STEVENS ON CORPORATIONS, at § 133.

[44] MORAWETZ, PRIVATE CORPORATIONS (2nd Ed.), at § 208.

[45] CLARK, CORPORATIONS (3rd. Ed.), at § 163.

[46] See Moores v. Citizens' National Bank of Piqua (1884), 111 U.S. 156, 166, 4 Sup. Ct. 345, 28 L. Ed. 385; Western Union Telegraph Co. v. Davenport (1878), 97 U.S. 369, 24 L. Ed. 1047. The view is that a stockholder "cannot be deprived of his property without consent or negligence of his, except by operation of law."

[47] COOK, *op. cit.*, at §§ 358, 367, 370.

[48] FLETCHER, *op. cit.*, at §§ 5551, 5553.

[49] Christy, Transfer of Stocks (second edition), § 244 at p. 409; § 21 at p. 41. With this qualification: The former owner of the stock (A) may compel the corporation to go into the market and purchase similar stock. See also West v. Tintic Standard Mining Co., 71 Utah 158, 263 p. 490.

ages from the corporation and leave D, the bona fide purchaser, in full ownership of the stock, the theory being that all rights and equities to particular shares of stock are cut off by registration on the corporate books and sale of the new certificates, the transferee of the new certificate taking free of infirmities previous to the new issue.[50] The consequences of the federal rule are far-reaching. If the first view finds acceptance, it is plain that no bona fide transferee of a certificate can rest certain of an indefeasible right as shareholder without inquiry not only of the current record owner but also of every holder of the particular stock all along the chain of title back to the initial issue. This much more uncertainty must hover over every transfer of stock.

To what extent a corporation may be held estopped from asserting the invalidity of a stock issue as against an innocent transferee of the certificate is unsettled locally.[51] Neither is jurisprudence abundant on the efficacy as notice to investors of conditions or limiting provisos in charters and by-laws.[52] These are areas of potential discrepancy with the representative character of the certificate.

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[50] COOK, *op. cit. supra* note 47, citing Winte v. Montgomery Gaslight Co., 89 Ala. 544 (1889). But the corporation may recover damages from the transferee obtaining registration, on his warranty of title and right to transfer, no matter how innocent he may be. COOK, *id.*, at # 367; CHRISTY, *op. cit.*, at § 244, and cases cited. Also, BALLANTINE, *op. cit.*, § 331 at 762.

[51] The rule at common law is stated as follows: An over-issue of shares is void and do not give the holders thereof the rights or liabilities of shareholders. Even bona fide purchasers of the share certificates do not acquire the rights of a shareholder, but have a right to recover damages from the corporation for misrepresentation. BALLANTINE, *op. cit.*, at § 325, and cases cited. 11 FLETCHER, *op. cit.*, at §§ 5144, 5180. Note, 37 YALE L. J. 362. But see CHRISTY, *op. cit.*, §§ 17 to 21: The innocent purchaser may oblige the corporation to purchase similar stock on the market to replace stock defective due to forgery or over-issue. This is the rule adopted in the new Commercial Code.

Similarly, forgery in the execution of the certificate at the source generally prevents title from vesting in a holder. BALLANTINE, *id.*, at § 332, p. 767.

But mere irregularities or a departure from procedure in the issuance of shares may estop the corporation from denying the validity of the issue against a bona fide purchaser. BALLANTINE, *id.*, at § 325; also CHRISTY, *op. cit.*, §§ 17 to 21.

[52] Preemptive rights by authority of by-laws have not been looked upon with favor:

Restrictions on transfer in terms of a preemptive privilege in favor of the issuing corporation and fellow stockholders received a setback in Fletcher v. Botica Nolasco, 47 Phil. 583. See Feliciano, *On the Shareholders' Right of Preemption: Law and Practice*, 28 PHIL. L. J., 433, note 2. But see Lambert v. Fox, 26 Phil. 588.

A similar dislike for "secret" liens in favor of the corporation is noted:

"A lien upon stock in favor of corporations for debt or liability of stockholders other than unpaid subscription due and payable would be an obstacle to the trading of shares upon which many people depend for their credit. Before accepting a transfer of corporate shares, a prospective transferee would have to inquire into unregistered

The law on chattel mortgages contributes its share to the incertitude resulting from stock transfers. The Civil Code affirms that stocks may be the subject of mortgages.[53] To constitute a chattel mortgage on shares, valid against third persons, recording in the chattel mortgage registry is essential;[54] but neither delivery of the certificate [55] nor entry on the corporate books [56] is necessary. The certificate remains, without notation of encumbrance,[57] in the hands of the mortgagor—an invitation to fraudulent transfers.[58] Irrespective of his lack of actual knowledge of the mortgage, a subsequent transferee obtains the share certificate subject to the mortgagee's lien.[59] A prospective transferee, acting with all due prudence, can ill afford to overlook an examination of the appropriate chattel mortgage registry.[60]

Obiter dictum in *Bank of the P.I. v. Caridad Estates* [61] poses a comparable difficulty referent to pledges of stock. Shares may be

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claims, equities, or liens upon said shares in favor of the corporation. Such a situation should not be created if it could be avoided." Bank of the P. I. v. Caridad Estates (CA), G.R. No. 16; VII Lawyers Journal, 850.

[53] Articles 2095 and 2140, R.A. 386; Monserrat v. Ceron, 58 Phil. 469; Guan v. Samahang Magsasaka, Inc., 62 Phil. 472; Bachrach Motor Co. v. Ledesma, 64 Phil. 681.

[54] § 4, Act 1508.

[55] Although § 4 of Act 1508 provides for the creation of a chattel mortgage by registration or in the alternative by delivery of the chattel, Article 2140 of R. A. 386 provides that if the movable, instead of being recorded, is delivered to the creditor or a third person, the contact is a pledge and not a chattel mortgage. Act 1508 must be deemed amended to this extent (Article 2270, R. A. 386).

[56] Monserrat v. Ceron, *supra;* Bank of P. I. v. Caridad Estates, *supra;* Guan v. Samahang Magsasaka, *supra;* Bachrach Motor Co. v. Ledesma, *supra.*

[57] Neither Act 1508 nor the Civil Code provides for notation on the certificate.

[58] The possession of the unendorsed certificate and the lack of any indication on the books of the corporation that the shares are encumbered, if the mere registration of the mortgage is sufficient to create a lien on the stock without actual notice, is very likely to mislead persons dealing with the mortgagor on the strength of his apparent title. FISHER, THE PHILIPPINE LAW OF STOCK CORPORATIONS (1929), p. 165.

[59] Article 319 of the Revised Penal Code penalizes the removal, sale, or pledge of the mortgaged property, without consent of the mortgagee written on the back of the mortgage and noted on the record thereof in the office of the register of deeds of the province where such property is located. The requirement is for notation of the consent on the back of the mortgage deed rather than on the certificate itself. Moreover, the penal sanction may not prevent the mortgagor from alienating the mortgaged share certificates to a bona fide purchaser wiithout securing the requisite approval.

[60] § 14 of Act 1508 provides for the proper place of registration. Since Guan v. Samahang Magsasaka, *supra,* it has been settled that the property in the shares may be deemed situated in the province in which the corporation has its principal office or place of business. If this province is also the province of the owner's domicile, a single registration is sufficient. If not, the chattel mortgage should be recorded both at the owner's domicile and in the province where the corporation has its principal office or place of business.

[61] *Supra,* note 52. *Infra,* note 64.

pledged by delivery of the certificate duly indorsed.[62] The feasibility of wrongful transfer by the pledgee is obviously unsatisfactory to the pledgor,[63] but the latter's remedy is close at hand. The optional device of recording the pledge on the stock books assertedly corresponds to publicity binding on third persons obtaining the share certificate without actual notice of the encumbrance.[64] A would-be transferee, compelled to inquire from corporate records, must face the predicament that the books of the corporation are not public records. Not being a registered stockholder, he is without authority to compel disclosure thereof.[65]

An unsympathetic construction of the new Civil Code may augment the transferee's enigma. Under the prior law, the embodiment of the pledge of stock in a public instrument will not avail as notice to unsuspecting third parties.[66] But the rejected requisite calling

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[62] Article 2095, R. A. 386, on pledge of incorporeal rights, including shares of stock, requires that "the instrument proving the right pledged shall be delivered to the creditor, and if negotiable, must be indorsed." Since share certificates under Philippine law are not truly negotiable, a literal reading of the article would impose no requirement of indorsement for a valid pledge thereof. However, it is usual for the pledgee to insist on an indorsement.

Observe, furthermore, the objections at common law to a delivery of a share certificate in pledge without indorsement:

"Mere delivery of a certificate of stock without any written assignment or transfer may vest an equitable title, or give a lien enforceable in equity, but since it gives the person to whom the certificate is delivered no control over or possession of the stock, it does not constitute a valid pledge." 12 FLETCHER, *op. cit.*, at § 5640, pp. 844-5, and cases cited.

[63] Pledge by delivery of the indorsed certificate, without more, leaves the pledgor susceptible to the estoppel rule in the event of wrongful transfer by the pledgee to a third person in good faith, at least, where the indorsement is in blank. *Supra*, note 22. Where the indorsement is special, the pledgee might wrongfully have himself registered as shareholder with the corporation, and pass the new certificate on to the bona fide transferee. The rights of the pledgor would depend on which of the two conflicting theories is adopted. *Supra*, notes 41-49.

[64] Bank of P. I. v. Caridad Estates, *supra* note 52.

[65] § 51 of the Corporation Law grants the right of inspection of corporate books only to directors, members, or stockholders. "The books and records are not open to the public and even if access to them were granted, would be available only to persons in the vicinity of the principal office of the concern." FISHER, *op. cit.*, at 163, citing National Bank v. Western Pacific R. R. Co., 157 Calif. 573, 27 L. R. A. (N.S.) 987.

[66] In passing on the validity of a pledge of stock in Bachrach Motor Co. v. Ledesma, *supra* note 20, the Supreme Court said:

"It is true, according to Article 1865 of the (old) Civil Code, that in order that a pledge may be effective as against third persons, evidence of its date must appear in a public instrument in addition to the delivery of the thing pledged to the creditor. This provision has been interpreted in the sense that for the contract to affect third persons, it must appear in a public instrument in addition to delivery of the thing pledged. (Ocejo, Perez & Co. v. Int'l Banking Corp., 37 Phil. 631; Tec Bi & Co.

for recital of a description of the object pledged and the date of the contract in a public writing, as constructive notice, has been reintroduced in the new Code.[67] To the third person transferee, the lien is rendered almost undiscoverable, for the impracticability of scrutinizing every public instrument is evident.

Attachments and executions are due for mention. Under the Rules of Court, stocks, shares, or an interest therein may be levied upon by leaving with the president or managing agent of the issuing corporation a copy of the order, with a notice of the levy.[68] The certificate itself need not be seized; generally it remains in the owner's possession, free from any indication of an established lien. To ascertain the absence of a prior attachment or execution levied on the stock, the purchaser or pledgee of a share certificate is put to inquiry at the offices of the corporation, although the corporate records are not open to inspection by outsiders.[69]

In spite of having elicited information in this wise, the transferee remains vulnerable to subsequent levies on the stock. Since *Uson v. Diosmito*,[70] the rule has been that until a transfer of stock is registered on the corporate books, the stock may be subjected to execution or attachment by creditors of the record owner-transferor, at least where such creditors are unaware of the antecedent transfer.[71] To provide for this eventuality, recording by the transferee on the stock books is exigent.

Thus, judicial aversion to unapparent limitations or engagements detracting from the quasi-negotiability of share certificates

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v. Chartered Bank, 41 Phil. 596; Te Pate v. Ingersoll, 43 Phil. 394). It cannot be denied, however, that section 4 of Act No. 1508, otherwise known as the Chattel Mortgage Law, implicitly modified article 1865 of the Civil Code in the sense that a contract of pledge and that of chattel mortgage, to be effective as against third persons, need not appear in public instruments provided the thing pledged or mortgaged be delivered or placed in the possession of the creditor (Mahoney v. Tuason, 39 Phil. 952)."

Under the law then in force, a pledge and a chattel mortgage constituted by delivery without registration could hardly be told apart.

[67] Article 2096, R. A. 386. The requirements of Article 1865 of the old Civil Code are restored. *Supra*, note 66. Article 2096 reads as follows:

"A pledge shall not take effect against third persons if a description of the thing pledged and the date of the pledge do not appear in a public instrument."

Article 2140 of the new Civil Code sets a pledge apart from a chattel mortgage. Clearly, the provisions of the Chattel Mortgage Law can no longer be made to apply to pledges of stock.

[68] § 7(d), Rule 59; §14, Rule 39, Rules of Court.

[69] *Supra*, note 65.

[70] 61 Phil. 535; *contra*, Uy Piaco v. McMicking, 10 Phil. 286. The *Uson* case differs from the majority view in the United States. See SALONGA, *op. cit.*, p. 432; TOLENTINO, *op. cit.*, at 736; BALLANTINE, *op. cit.*, at § 329, p. 756.

[71] Fua Cun v. Summers, 44 Phil. 705.

has been manifested reasonably;[72] yet, possession of the certificate notwithstanding, the title of a transferee of stock stands contingent on sundry risks, which include:

(a) An unauthorized or forged transfer, or some other infirmity or restriction not apparent on the face of the certificate, without estoppel on the part of the true owner of the stock;

(b) A defect rendering the issue void; i.e., over-issue or forgery in the execution of the certificate;

(c) A previous chattel mortgage on the stock, without notation on the certificate;

(d) A wrongful transfer by a pledgee with pretense of ownership, where the pledge has been noted on the corporate books and/or appears in a public writing.

(e) A prior attachment or execution against the transferor levied on the stock.

(f) Before recording of the transfer on the stock books, an attachment or execution levied against the transferor on the stock.

Lessening the hazard, without in truth providing for every contingency, necessitates perusal of corporate records, of chattel mortgage registers, immediate recording on the corporate books, and inquiry of every previous holder of the stock certificate. These measures entail time, expense, and effort far beyond convenient.

What then of quasi-negotiability?

III

An Act to Make Uniform the Laws of Transfer of Title to Shares of Stock, authored by Professor Samuel Williston, was approved by the National Conference of Commissioners on Uniform State Laws in 1909 and is now law in almost all the states of the American union.[73] As the commissioners assert, the fundamental purpose of the act is to make the certificate, to the fullest extent possible, the representative of the shares.[74] Negotiability is sought to be accorded the certificate.[75]

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[72] Santamaria v. Hongkong & Shanghai Bk., *supra* note 14:

"A bona fide pledgee or transferee of stock from the apparent owner is not chargeable with knowledge of the limitations placed on it by the real owner, or of any secret agreement relating to the use which might be made of the stock by the holder."

Also, Bank of P. I. v. Caridad Estates, *supra* note 52.

[73] 6 Uniform Laws Annotated; Cumulative Annual Pocket Part for 1954, p. 6. The Uniform Act has been in force in all 48 states and in the District of Columbia, Alaska, and Hawaii. See FRAY, CASES ON CORPORATIONS AND PARTNERSHIPS (Temp. Ed., 1951), p. 390. But Pennsylvania has lately adopted the Uniform Commercial Code, *infra*.

[74] Commissioners' note to § 1 of the Uniform Stock Transfer Act, 6 U. L. A. 2. The transfer of the certificate is made to operate as a transfer of the shares, whereas at common law the registry on the books of the company makes the complete transfer.

The Transfer Act does not purport to forbid a corporation from recognizing the exclusive right of a person registered on its books as the owner of shares to vote the same, receive dividends thereon, or to hold the registered owner liable for calls and assessments.[76] Recording of the transfer on the stock books remains desirable to

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Ibid. Under the Transfer Act, recording on the books of the corporation bears an analogy to registration of a conveyance under the Torrens system. BALLANTINE, *op. cit.*, at § 321, p. 739; compare, Commissioners' note to § 1 of the Transfer Act, 6 U. L. A. 2.

[75] Commissioners' note to §§ 1, 5, and 6 of the Transfer Act, 6 U. L. A. 2, 10, 11. Murtland Holding Co. v. Egg Harbor Comm. Bank, 123 N. J. Eq. 117, 196 Atl., 230. BALLANTINE, *op. cit.*, at § 332; I WILLISTON, SALES (2d Ed., 1924), 717, n. 4.

Notwithstanding the avowed purpose of the Transfer Act to encourage the treatment of certificates as negotiable, a few will quarrel with the use of the term and, incidentally, with the title of this paper. A few courts, slow to discard notions of estoppel, insist, that the Transfer Act has not made certificates negotiable and that it is a mere codification of common law rules. Peckinpaugh v. Noble & Co., 288 Mich. 464, 470, 213 N. W. 859, 861, 52 A. L. R. 941; Jenkins v. Continental Trust Co., 150 Md. 416, 133 A. 610; Hazard v. Powell, 23 Ohio App. 71, 154 N. E. 357; Nicholson v. Morgan, 119 Misc. 309, 196 N. Y. S. 147 (1922); Stolz v. Carroll, 99 Ohio 289, 124 N. E. 226; Ironside v. Levi, 278 Mass. 18, 179 N. E. 226.

The legal treatment of a certificate should not be determined by an a priori definition of negotiability. Tested by the definition in the Negotiable Instruments Act, a share certificate cannot be classed as negotiable for one thing, it is not an unconditional promise to pay a sum certain in money. The term should be used not as of special significance in and of itself but only as indicating certain legal features and consequences not common to commercial instruments generally. Primarily, "negotiable" indicates transferability with a certain facility; another quality commonly associated with it is the possibility that a transferee may acquire on the instrument better rights than those assertable by his tranferor. Negotiability should be regarded as resulting from and connoting the incidents actually attributed by law to the instrument, rather than a reason for or against the attribution of those incidents. Indeed, the transfer Act has to a further extent produced results consistent with negotiability. STEVENS, *op. cit.*, §§ 135-137, pp. 623-624. Aigler, *Recognition of New Types of Negotiable Instruments*, 24 COLUM. L. REV. 563.

However, it should not be lost sight of that negotiability consequent to the Transfer Act is not negotiability under the Negotiable Instruments Law; they do not correspond in every respect. Strange, for instance, that the Transfer Act is so drawn that it does not apply to make negotiable a bearer certificate, that is, a certificate for shares which provides that it is the property of the bearer and that title is transferable by delivery in the same manner as a negotiable instrument payable to bearer. American Surety Co. v. Cunningham, 200 Minn. 566, 275 N. W. 1, 5, 112 A. L. R. 892; Edgerly v. First National Bank of Boston, 292 Mass. 181, 197 N. E. 518, noted in 3 U. OF CHI. L. REV. 508, 16 Boston U. L. Rev. 438. BALLANTINE, *op. cit.*, § 332 at 763, note 10.

[76] § 3, Uniform Stock Transfer Act. Being collateral to the issue of negotiability, this topic is not pursued further. For a discussion, see FLETCHER, *op. cit.*, Chapters XXIV and XXV. § 3 is couched permissively; hence, the corporation may refuse to treat with the registered owner and deal with the unregistered transferee instead. Turnball v. Longacre Bank, 249 N. Y. 159, 163 N. E. 135; Nat'l Surety Co. v. Indemnity Ins., 237 App. Div. 485, 261 N. Y. S. 605.

fix the transferee's rights relative to the corporation.[77] Beyond this, registration with the corporation is shorn of its common law significance.[78]

The Act protects a person who, for value and in good faith, obtains the share certificate with the indorsement of the person appearing by such certificate to be the owner thereof; or purchases and obtains delivery of the certificate with written assignment or power of attorney of such person, even if contained in a separate document.[79] Both delivery and assignment are essential to pass title.

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[77] Barbato v. Breeze Corp., 128 N. J. L. 309, 26 A. 2d 53. BALLANTINE, *op. cit.*, at § 329.

[78] Commissioner's note to § 1, Transfer Act; 6 U.L.A. 2.

Among the provisions rendering registration on the stock books less necessary is § 21 of the Transfer Act, which enables further transfer of the stock, without having to obtain a new certificate in his name, by a transferee through *special* indorsement. § 21 reads:

"Definition of person appearing to be the owner of certificate.—The person to whom a certificate was originally issued is the person appearing by the certificate to be the owner thereof, and of the shares represented thereby, until and unless he indorses the certificate to another specified person, and thereupon such other specified person is the person appearing by the certificate to be the owner thereof until and unless he also indorses the certificate to another specified person. Subsequent special indorsements may be made with like effect."

[79] § 1, Transfer Act:

"How title to certificates and shares may be transferred.—Title to a certificate and to the shares represented thereby can be transferred only,

"(a) By delivery of the certificate indorsed either in blank or to a specified person by the person appearing by the certificate to be the owner of the shares represented thereby, or

"(b) By delivery of the certificate and a separate document containing a written assignment of the certificate or a power of attorney to sell, assign, or transfer the same or the shares represented thereby, signed by the person appearing by the certificate to be the owner of the shares represented thereby. Such assignment or power of attorney may be either in blank or to a specified person.

"The provisions of this section shall be applicable although the charter or articles of incorporation or code of regulations or by-laws of the corporation issuing the certificate and the certificate itself, provide that the shares represented thereby shall be transferable only on the books of the corporation or shall be registered by a registrar or transferred by a transfer agent."

The mode of transfer designated in (a) above is preferable. A transfer as in (b) may expose the transferee to the risk contemplated in § 4:

"Title derived from certificate extinguishing title derived from a separate document.—The title of a transferee of a certificate under a power of attorney or assignment not written upon the certificate, and the title of any person claiming under such transferee, shall cease and determine if, at any time prior to the surrender of the certificate to the corporation issuing it, another person, for value in good faith, and without notice of the prior transfer, shall purchase and obtain delivery of such certificate with the indorsement of the person appearing by the certificate to be the owner thereof, or shall purchase and obtain delivery of such certificate and the writ-

An attempt to transfer without delivery of the certificate is ineffectual and gives rise to a mere promise to transfer.[80] Delivery without indorsement, on the other hand, imposes the obligation to indorse, but the intended transfer is not complete till indorsement is actually made.[81] The good faith [82] and value [83] requirements have been so

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ten assignment or power of attorney of such person, though contained in a separate document."

[80] § 10, Uniform Stock Transfer Act. This section is criticized in BALLANTINE, *op. cit.*, § 327.

[81] § 9, Uniform Stock Transfer Act.

[82] § 22, Uniform Stock Transfer Act. The section reads in part:

". . . (2) A thing is done 'in good faith' within the meaning of this act, when it is in fact done honestly, whether it be done negligently or not."

Were ordinary commercial patterns of carefulness used as standards of measuring conduct, bona fides would mean "business-like action" or commercial honesty. The Transfer Act, however, apparently intended a more liberal test of good faith, for it provides that negligent conduct is not indicative of dishonesty. Where there is no actual notice, therefore, bad faith can be demonstrated only by proving knowledge that should put one on suspicion or by proving that the instrument was obtained "out of the ordinary course of business." To this extent, the good faith provision of the act does not materially limit the negotiability of share certificates. See De Boer v. Anthony, 15 N.E. 2d 260; Edgerly v. First Nat'l Bank of Boston, 292 Mass. 81, 197 N.E. 518; Bk. of U.S. v. Copper-Bessemer Corp., 146 Misc. 20, 261 N.Y.S. 687; Muffat v. Detroit-Macomb Land Co., 252 Mich. 692, 234 N.W. 148; Hazard v. Powell, 230 Ohio App. 71, 154 N.E. 357; Crosby v. Simpson, 234 Mass. 568, 125 N.E. 616. 7 U. CHI. L. REV. 497; I MEYER, THE LAW OF STOCKBROKERS AND STOCK EXCHANGES, 348 (1931); Steffen, *A Proposed Uniform Act Making Investment Instruments Negotiable*, 34 COLUM. L. REV. 632, 653 (1934).

Bad faith under the Transfer Act appears to correspond to "actual" bad faith—as distinguished from "objective" bad faith—under the Uniform Negotiable Instruments Law, as interpreted by American courts. Compare also: Uniform Sales Act, § 76; Uniform Warehouse Receipts Act, § 58; Uniform Bills of Lading Act, § 53; Uniform Fiduciaries Act, § 1. For "actual" bad faith, see: Benton v. Sikyta, 84 Neb. 808, 122 N.W. 61 (1909); Gigoux v. Moore, 105 Kan. 361, 366, 184 Pac. 637, 639 (1919). For "objective" bad faith, see: Gerseta Corp. v. Wesser Campbell Silk Co., 3 F. 2d 236, 238; Rochester and Charlotte Turnpike Co. v. Paviour, 164 N.Y. 381, 58 N.E. 114. Note, 81 PA. L. REV. 617. See § 56, N.I.L.

The new Commercial Code, in adopting definitions of "good faith" and "notice" (*infra*) substantially in accord with § 22 (2) of the Transfer Act and § 56 of the N.I.L., would seem to work no change.

[83] § 22, Uniform Stock Transfer Act, reads in part:

(1) In this act, unless the context or subject-matter otherwise requires—

". . . "Value" is any consideration sufficient to support a simple contract. An antecedent or pre-existing obligation, whether for money or not, constitutes value where a certificate is taken either in satisfaction thereof or as security therefor."

This definition would seem to indicate that even one purchasing for a "peppercorn" is protected. An unusually low price, however, should be evidence of bad faith. The value and good faith requirements must, therefore, be construed together, and since both value and good faith are defined so broadly, these requirements cannot be said materially to restrict negotiability. McAllister v. McAllister Coal Co., 120 N.J.Eq. 394, 184 Atl. 716; Adams v. Silver Shield Min. & Mill. Co., 82 Utah 586,

broadly construed as to constitute no material impediment to negotiability.

Manifest in the Transfer Act is that a forged indorsement on a certificate cannot deprive a stockholder of his rights, the theory being that a genuine indorsement or assignment is requisite to pass title.[84] The transferee through an improper indorsement cannot prevail—this risk is his to bear. The limitation is not immanent. Nothing in the nature of the Transfer Act prohibits legislation permitting the passage of title to a bona fide transferee notwithstanding a simulated indorsement. Such modification would render share certificates even more negotiable.[85] Fear is entertained, however, that this would lead to an increase in the incidence of questionable dealings in and theft of certificates.[86] For reasons advanced hereafter, it may be just as well that negotiability is restrained by this concession to security in the retention of share certificates.

Beyond the requirement of a valid indorsement, assignment, or power of attorney, the bona fide transferee for value of the certificate acquires a right to the stock, though delivery may have been made by one having no right of possession and having no authority from the owner of the certificate or from the person purporting to transfer title.[87] Title will pass to the innocent transferee for value notwithstanding fraud, duress, mistake, revocation, death, incapacity, or lack of consideration or authority supervening on the chain

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21 P. 2d 886; also, National City Bank v. Wagner, 216 Fed. 473, 132 C.C.A. 533; Peckinpaugh v. Noble, *supra* note 75. Note, 7 U. CHI L. REV. 497, 498.

[84] §1, Transfer Act. Angus v. Cincinnati Morris Plan Bank, 56 Ohio App. 444, 10 N.E. 2d 1019; Atherton v. Michigan Guaranty Corp., 237 Mich. 133, 211 N.W. 83; Arkansas Power & Light Co. v. Bauer-Pogue & Co., 194 Ark. 1002, 110 S.W. 2d 529; Wood v. Stoneham, 206 App. Div. 507, 201 N.Y.S. 483.

The result may be explained by a desire to promote examination for erasures and forgeries on the part of the transferee.

[85] Share certificates would become more negotiable in the sense that one of the forms now required for negotiability and for transfer—a correct indorsement—would be unnecessary, and even unindorsed or falsely indorsed certificates would then be negotiable. Share certificates would then be treated like bearer bonds. Note, 7 U. CHI. L. REV. 497, at 501.

[86] Coats v. Guaranty Bank and Trust Co., 170 La. 871, 875, 129 So. 513, 514.

See also 7 U. CHI. L. REV. 497, at 501, to this effect: "Eliminating the indorsement requirement, however, is said to be impractical because stock certificates are almost always registered and the registry is highly convenient for determining who can vote and receive dividends. But turning share certificates into bearer instruments would not impede maintaining the registry: instead of submitting registrations upon receipt of correctly indorsed certificates, as is the practice today, corporations could enter transfers upon receiving unindorsed certificates."

[87] § 5, Uniform Stock Transfer Act.

of title.[88] Moreover, no lien or restriction may bind the transferee unless noted on the certificate itself.[89]

Under the Uniform Stock Transfer Act, even a finder or thief of a certificate indorsed in blank may pass good title through deliv-

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[88] § 6, Uniform Stock Transfer Act:

"Indorsement effectual in spite of fraud, duress, or mistake, revocation, death, incapacity or lack of consideration or authority.—The indorsement of a certificate by the person appearing by the certificate to be the owner of the shares represented thereby is effectual, except as provided in § 7, though the indorser or transferor,

"(a) was induced by fraud, duress or mistake, to make the indorsement or delivery, or

"(b) has revoked the delivery of the certificate, or the authority given by the indorsement or delivery of the certificate, or

"(c) has died or become legally incapacitated after the indorsement, whether before or after the delivery of the certificate, or

"(d) has received no consideration."

§ 7, Uniform Stock Transfer Act, reads as follows:

"Rescission of transfer.—If the indorsement or delivery of a certificate,

"(a) was procured by fraud or duress, or

"(b) was made under such mistake as to make the indorsement or delivery inequitable; or

"If the delivery of a certificate was made

"(c) without authority from the owner, or

"(d) after the owner's death or legal incapacity, the possession of the certificate may be reclaimed and the transfer thereof rescinded, unless

"(1) The certificate has been transferred to a purchaser for value in good faith without notice of any facts making the transfer wrongful, or

"(2) The injured person has elected to waive the injury, or has been guilty of laches in endeavoring to enforce his rights.

"Any court of appropriate jurisdiction may enforce specifically such right to reclaim the possession of the certificate or to rescind the transfer thereof and, pending litigation, may enjoin the further transfer of the certificate or impound it."

Upon sale of a certificate, the transferor is also held to implied warranties similar to those in a transfer of negotiable paper. §§ 11 and 12, Uniform Stock Transfer Act.

See also § 8, U.S.T.A., providing that rescission of transfer of certificates does not invalidate subsequent transfer by transferee in possession.

[89] § 15, U.S.T.A.:

"There shall be no lien or restriction unless indicated on certificate.—There shall be no lien in favor of a corporation upon the shares represented by a certificate issued by such corporation and there shall be no restriction upon the transfer of shares so represented by virtue of any by-laws of such corporation, or otherwise, unless the right of the corporation to such lien or the restriction is stated upon the certificate."

The prospective transferee is consequently relieved of the necessity for inquiry to forestall various risks to which he would be subject under present Philippine law.

But, even under the Transfer Act, not every infirmity may be observed on the face of the certificate. A clever forgery may be difficult to discover. Furthermore, the Transfer Act does not concern itself with the relationship of the issuing corporation to the innocent transferee. Thus, no indication is given as to the extent to which certain inherent infirmities in the issue of share certificates, such as lack of corporate power by reason of over-issue or forgery in the execution of the certificate, affect such

ery thereof to a transferee for value in good faith.[90] Greater care is needed to protect share investments. The assumption, nonetheless, is that the shareholder is able to and should accord his stock certificates the same care due bills of exchange, promissory notes, bonds, or other negotiable paper. By shifting the burden of loss to the improvident holder, the Transfer Act essays to favor the innocent transferee. The risk is placed on those best able to guard against it.[91]

The asserted design of the Transfer Act to make the certificate more fully representative of the stock conduces to some difficulty in connection with attachments or executions. On one hand, to permit levy by notice to the corporation, as under the Rules of Court,[92] would leave the certificate without indication of this lien. To prefer the creditor pursuant to such attachment would not be in accord with negotiability, binding the transferee to a levy unapparent on the certificate; but insistence upon prefering the transferee in good faith in spite of this levy would enhance the possibilities of transfers in fraud of attaching creditors. Consequently, the Transfer Act discards this method of levy and requires actual seizure of the certificate by the attaching officer, surrender thereof to the issuing corporation, or an injunction against its transfer.[93] In so restricting

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transferee. *Supra*, note 51. Moreover, query: Is a mere reference on the certificate to a restriction contained in a separate document, by-law, etc., without restatement or description of such restriction thereon, sufficient to bind a transferee under the Transfer Act?

Neither does the Transfer Act resolve the conflict of opinion as to the effect of registration on forgery. Should the issue by the corporation of a new certificate subsequent to a forged transfer serve to protect the bona fide transferee of the new certificate in his title as shareholder, even against the claim of the victim of the forgery? *Supra*, notes 41-50. In 23 Minn. 493, the opinion is expressed that adoption of the Transfer Act, with its end of negotiability, should persuade adherence to the Cook-Fletcher-Christy view.

[90] Peckinpaugh v. Noble, *supra* note 75; Turnbull v. Longacre Bank, 249 N.Y. 159, 163 N.E. 135, noted in 38 YALE L. J. 390.

Thus, if B—having access to but not being entrusted with the custody of a certificate indorsed in blank by the true owner A—abstracts the aforesaid certificate and transfers the same to C, an inherent purchaser for value, the Transfer Act would uphold C's title. Current Philippine law would prefer A. *Supra*, p. 13.

[91] Certificate holders are at some time or other purchasers; they both fall within the investor class. Protection to the group is achieved by imposing a burden on some individuals within the class. Compare Steffen, *A Proposed Uniform Act Making Investments Negotiable*, 34 COLUM. L. REV. 632, 654 (1934); note, 7 U. OF CHI. L. REV. 497, 503.

[92] *Supra*, note 68.

[93] § 13, U.S.T.A. Consider also § 14, which reads:

"A creditor whose debtor is the owner of a certificate shall be entitled to such aid from courts of appropriate jurisdiction, by injunction and otherwise, in attaching such certificate or in satisfying the claim by means thereof as is allowed at law or in

the manner of levy, however, the Transfer Act has raised the poser of an effective attachment or execution when the certificate cannot be reached. Levying on stock pertaining to clever albeit uncooperative debtors may be less facile. Many jurisdictions in the United States, with due regard for the interests of attaching creditors, sacrifice negotiability by retaining the old method of levy and disregarding Section 13 of the Transfer Act.[94] Some have attempted a compromise.[95]

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equity, in regard to property which cannot readily be attached or levied upon by ordinary legal process." See also *infra*, note 138.

Note that the Transfer Act provides for three distinct methods of attaching stock under § 13. Attachment by injunction must issue against the holder and will not be satisfied by enjoining the corporation to refrain from registering a transfer. Elgart v. Mintz, 16 N.J. Misc. 289, 199 Atl. 63; Amm v. Amm, 117 N.J. Eq. 185, 175 Atl. 186; Johnson v. Wood, 15 N.J. Misc. 150, 189 Atl. 613.

In some quarters, the wisdom and effectiveness of this third alternative of attaching the shares by injunction is doubted. The sanction of an injunction will not deter a wrongful transfer of the certificate in every case. Observe that attachment by injunction leaves the certificate free from notation of the lien. If negotiation is effected in defiance of the court order, must the loss fall on the bona fide transferee of the certificate? To countenance a result unfavorable to the transferee would violate the spirit of the Transfer Act. If so, the injunction is far from fool-proof. On the other hand, to prefer the creditor over the bona fide transferee would render the injunction device as unsatisfactory from the viewpoint of negotiability as the common law method of levy by notice to the issuing corporation. See 28 CAL. L. REV. 470, 476; cf., Carroll County v. Smith, 111 U.S. 556.

[94] These include California, Colorado, Florida, Kansas, Georgia, and Massachusetts. California omits § 13. The only means of levy or attachment provided is by notice to the corporation. See Deering's Code of Civil Procedure, § 541 (1949); Partch v. Adams, 55 Cal. App. 2d 1, 5, 130 P. 2d 244, 247 (1st Dist., Ct. App. 1942); see comment, 28 CAL. L. REV. 470 (1940). Colorado also omits § 13. However, previous attachment statutes were repealed here, so that the only method by which a creditor can reach shares in Colorado appears to be means of § 14 of the Uniform Stock Transfer Act. Editor's note to Colo. Stat. Ann., c. 41, § 99 (1935). Florida leaves in force the previously existing method of attachment by notice to the corporation. Fla. Stat. Ann. 688.15, 55.26, 55.30 (1941). The same result is provided for in Kansas. Laws, Kansas, c. 17, Art. 3218 (1949). Massachusetts omits § 13. Central Mortgage Co. v. Buff, 278 Mass. 233, 179 N.E. 628 (1932). Georgia of corporate stocks unaffected. Laws 1939, No. 273, § 13.

Other variations from the wording of the draft appear in Connecticut, Hawaii, Nebraska, New Hampshire, Oklahoma, and West Virginia. Statutory notes to Uniform Stock Transfer Act, 1954 Cumulative Supplement to 6 U.L.A., § 13, p. 88.

[95] The Missouri section provides:

"In addition to the remedies provided by §§ 513.115 and 513.120 and related sections of the Revised Statutes of Missouri (1949) providing for attachment or execution upon shares of stock, attachment or execution against shares of stock for which a certificate is outstanding shall be valid when such certificate is actually seized by the officer levying the attachment or execution against other personal property; Provided, that a levy of attachment or execution resulting in actual seizure of such certificate shall take precedence over all other remedies provided by law when made at

Adoption of the concepts of negotiability in the Philippines may call for clarification of the present mode of constituting pledges on stock certificates. Delivery to the pledgee of the certificate duly indorsed, in consonance with the Civil Code,[96] presents a situation fraught with danger to the pledgor. Should pledgee manage an unauthorized transfer to a transferee for value and in good faith, title ought to pass to the latter, irrespective of the unnoted lien.[97] A suggested alternative would have pledges created by delivery of the certificate with a restrictive indorsement.[98]

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substantially the same time as such other levy, and prompt notice thereof given to the corporation issuing such shares. In case of levy under said §§ 513.115 and 513.120 of the Revised Statutes of Missouri 1949, the innocent holder for value and without notice of any certificate of shares of stock subject to such levy may, in addition to the assertion of claim as now provided for under § 513.130 of said statutes, notify the corporation issuing such shares, that he has acquired rights to the certificate therefor, and in the event that such notice shall be given prior to actual sale of said shares under execution, it shall be the duty of the corporation to forthwith notify the officer making the levy or attachment, of the assertion of such adverse claim and such notice shall act as a stay of further proceedings in connection with such attachment or levy, and it shall be the duty of the party asserting such claim to promptly obtain an adjudication of the rights of the parties. Until such rights are adjudicated the corporation shall not be compelled to issue a new certificate for such shares of stock until the old certificate is surrendered to it." Mo. Rev. Stat. §403.170 (1949).

§§ 513.115 and 513.120 refer to attachment by notice to the corporation.

For a general laudatory comment on the compromise measure, see note, WASH. U. L. Q (1951), p. 384; for recommendations along the same line, see 28 CAL. R. REV. 470.

§ 13 of the Montana Act also permits attachment and levy by notice to the corporation in addition to the methods sanctioned by the Uniform Act. Mont. Rev. Code Tit. 15-640 (1947). Vermont permits an attachment by notice to the corporation, but provides that the attachment shall have no effect upon the rights of an innocent holder for value of the certificate. Vt. Laws § 5818 (1947).

[96] Article 2095, R.A. 386.

[97] The danger is present whether the certificate be indorsed specially or in blank. §§ 6, 7, 21, Uniform Stock Transfer Act. See also Jones v. Courts, 64 Ga. App. 239, 12 S.E. 2d 446; Adams v. Silver Shield Min., 82 Utah 586, 21 P. 2d 886.

Under present Philippine law, the pledgor may obviate the consequences unfavorable to himself by registration of the pledge on the books of the corporation or by recording the pledge in a public instrument, thereby binding prospective transferees to notice of the pledge agreement. Article 2096, R.A. 386; Bank of the P.I. v. Caridad Estates, *supra* note 52. See *supra*, notes 61 to 67. Retention of these schemes for enabling constructive notice is plainly not in accord with the concepts of share certificate negotiability under the Uniform Stock Transfer Act, which require liens to appear on the certificate in order to bind transferees without actual notice thereof.

[98] The Uniform Stock Transfer Act does not specifically provide for restrictive indorsements. Neither does it prohibit the same. See State ex rel. Moulin v. Ideal Savings & Homestead Ass'n, La. App. 1938, 178 So. 521. Compare §-260 of the Negotiable Instruments Law. § 8-304 of the new Uniform Commercial Code recognizes restrictive indorsements. Provisos for enforcing a pledge so constituted upon non-

The local provision for constituting a chattel mortgage by recording on the registry without annotation of the lien on the share certificate is in opposition to negotiability.[99] Retention of the chattel mortgage as a separate form of utilizing shares of stock by way of security should involve, in consonance with the design of negotiability, a requirement for due notation of the encumbrance on the face of the certificate.[100]

IV

That enactment of a measure akin to the Transfer Act would remove many of the risks to which pledgees and purchasers of stock are susceptible under current Philippine corporation Law seems established. Accepting the promise of mercantile advantage derived from enhanced transferability of share certificates—a proposition indorsed by local courts [101]—the draft merits modeling after to ameliorate the imperfect state of the law on stock transfers. However, criticisms have lately been directed at the Transfer Act in the United States. The more vital bring into question the principles underlying the legislation, and cast doubt on the desirability of certificate negotiability itself. Other views, accepting the soundness of negotiability, call attention to shortcomings of the Transfer Act in practice.

Fundamentally, the argument for share certificate negotiability rests on the encouragement to investment consequent to the easy movement of certificates and assurance that possession thereof bespeaks good title.[102] The assumption is that the interests of commercial society in general, and the investing public in particular,[103] require the protection accorded by law in making the certificates as

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fulfillment of the obligation and for issuance by the corporation of a new certificate pursuant thereto are feasible.

[99] *Supra*, note 60.

[100] Indeed no real bar exists for elimination of the chattel mortgage as an alternative mode of employing stock as collateral. The pledge is as convenient. However, the parties may desire that possession of the certificate remain with the pledgor.

Notation on the certificate should be in addition to the requisite of recording on the chattel mortgage registry. The registry retains its value as proof of the mortgage when the documents evidentiary of the encumbrance have been lost or destroyed, and is accessible to other than those dealing with the certificate.

[101] *Supra*, notes 20 and 52.

[102] *Supra*, notes 7 and 19.

[103] For lucidity, "former holder", "former owner", and words of the same import will hereafter be employed to designate the holder of the certificate who is deprived thereof by wrongful or unauthorized transfer. "Transferee", "purchaser", and similar words will indicate the party to whom the certificate is transferred following misappropriation. "Investing group", "investor class", etc. designate investors in stock in general, and may embrace both "former holder" and "transferee", but do not include brokers and intermediaries.

fully representative of the stock as practicable. Much of the burden imposed by the conversion to negotiability falls on the holder of the stock, from whom greater care is expected to prevent mislaying or deprivation of his certificate. Observe that the holder of the stock himself appertains to the investor group. Thus, the Transfer Act is not all boon to the investing class. It requires more of the holder of share certificates even as it benefits the prospective pledgee or purchaser; both coincide in the investor group.[104] Nonetheless, the reappraisal managed by the Transfer Act probably results in greater advantage to the investing group than it does disadvantage, for the holder normally has it within his power to guard against misappropriations with comparative facility, while the would-be purchaser or pledgee under current law can only with difficulty, if at all, determine the imperfections detracting from the value of the certificate.[105]

The most serious charge against the Transfer Act is that it ignores the existence of stock exchange and brokerage practices.[106] Under the stockbrokerage system, duly licensed brokers perform the service of buying or selling securities for the general public on a commission basis.[107] Sales are made on a stock exchange [108] or "over the counter." [109] Transactions in stock generally involve the purchase by a broker on behalf of the buyer, from another broker on behalf of the seller. Accepted practice has the selling broker guaranteeing all certificate indorsements to the purchasing broker.

With the brokerage system in the picture, it is alleged that the argument for negotiability degenerates into a fallacy. Concededly, purchasing brokers do not act as guarantors to their customers generally; their obligations to the latter rest upon a scrupulous observance of "banker's diligence," no more.[110] But assertedly the purchaser can secure full protection by requiring his broker to certify to the regularity of indorsements on the certificate and to the effect that the shares are obtained free from adverse claims.[111] With this

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[104] Note, 7 U. CHI. L. REV., 497, 503.

[105] *Supra*, note 91.

[106] The arguments against negotiability stated here are taken from the note, 7 U. CHI. L. REV. 497; also BALLANTINE, *op. cit.*, at § 332, p. 765.

[107] MEYER, LAW OF STOCKBROKERS AND STOCK EXCHANGES (1931), Vol. 1, 249.

[108] While only member brokers can conduct business on an exchange, nonmembers by agreement frequently buy or sell through members.

[109] "Over the counter" transactions are made outside the exchange and involve stocks not listed thereon, by and large. MEYER, *op. cit.*, p. 247; 7 U. CHI. L. REV. 497, 506.

[110] Isham v. Post, 141 N.Y. 100, 105; MEYER, *op. cit.*, at 265-6.

[111] 7 U. CHI. L. REV. 497, 504. But query: Is this usual practice in Philippine brokerage circles?

assurance, the purchaser need not concern himself with negotiability. On the basis of the certification, he may recover damages from his broker; the latter, in turn, from the selling broker.[112] Brokers are known to carry insurance against losses which may be charged against them by reason of unauthorized transfers; investors seldom do. Accordingly, the Transfer Act concept of negotiability is disapproved of as shifting the budren of loss to the former holder of the certificate, professedly without corresponding benefit to transferees. The suspicion is that advantage runs not to the investor group but to stockbrokers.[113]

It is not clear that a rule favoring a fairly facile movement of shares through the brokerage system, without imposing burdensome requirements of inquiry, may not at least be good commercial policy; that the business advantages derived, whether reflected in simplified brokerage transactions, fewer losses on the exchange, lower insurance rates, or otherwise, are not sufficiently important to outweigh a comparatively slight burden on certificate holders in terms of heedfulness. True, certified brokers do not as a matter of business practice treat share certificates as fully negotiable. Brokerage procedure demands, whenever an indorsed certificate is presented by other than the registered owner, that the presenter procure on a standard form blank a waiver signed by the registered owner and often notarized or guaranteed.[114] That cautious brokers demand as much is nevertheless no reason for requiring more. Certainly, mercantile requirements will not be served by compelling the exceedingly onerous, time-consuming, and costly investigation now required in Philippine law to ascertain freedom of stock from infirmities. In substantially lightening the task of ascertainment, negotiability really accords with mercantile custom.[115]

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[112] MEYER, *op. cit.*, at 588-594. The assumption here is that recovery from the malfeasant himself is seldom feasible.

[113] As to pledges, of course, advantage runs to those accepting stocks as collateral, generally bankers. Ultimately, insurance firms benefit. 7 U. CHI. L. REV. 497, 502.

Share certificates are investments held for a relatively long period. The contention is that, unlike short term credit devices and ordinary commercial paper, the property interest in long term investment securities overcomes a disputable commercial or business need for negotiability. *Ibid.*, at 522.

[114] *Ibid*, at 508. There is some doubt as to whether a bank guaranteeing a signature is legally bound thereon. Christy, *op. cit.*, at § 44. Compare § 8-312 of the new Uniform Commercial Code, which indicates the effect of guaranteeing signatures or indorsements.

The brokerage practice of requiring guarantees of signatures is a prudent measure in view of the Transfer Act rule on forgeries.

[115] Much—but not all—of the disagreement with the note in 7 U. CHI. L. REV. 497 is due to the fact that the aforesaid note apparently takes a narrower view of negotiability, concerning itself solely with problems occasioned by lost or stolen cer-

Apprehension is expressed that negotiability may have a deleterious effect in encouraging incautious brokerage practices and bringing about the growth of professional "fences" specializing in trading stolen items.[116] Threatened criminal penalties are frequently ineffective, for a pretense of "honesty" is simple. The draft has been law for a considerable period in most jurisdictions of the United States without observable ill result; but even if such were indeed the case, a total negation of the principles of negotiability would seem unjustified. A limited concession through adoption of a rule as suggested hereinafter, without disposing of negotiability *in toto*, might well regulate brokerage procedure through imposition of civil liability in favor of wrong holders of stock.

That the Transfer Act and negotiability procure no direct benefit to the investor group has not in fact been indisputably shown. It is insufficient to contend that the interests of the transferee are taken care of by recourse to the broker's certification giving assurance relative to the stock. A truism has it that a buyer "wants to know what he gets." A transferee obtains a share certificate with the expectation of becoming owner of the stock. Beyond assurance that the funds he expends will be restored, he desires that his investment be preserved. He bargains to be a stockholder, with consequent rights and privileges. He expects a "good buy," without the disadvantages and inconveniences of seeking reimbursement. Insofar as negotiability affords this, it benefits the investor group, especially when the corresponding burden on the investing segment represented by the prior holder of the certificate is not overly onerous and with consequences easily avoided.

The criticism manifests a transcendental concern for the issue of who shall bear the loss in brokerage transactions, obscuring the headway achieved by the Transfer Act in other areas. The contention is that the negotiability and good faith provisions, when made to apply to stockbrokers, set a standard of conduct inferior to that adopted by brokerage houses for themselves. Then the query is posed: If a broker not employing the protective devices generally utilized by stockbrokers takes an indorsed instrument from a thief, finder, or a person selling without authority, why should the broker

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tificates. *Ibid.*, especially at 497, note 1, where the author dissociates himself from issues concerning from liens and claims of prior owners' creditors.

[116] *Ibid*, at 510-512. But the writer admits it is dubious whether the Transfer Act provisions will encourage less cautious brokerage practices among reputable firms:

"Brokerage houses like to be considered as 'substantial' or 'conservative' firms, and so they often attempt to impress new customers with extremely cautious business methods. Furthermore, litigation is costly, furnishes bad publicity, reveals agency secrets, and sometimes necessitates political intrigues; consequently brokers usually attempt to stay out of the courts . . ."

himself not bear the loss irrespective of the registered owner's carelessness?[117] A suggested rule would penalize brokers accepting such certificates by concealing a civil action in favor of the prejudiced owner against brokers failing to observe the reasonable care required by the profession.[118] The loss is thereby deviated to brokers who neglect observance of the standards set in regulation of the group. Yet this modification need not upset the scheme of negotiability entirely.

In the Philippines, where few areas by comparison are serviced by stockbrokers, greater consideration should be had of stock transactions taking place outside the pale of the brokerage system. The argument for placement of loss on brokers cannot be of application here. With only the former holder and the bona fide transferee to choose from, the case for negotiability—laying the risk on the one best able to guard against it—becomes ascendant. The plea for freeing the prospective transferee from impracticable requisites of inquiry is reasserted.

At any rate, negotiability detracts but slightly from the property interests of stockholders. By reason of the forgery[119] exception, results unfavorable to them may largely be avoided by taking the elementary precaution of not indorsing a certificate until necessary. The restriction is by no means insufferable.

The contribution of negotiability to certainty in this area of commercial law is not to be gainsaid. Moreover, the concept affords a rule of thumb—convenient, easy of application. Less may be said for a suggested comparative negligence standard.[120] In this field, where the volume of transactions presses a need for uniformity and certainty in the law, the potential of an amorphous case-to-case approach for creating a judicial morass is ample.

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[117] *Ibid*, at 522.

[118] 7 U. CHI. L. REV. 497, 510. But it is difficult to regard the registered owner's conduct as immaterial when negligence imputable to him is so gross as to amount to participation in the wrong.

This provision need not be embodied in the measure granting negotiability to share certificates. Separate legislation or regulation governing stock brokerage procedure would be equally adequate.

The drafters of the Uniform Commercial Code have, however, not seen fit to provide accordingly. *Infra*.

[119] *Supra*, note 84. Upper the Cook-Fletcher-Christy view, see previous notes 47 to 50, a holder may lose title consequent to a forgery if registration is had on the corporate books and the new certificate passed on to a transferee in good faith; but only if the corporation making wrongful registration is unable to issue a new certificate for similar stock or purchase the same on the market (*supra*). Otherwise, a certificate holder appears fairly able to protect himself against misappropriation by keeping the certificate unindorsed.

[120] 7 U. CHI. L. REV. 497.

For the moment, share certificate negotiability appears firmly established in the United States. But there are those who, accepting these premises, strike at the fringes of the Transfer Act. The draft has not been unimpeachable in practice. For instance, the measure, contemplating a hand to hand movement of the certificate from transferee, proves unwieldy in adjusting rights out of a stock market transaction.[121] The institution of the clearing house proves particularly vexing, for rarely does the same certificate travel through the entire transaction from seller to purchaser.[122] Some of these failings have already been adverted to.[123] These are sought to be remedied in the new Uniform Commercial Code, to which we now refer.

V

An official draft of the Uniform Commercial Code was approved by the American Law Institute in May, 1952, and by the National Conference of Commissioners on Uniform State Laws in September, 1952.[124] Alterations were recommended at meetings of the co-sponsoring organizations in 1954.[125]

The Code culminates over ten years of research by an imposing array of legal talent.[126] It has been much commented upon [127] and glowingly appraised as "perhaps the most monumental work of its kind undertaken during the past quarter of a century." [128] The phrase may be premature, for the Code has yet to withstand the test of efficacy in operation; but there is every reason to believe that the Code

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[121] MEYER. *op. cit.*, Also, Israels, *Article 8—Investment Securities*, 16 Law & Contemporary Problems, 249, 258-260.

[122] A.L.I., Uniform Commercial Code (1952), Comment 3 to § 8-313, at p. 665.

[123] See especially *supra*, note 89.

[124] Uniform Commercial Code (1952). See also: 22 TENN. L. R. 776, 777.

[125] Supplement No. 1, Uniform Commercial Code (January, 1955).

[126] Uniform Commercial Code (1952), p. 4-6, gives the names of numerous judges, practicing lawyers, and law teachers who acted either as advisers or as draftsmen. The production of the Uniform Commercial Code was under the direct supervision of a drafting board headed by Judge Herbert F. Goodrich, Director of the American Law Institute. The work of drafting and criticism is said to have been done by a smaller group of draftsmen and advisers under the direction of Prof. Karl N. Llewellyn, who had direct charge of the preparation of five of the ten articles of the Code. Article 8, on Investment Securities, appears to have been drafted by Soia Mentschikoff (Mrs. Llewellyn), under the supervision of Prof. Llewellyn, 16 Law & Contemp. Prob., pp. 142-143.

[127] Legal periodical articles on the Code include symposiums in 16 Law and Contemporary Problems, Winter & Spring (1951); 14 Ohio S. J. J., Winter & Spring (1035); 22 TENN. L. REV. 776-872 (1953).

[128] Mr. Barrett, Commissioner on Uniform State Laws for the State of Arkansas and Chairman of the Executive Committee of the Nat'l Conference of Commissioners on Uniform State Laws. See 22 TENN. L. REV. 776, 777.

will go far toward achieving its purposes. To date only Pennsylvania has enacted the draft into law,[129] but the enthusiasm elsewhere is evident.[130]

The Uniform Commercial Code is decidedly an ambitious piece of legislation drafting. In nine articles, it restates the bulk of American statutory law relating to commercial transactions. Article 8 alone, in treating of investment securities, tries to encompass and uniformly deal not only with stock certificates but also with bonds and other types of investment paper commonly traded in upon security exchanges and over-the-counter markets.[131] The provisions thereof encroach into areas previously covered by the Uniform Stock Transfer Act, as well as by portions of the Uniform Negotiable Instruments Law and the Uniform Fiduciaries Act.[132]

No more than a survey of the broader aspects of the draft is ventured.[133] Of primary concern here is that the scheme of negotiability, far from being curtailed, has been developed. Fourteen of the twenty-two sections of the Transfer Act have been rephrased, but the basis of negotiability is retained.[134] The treatment of forged and unauthorized transfers remains largely unaltered.[135] The "good

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[129] See Foreword, Supplement No. 1, Uniform Commercial Code (January, 1955). Penn. Act of July 27, 1953, P.L. 624.

[130] The Uniform Commercial Code has been referred to legislative commissions of various types in California, Conn., Mass., New Hampshire, Texas, and other states; and in New York, a special appropriation was made to the New York State Law Revision Commission for the study of the Code.

[131] § 8-102 defining "security".

[132] See under Comment, Prior Uniform Statutory Provisions, Commercial Code (1952).

[133] Fortunately, the comments by the drafters are very informative. The commentaries in legal periodicals may also be consulted.

[134] Negotiability was retained although, before the New York Law Revision Commission, the general question of the desirability of treating "with like attributes of negotiability" instruments which evidence a liquidated money obligation and those which evidence a share in an interprise was raised Supplement to the UCC (1955), p. 171.

[135] § 8-311 of the UCC on effect of unauthorized indorsements:

"Unless the owner has affirmed an unauthorized indorsement or is otherwise estopped from asserting its ineffectiveness

"(a) he may assert its ineffectiveness against the issuer or any purchaser other than a purchaser for value and without notice of claims of ownership who has in good faith received a new security on registration of transfer of the security so indorsed; and

"(b) An issuer who registers the transfer of a security so indorsed is subject to liability for improper registration."

Note that there is a modification of the rule as to the ineffectiveness of forged signatures where a bona fide purchaser has received a new security on registration of transfer. *Infra.*

As to unauthorized transfers in general, § 8-315 provides:

faith"[136] and "value" [137] provisions, though more explicit, do not reflect any major change. The same may be said referent to the section on attachment or levy upon security.[138] On the other hand,

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"(1) Any person against whom the transfer of a security is wrongful for any reason, including his incapacity, may against anyone except a bona fide purchaser reclaim possession of the security or obtain possession of any new security evidencing all or part of the same rights or have damages.

"(2) If the transfer is wrongful because of an unauthorized indorsement, the owner may also reclaim or obtain possession of the security or new security even from a bona fide purchaser if the ineffectiveness of the purported indorsement can be asserted against him under the provisions of this Article on unauthorized indorsements.

"(3) The right to obtain or reclaim possession of a security may be specifically enforced and its transfer enjoined and the security impounded pending the litigation."

Also, 8-301, on the rights acquired by a purchaser:

"(1) Upon delivery of a security the purchaser acquires the rights in the security which his transferor had or had actual authority to convey except that a purchaser who has himself been a party to any fraud or illegality affecting the instrument or who as a prior holder had notice of a claim against it cannot improve his position by taking from a latter bona fide purchaser.

"(2) A bona fide purchaser in addition to acquiring the rights of a purchaser acquires also a perfect title to the security.

"(3) A purchaser of a limited interest acquires rights only to the extent of the interest purchased."

[136] § 1-201 (19): "'Good faith' means honesty in fact in the conduct or transaction concerned."

§ 1-201 (25): "A person has 'notice' of a fact when

"(a) he has actual knowledge of it; or

"(b) he has received a notice or notification of it; or

"(c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists."

In this connection, see also § 8-304 on notice to purchaser of claims of ownership. Note especially the arbitrary 6 months' period covering "forgotten" notices.

[137] § 8-303, UCC.

[138] § 8-317: Attachment or Levy upon Security:

"(1) No attachment or levy upon a security or any share or other intrest evidenced thereby which is outstanding shall be valid until the security is actually seized by the officer making the attachment or levy but a security which has been surrendered to the issuer may be attached or levied upon at the source.

"(2) A creditor whose debtor is the owner of a security shall be entitled to such aid from courts of appropriate jurisdiction, by injunction or otherwise, in reaching such security or in satisfying the claim by means thereof as is allowed at law or in equity in regard to property which cannot readily be attached or levied upon by ordinary legal process."

It will be observed that the Transfer Act method of levy is adhered to substantially. Attention is directed to the discussion *supra*, notes 93 and 94. Adoption of this mode of attachment may be less controversial than it has been in the United States, where much of the difficulty is caused by the existence of various independent jurisdictions and the possibility of conveying share certificates from one to the other. Moreover, query: It levy any less difficult under the Rules of Court with respect to ordinary chattel? Rule 59, § 7 (c).

some modifications are immediately apparent. For example, share certificates may, under the Code, appear in bearer form.[139]

Article 8 of the Uniform Commercial Code is much more comprehensive than the Uniform Stock Transfer Act and meticulous in its attention to the details of negotiability. In protecting the bona fide purchaser of stock certificates against defenses of the issuing corporation, the article perhaps makes its principal contribution. The Transfer Act suffers from lack of a comparable provision, the correlative rights and obligations of the issuer and the bona fide purchaser being left for discovery elsewhere.[140] Part 2, Article 8, of the Code proceeds on the assumption that it is for the issuer, rather than for the purchaser, to ascertain that the certificate complies with the law governing its issue.[141] The policy of denying enforcement to issuer's restrictions [142] and liens [143] not noted on the certificate is

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[139] §§ 8-102 and 8-309, UCC.

[140] *Supra*, note 89.

[141] §§ 8-201 to 8-208, UCC. Briefly the foregoing sections lay down rules which include:

A security other than a government obligation, issued with a defect affecting its validity, remains valid in the hands of a bona fide purchaser for value without notice, unless the defect involves:

(a) A violation of a constitutional provision (§ 8-202 [2] [a]);

(b) An overissue (§ 1-104); or

(c) A forgery (§§ 8-202 [3], 8-205, 8-201 [18] and [43]).

But a purchaser other than the person taking on an original issue is protected from even a violation of a constitutional provision. (§ 8-202 [a]).

In the event of an overissue, the company may be required to replace the security by obtaining an identical security if reasonably available for purchase (§ 8-104 [a]); otherwise, to restore the price. (§ 8-104 [b]). (On this point, the 1952 draft was amended at the New York meetings in 1954, to avoid the objections expressed in Israels, *Investment Securities*, 16 Law & Contemp. Prob. 249, 255.)

Where an unauthorized signature is placed on a security by a person entrusted by the issuer with the signing, immediate preparation for signing, or with the responsible handling of the security or similar securities, the forgery or unauthorized signing does not render the signature ineffective in favor of a purchaser for value and without notice of the lack of authority. (§ 8-205)

A purchaser is charged with notice of information set forth on the security itself but a reference on the security to another instrument, idenure, or document, or to a constitution, statute, ordinance, rule, regulation, order, or the like does not of itself charge a purchaser for value with such notice even though the security expressly states that a person accepting it admits such notice. (§ 8-202 [5])

Other provisions include § 8-203 on staleness as notice of defects or defenses, and 8-206 on completion or alteration of instruments.

[142] § 8-204. "The prevalent assumption that securities which travel freely in financial markets are free of equities and readily salable should not be lightly negated, and a strict rule as to notice of restrictions is here imposed. However, a purchaser's actual knowledge of the existence of an unnoted restriction may create notice of a claim of ownership." Comment on § 8-204, Supplement to UCC (1955), citing § 8-304 and Comment, Baumohl v. Goldstein, 95 N.J.Eq. 597, 124 A. 118 (1924).

continued, with the added requisite that the notation be conspicuous." [144]

As in the Transfer Act, the issuer may treat the registered owner as the person exclusively entitled to vote and otherwise exercise the rights of an owner,[145] and responsible as to calls, assessments, and the like.[146] The provision remains permissive; the corporation may, at its option, disregard the registered owner and deal with the actual holder of the certificate.[147]

Carefully avoiding the error of the Transfer Act in neglecting to take into account the stockbrokerage system, the framers of the Uniform Commercial Code attempt to restate the law in terms of the actual practice and understanding in these circles. No longer are brokers to be regarded as "purchasers".[148] The duty of each party in the multiple relationships arising out of a brokerage transaction is specified.[149] In view of exchange practices, a new concept of delivery is introduced.[150]

The Code decides the effect of registration on forged transfers. Irrespective of a prior forgery, a bona fide purchaser for value obtains good title upon registration of the transfer on the stock books

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[143] § 8-103.

[144] §§ 8-204 and 8-103. § 1-201 (10) defines what is "conspicuous".

[145] § 8-207 (1). The section is stated affirmatively, rather than negatively as in the Transfer Act.

The rule of such cases as Turnbull v. Longacre Bank, 249 N.Y. 159, 163 N.E. 135 (1928), which held the issuer liable for paying out dividends to the record holder after the transferee had given notice of the transfer and demanded that a new certificate be issued to him, is left unchanged. Comment to § 8-207, UCC (1952), at p. 644.

[146] § 8-207 (2)

[147] Thus, the corporation is free to require proof of ownership before paying out dividends or the like if it chooses to. Barbato v. Breeze Corporation, 128 N.J.L. 309, 26 A. 2d 53 (1942). Comment, UCC (1952), at 644.

The matter of registration on the stock books and the responsibilities of transfer agents and registrars are dealt with in §§ 8-401 to 8-407, also 8-208.

[148] Supplement to the Uniform Commercial Code (1955), p. 171. § 8-302 (2) reads:

" 'Broker' means a person engaged for all or part of his time in the business of buying and selling securities, who in the transaction concerned acts for, or buys a security from or sells a security to a customer. Nothing in this article determines the capacity in which a person acts for purposes of any other statute or rule to which such person is subject."

See Section 1-201 (32). A broker has no "interest in property."

[149] Comment to § 8-314, UCC (1952), p. 667.

Note, however, that no statute can protect the customer against the dishonest broker who, having possession of securities registered in "street name," sells or pledges them to a bona fide purchaser in violation of his legal duty. See Israels, *op. cit.*, at 259.

[150] §§ 8-313 and 8-314 of the Uniform Code of Commerce.

and issuance to him of a new certificate.[151] This rule is asserted to be in accord with modern commercial practices, since a purchaser through a broker normally receives and sees only a new certificate registered in his name, without in fact relying upon the forged or unauthorized indorsement on the original security transferred.[152] But the original owner of the stock is not without his remedy. He may compel the issuer, who wrongfully registered the transfer,[153] to issue a similar certificate in his favor; or, in the event of an over-issue, to replace the same with like securities reasonably available for purchase.[154]

Under the Uniform Commercial Code, a corporation may issue new securities to replace lost, destroyed, or stolen ones, upon filing of a sufficient bond.[155] Should the "original" certificate come into the hands of a bona fide purchaser, the Code accords him preference as shareowner.[156] In turn, the transferee in good faith of the new

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For instance, delivery to the purchaser may be completed while the security is still in the hands of the broker (§ 8-313 [1]). Therefore, no intervening notice of ownership claims before the purchaser takes actual physical possession of the security can divest him of his rights.

On the other hand, the broker is regarded as the holder of securities not specifically identified as belonging to a particular customer, irrespective of bookkeeping entries. (§ 8-313 [2])

§ 8-312 states the liability of a signature or indorsement guarantor.

[151] §§ 8-311 and 8-315, *supra*, note 135.

Compare this rule with the Cook-Fletcher-Christy view stated earlier, *supra*, notes 47 to 50. The Uniform Commercial Code goes beyond the opinion expressed by the aforesaid authorities. Even the transferee obtaining registration in his name is protected, not merely the subsequent transferee in good faith of the new certificate. Under the Transfer Act, the title of the former owner deprived or his certificate through forgery may not be defeated by the transferee obtaining registration, no matter how innocent the latter may be. *Supra*, note 50. The bona fide purchaser holding a reissued certificate is protected under the Uniform Commercial Code. The line of cases which has refused to apply this rule where the new certificate is still in the hands of the party to whom it was issued is expressly rejected. See Comment to § 8-311, UCC (1952), p. 662.

[152] *Ibid.*

[153] The Code imposes an obligation on owners of lost or misappropriated certificates to give notice to the issuer within a reasonable time. The notification is vital, for where the same is not promptly given, the owner forfeits his right to seek indemnity from the issuer for improper registration of transfers, even on forged indorsements. § 8-404. In § 8-405, the Code embodies a long standing corporate practice of voluntarily issuing new securities to replace lost, destroyed or stolen certificates. § 8-406 designates the duties of authenticating trustees, transfer agents, or registrars.

[154] §§ 8-311, 8-404, and 8-104, UCC.

[155] § 8-405.

[156] §§ 8-405, 8-104, 8-402-3, 8-311 to 8-312.

certificate is protected by resort to the issuer; but where honoring both securities would result in an over-issue and a replacement cannot reasonably be purchased, the new certificate is retired and the purchaser thereof relegated to an action for damages.[157]

CONCLUSION

Indeed, no small amount of trepidation accompanies the preparation of this paper. There is offered no panacea for all corporate ills. With the frailty of all human undertakings, even the most deliberate of reforms breed their own share of deficiencies. So may it be with stock certificate negotiability. The ultimate answer certainly is not here. But should the survey give true guide to permit alighting upon the blunter horn of the dilemma, this accomplishment alone we deem well worth the effort.

Under the Transfer Act, the bona fide purchaser of the original certificate would be denied title to the stock, as against a bona fide transferee of the new certificate. The former's remedy is an action for damages against the issuer.

[157] *Ibid.* The issuer is in any event entitled to reimbursement from the former owner on the latter's bond. See comment, § 8-405, UCC (1952), p. 681-2.

Article 8 of the Uniform Commercial Code includes a few other sections. § 8-319 is a statute of frauds provision.

As in the Transfer Act, warranties run in favor of a purchaser for value of stock. A further provision eliminates all substantive warranties in the case of deliveries by intermediaries. See § 8-306. §8-407 also provides for warranties by a person who presents a security to the issuer for registration of a transfer.

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