1889

Negotiability of Corporate Stock

Robert Henry Wilson

Follow this and additional works at: http://scholarship.law.cornell.edu/historical_theses

Part of the Law Commons

Recommended Citation
Wilson, Robert Henry, "Negotiability of Corporate Stock" (1889). Historical Theses and Dissertations Collection. Paper 152.
NEGOTIABILITY OF CORPORATE STOCK.

THESIS

— by —

ROBERT HENRY WILSON.

1889.
CONTENTS.

INTRODUCTION.

Law Merchant.

Certificates of stock.

Quasi-negotiability.

Legal and equitable title.

CLASSIFICATION.

1. As between the immediate parties.

The equitable title.

Legal title.

Conclusion.

2. As between the parties and the corporation.

Rights and obligations of the corporation.

Rights of holders of stock.

Conclusion.

Transfer on company's books.

General principle.

3. As relating to the rights of third parties.

Rights of creditors.

Exceptional rule.

General rule.
Bona fide holders. 14--20.

English rule. 14--15.

American rule. 15.

Title through a thief. 15--16.

Title through a trustee. 16.

Title through a pledgee. 16--18.

Title through a bailee. 18.

Title through an agent. 18--19.

DOCTRINE OF LIS PENDENS. 19.

SUMMARY AND CONCLUSION. 19--20.
NEGOIABILITY OF CORPORATE STOCK.

INTRODUCTION.- This subject is one of great importance, as it involves the discussion of a question in the law of corporations, which is not only of interest and importance to the professional man, but is equally so to every business man, for the stock of corporations, or more properly speaking the certificates of stock, have reached a position so nearly analogous to that of commercial paper, that there is scarcely any business man who does not at some time enter into a transaction in regard to the stock of some corporation, which though it is not usually so, might if litigated, involve the very question which is here to be discussed; and therefore a knowledge of the leading principles,- for we can not hope to enter very fully into the details,- may serve to avoid complicated and costly litigation.

LAW MERCHANT.- From a very early date there has existed what is known as the "Law Merchant", or the "Custom of Merchants", and it has been this customary law, for such it may properly be considered, that has given to commercial paper its character of negotiability; and a paper can only be said to be negotiable in the strict legal meaning of that term when it falls within the "Law Merchant."
Now certificates of corporate stock are by all the authorities said to be non-negotiable, but notwithstanding these statements, they are treated by the courts and more particularly by business men and dealers in stock as possessing nearly every attribute which characterizes commercial paper. The only reason conceivable for such a position is that the "Law Merchant" had been firmly established and most of its rules promulgated before the advent of corporations, or not so much the advent of the corporations themselves, as the placing of their stock upon the market.

And that as the whole "Law Merchant" is built up and added to only as the convenience, or imagined convenience, of merchants, or the exigencies of trade demand, and as certificates of corporate stock have been given all the qualities of commercial paper, it has been thought unnecessary to hold that they were within the "Law Merchant," for the same object was accomplished by another, and wholly independent course of reasoning: - the well-known doctrine of estoppel.

And it seems better that it should be treated of and adjudicated upon as a separate branch of the law, and the rules governing it, should not be drawn by analogy from any other branch of the law. "General rules formed from, and applicable to other instruments and securities cannot with any certainty, clearness or satisfactory results be applied to certificates of stock. They should be treated of by
themselves. It is also to be observed that the future character and status of certificates will be much clearer, better, and more satisfactory if the law governing them be formed on its own basis."

CERTIFICATES OF STOCK.— Stock corporations is represented by what is known as a certificate of stock and these certificates have since the time when corporations began to form an important part of the business community, been used and transferred in a manner very similar to that pursued in relation to commercial paper, the prevailing opinion being that they are negotiable, but with one or two exceptions (notably in Michigan, where by a statute they are expressly declared to be negotiable, 4 Michigan. 465-473.) this opinion is erroneous, for a certificate of stock differs from negotiable paper in several important respects, notable among which is that it is neither a promise to pay, nor an order on any body else to pay a sum of money. And as was said in Weyer vs. Second National Bank, 57 Indiana 198-208, "the difference between a promissory note and a certificate of bank stock is so wide and marked that a rule of law governing the transfer of the former is by no means applicable to the latter."

QUASI-NEGOTIABILITY.— Some writers have tried to express the status of certificates of stock by applying to them the term of "quasi-negotiable", but this term is not satis-
factory as it fails to give any clear idea of the real character of such certificates, or as it is expressed by Mr. Cook in his admirable treatise on the subject, "It is of little satisfaction to any body to be told that certificates of stock have a quasi-negotiability. The term itself has been coined to describe the character of certain things which can be understood only by a study and knowledge of the characteristics of the thing described. Especially is this true of certificates of stock...The information sought for is not whether the certificate of stock is quasi-negotiable, but whether the holder of it is protected under different states of fact and circumstances."

LEGAL AND EQUITABLE TITLE. It has also been sought to draw a distinction between the legal and the equitable title in the transfer of certificates, claiming that by the transfer the grantee takes the equitable title to the stock, and the grantor holds the legal title in trust until the grantee has the stock transferred to himself on the books of the company, when the legal title vests in him. But this distinction is unsatisfactory, and the majority of the states hold, that a valid transfer of a certificate of stock to a bona fide purchaser passes both the legal and equitable title to the stock.

With these introductory remarks and explanations
we now pass to a consideration of the rules of law governing the transfer of certificates of stock, and for convenience in so doing, the subject will be treated of under the following heads:

I. As between the immediate parties.

II. As between the parties and the corporation.

III. As relating to the rights of third parties.

I. AS BETWEEN THE IMMEDIATE PARTIES.

THE EQUITABLE TITLE. There seems to be quite a difference of opinion between the different courts as to the effect of a transfer of certificates of stock, some holding that the transfer only passes the equitable title, and that it is incumbent upon the transferee to go to the corporation and have the stock transferred on its books to his own name before he can claim the benefits derived from a possession of the legal title. This position is based upon the interpretation and effect given to the provision which is usually embodied in the charter or bylaws of corporations, to the effect that stock shall be transferable only on the books of the company. Such seems to be the holding of the Supreme Court of Tennessee, in the case of Cherry vs. Frost 21 Am. L. Reg. 57., where the court says: "Although by the bylaws of a corporation, shares of the stock may only be transferable upon the books of the company, an equitable
right in them may be acquired by delivery of the certificate, or by written assignment or contract which will be good between the parties, and may be perfected as against the corporation and third persons by notice of the assignment or contract." So in the case of Cornick vs. Richards 3 Lea l. some of the judges were of opinion that a complete legal title to stock could only be acquired by a transfer on the books of the company, that an assignment of a certificate of stock with a blank power of attorney to make the transfer on the books did not give a complete legal title, but only an equitable one, good between the parties, and which might be made good against the corporation, and the creditors and assignees of the assignor by notice to the corporation.

THE LEGAL TITLE.—The Better Doctrine. The other and better supported opinion both as to precedent and reasoning, is that a transfer of the certificate passes the legal title to the stock. The authorities which support this doctrine say, that the provision in the bylaws of a corporation, that its stock shall be transferred only on the books of the company, is merely a provision for its own safety, and in nowise interferes with a legal transferee by a stockholder of all his interest, legal and equitable, in the stock; and the only effect of such a provision is that, unless the transferee has the stock transferred to his own name, on the com-
pany's books he will not be entitled to vote as a share-
holder, or to receive dividends, et cetera. This position
is taken and ably discussed in one of the leading cases in
New York, (McNeil vs. The Tenth National Bank, 46N.Y. 325.)
where the court says: "It has also been settled by repeated
adjudications that as between the parties, the delivery of
the certificate, with the assignment and power endorsed,
passes the entire title, legal and equitable, in the shares
notwithstanding that by the terms of the charter or bylaws
of the corporation, the stock is declared to be transferable
on its books; that such provisions are intended solely for
the protection of the corporation, and can be waived or as-
serted at its pleasure, and that no effect is given to them,
except, for the protection of the corporation; that they do
not incapacitate the shareholder from parting with his in-
terest, and that his assignment, not on the books, passes the
entire legal title to the stock, subject only to such liens,
or claims as the corporation may have upon it, and except-
ing the right of voting at elections, etc."

The same position is taken by Mr. Taylor in his treat-
ise, but he does not seem to place it upon the ground, that
the phrase "transferable only on the books of the company"
is not a restriction upon the right of the holder to trans-
fer, and only a protection to the corporation, but rather upon
the ground that this fact follows from certificates of
stock being negotiable. Although here Mr. Taylor would seem to infer that he thought certificates of stock were negotiable, in another part of his work he clearly bases their transferability upon the ground of estoppel.

CONCLUSION.- Thus it would seem to follow from the weight of authority, in the adjudicated cases, that the assignor, by his transfer passes all his estate to the assignee, and that as between him and the assignee, the contract is as binding, and the effect is the same as in the case of a negotiable instrument. So we see that although, strictly speaking, certificates of stock are not negotiable, still as between the immediate parties, at least, they possess the same qualities.

II. AS BETWEEN THE PARTIES AND THE CORPORATION.

RIGHTS AND OBLIGATIONS OF THE CORPORATION.- Corporations usually seek by means of an express stipulation, on the face of back of the certificate of stock, to have them transferable only on the books of the company; but, as was shown in the previous subdivision, this in no way effects the power of the owner to transfer his certificates, and only operates in favor of the corporation as a protection to it. (Mc Neil vs The Tenth National Bank, supra.)

This being the fact, it follows that no matter how perfect may be the transfer, or the contract between the immediate parties, if the transfer is not made on the company's
books, they are not legally bound to recognize the transferee as a stock holder, and are in no way bound to recognize his rights as such; consequently, if upon the paying of a dividend, the payment is made to the original owner before the transfer on the books, the transferee, as against the corporation, has no redress. (See Public Statutes of Mass.) This rule as to the exemption of the corporation from liability, has been carried very far in some of the states, as for example, it has been held that, where the certificate contained the following words, "Transferable only on the books of the company, in person or by power of attorney on surrender of this certificate." and a transfer was made, but was not entered on the books of the company, and the creditors of the transferee attached the stock, that the corporation was not liable for the loss, even though the transferee had notified the corporation that he held the certificates. (138 Mass. 240)

RIGHTS OF HOLDERS OF STOCK.— A question effecting the rights of bona fide holders of certificates of stock has often arisen, where by the act of an agent or servant of the corporation, they have been damaged, or have been placed in such a position, that were the corporation released from liability, they would be damaged. Such would be the case where an authorized agent of the corporation, by an act beyond his authorization, issues to innocent third persons certificates of stock which in truth, represent
no stock. In such a case it has been held, that the corporation is liable for all damage, where the purchaser acted in good faith. The leading case on this subject in New York is that of N.Y. & N.H. R.R. Co. v. Schuyler, 34 N.Y. 52. In which case the rail-road company, demanded that the holders of the certificates of over-issued stock, be restrained from claiming the rights of stock-holders, the court said: "I cannot subscribe to the idea that the duties of the plaintiff (the corporation) in respect to their stock were limited to themselves and existing shareholders. They extended also to the commercial community, whose confidence and trade the plaintiffs invited, and who, in turn, were entitled to good faith and fair dealing at the hands of the company, and they sprang into full vigor in behalf of every party, who entered into such dealing. ---The bona fide holder of any certificate, issued by a transfer agent, has a primary and direct claim, either to be admitted as a corporator, or if that is impracticable, from the excessive issue of stock, to be compensated for the fraud practised upon him." 

In such a case as this, it is not necessary, in order to maintain an action for relief, against the corporation, that the plaintiff show any privity, except such as is created by the tortious act, and the consequential injury. This is true for the reason, that the complainant is not seeking redress upon the contract, but for "the tortious act in the commission of
which the contract is an accidental incident."

CONCLUSION.- Here again we find that the principle of estoppel, and not that of the negotiability of corporate stock applies, for in the case above quoted from, the judge: "I am therefore of opinion that the plaintiffs are estopped, by the facts and circumstances of this case, to deny the authority of Schuyler (the agent) to do the acts, from which the injury to the defendants had arisen.---It is a mistake to suppose that the conventional rule of commercial negotiability has anything to do with this question, except in cases where the paper carries no notice on its face that it is made by somebody assuming to be an agent." In this case the act clearly shows on its face, that it was done by the agent, and therefore the liability of the corporation is placed solely on the principle that it is estopped from denying the apparently authorized acts of its agents. That such a rule as this should exist is absolutely necessary, for if it were not so, then a free use and transfer of corporate stock would not only be dangerous, but nearly impracticable, for a person could never be certain that he really owned the stock he possessed, and the time spent and labor expended in searching the title to each purchase, would be so great that their practical value would be totally lost.

TRANSFER ON COMPANY'S BOOKS.- Another question which arises between the corporation and the parties to the transfer, is
the right to the transferee to demand that the stock be transferred to his name on the company’s books. The corporation in issuing the stock to a person, holds out to the world, that such person is the owner of a certain number of shares of stock; and such ownership being complete, that he has the right of disposition over it. And therefore when a person, acting in good faith, deals with such person, the corporation is estopped by its own act from denying the title of the transferee, and so must register him as a stockholder.

"This proposition does not rest on any view of the negotiability of stock, but on general principles appertaining to the law of estoppel. The rules of estoppel are of comparatively recent origin, and their application to this subject has only been lately perceived. They are now fully recognized in England, and in this country as governing the present subject." (57 N.Y. 616.).

GENERAL PRINCIPLE—Here again we find that the principle of estoppel as applied to the parties to a transfer, and the corporation, tend to give to corporate stock, a character of transferability, as nearly complete as the negotiability of commercial paper.

III. AS RELATING TO THE RIGHTS OF THIRD PARTIES.

In considering this subject we will first consider the rights of creditors, and secondly the rights of bona fide holders of stock certificates.
RIGHTS OF CREDITORS.—Exceptional Rule. In a few of the states, notable in California and Massachusetts, it is provided by statute, that unless the assignment or transfer of the stock is recorded on the books of the corporation within a certain number of days,—in Massachusetts ten days,—that a creditor of the transferer can follow the stock into the hands of the transferee, and levy upon it. But these are strictly statutory provisions, and from a perusal of the cases, it seems quite clear that were there no such statutory rule, the courts would hold a transfer good as against creditors, even although the transfer was not recorded on the books of the company. This is certainly the general rule, in those states where there is no statutory regulation. But even in those states where the statutory regulation prevails, as soon as the transferee has a new certificate issued to him the creditor's rights are barred. (Cherry vs. Frost. 21 Am. L. Reg. 57.—Public Statutes of Massachusetts.)

The fact that these states have made this statutory regulation, goes far toward proving that it had been the practise, or if not the practise certainly the tendency, to treat these certificates of stock as possessing the same attributes as negotiable instruments; for if they were not so regarded, but merely as choses in action no such provision would be necessary.

General Rule.—With the exception of these few states, there seems to be no case in which the creditor of the transferer of
stock, has any more rights as to such stock, than he would to any negotiable paper.

**BONA FIDE HOLDERS.**- We now come to the rights of *bona fide* holders of corporate stock, for a valuable consideration. It may safely be said as regards the rights of *bona fides* that corporate stock is negotiable. This is certainly going further than any of the adjudicated cases on this subject, but although they refuse to say that *bona fide* holders are protested on this ground, still by another course of reasoning, they reach the same conclusion; and so long as a purchaser, in good faith, gets a good title it seems of little importance, whether it be placed on the ground of negotiability, or estoppel. Notwithstanding this all the cases hold that it is the law of estoppel, and nothing else that gives this protection.

**ENGLISH RULE.**- The English courts are more strict on this question than the American courts, but still they hold in some cases that a *bona fide* holder, for value, gets good title to the stock (3 Q.B. 584.) In a late English case, the English and American authorities were reviewed, and the court came to the conclusion, that while corporate stock was not negotiable, either in England or America, still that by American law *bona fide* holders would probably be protected to the same extent as a holder of negotiable paper. But basing the decision on English authorities the court refused to go as far as that in this case.
(20 Q.B.Div. 239., but see 3 Q.B. 584, supra.)

AMERICAN RULE.—There can be little doubt, in this country, that if an owner of stock certificates places his certificates on the market, with the endorsement and power of attorney signed in blank, and no fraud intervenes, that a bona fide holder takes it free from all equities. This question is easy, but when we come to the rights of a bona fide holder who has purchased from a thief, a trustee, a pledgee, or an agent we encounter a more difficult problem.—Each of these will be considered separately, and first as to

TITLE THROUGH A THIEF.—The general rule as to choses in action is that a thief cannot convey any better title than he himself has, but owing to the exigencies of commerce and trade, commercial paper has been excepted from this rule, and although corporate stock certificates, as has been previously shown, cannot be classed under this head, still they are in a certain degree excepted from the rule. The principle is that if the holder retains the same certificate which was conveyed to him by the thief, with the endorsement and power of attorney forged, that the rightful owner can recover it from the holder; but if the holder takes it to the corporation, and has it transferred to his own name, and a new certificate is issued to him, then the corporation will be estopped from denying his title. (3 Seld. 274.)
If the thief has the stock transferred to himself, and then sells it to a purchaser, in good faith and for value, and then the purchaser gets a new certificate, the principle is clear that the owner has no claim against him. But the transfer to the purchaser, must have such that he did not know, or could not know, of the forgery and theft. (126 Mass. 345. - 123 Mass. 110)

**TITLE THROUGH A TRUSTEE.** - It has been frequently held that a bona fide purchaser can get good title through a trustee, that he is invested with all the indicia of title, and has apparently absolute power of disposition over it. And it would not be permitted that the cestui que trust, who had invested the trustee with this authority, should set up any equities, as against a bona fide purchaser, who had no knowledge of the trust. [31 N.Y. 507.] This was a case in which the trustee had been permitted to transact the business of the cestui que trust, and in violation of his trust had conveyed the stock.

**TITLE THROUGH A PLEDGEE.** - It is a uniform rule, that a pledgee cannot convey any greater title than he himself possesses. That the right of the pledgor is to redeem his property. But this principle, as well as the one applicable to title derived from a thief, does not apply as to commercial paper; and as in that case, so in this, a bona fide purchaser from a pledgee may get a better title than the pledgee had, and may maintain his possession as against the pledgor.
The reason for this is that the pledgor has passed the legal title, with an unlimited power of disposition, and he cannot set up an unknown equity against the title acquired in good faith and for a valuable consideration. The title of the purchaser does not depend upon the actual title of the pledgee but upon the act of the pledgor, which precludes him from denying the title.

McNeil vs. The Tenth National Bank.—This case, reported in 46 N.Y. 325, is directly in point, and is a leading case in this state on the question. The Judge there says, "Simply intrusting the possession of a chattel to another, as depositary, pledgee, or other bailee, or even under a conditional executory contract of sale, is clearly insufficient to preclude the real owner from reclaiming his property in case of an unauthorized disposition of it by the person so intrusted.---The mere possession of chattels, by what ever means acquired, if there be no other evidence of property, or authority to sell from the true owner will not enable the possessor to give a good title.---But if the owner intrusts to another, not merely the possession of the property, but also written evidence over his own signature of title thereto, and of an unconditional power of disposition over it, the case is vastly different; There can be no occasion for the delivery of such documents, unless it is intended that they shall be used, either at the pleasure of the de-
pository, or under contingencies to arise. If the conditions, upon which the apparent right to control is to be exercised, are not expressed on the face of the instrument, but remain in confidence between the owner and the depositary, the case cannot be distinguished in principle from that of an agent, who receives secret instructions qualifying, or restricting an apparently absolute power."

Thus we see that by the application of the principle of estoppel, which applies to this whole subject, the quality of negotiability is worked out in a transfer by a pledgee, even though this transfer be unauthorized.

**BAILEE.** - The law pertaining to the pledgee applies equally well to the bailee, or the holder an executory contract of sale.

**TITLE THROUGH AN AGENT.** - The title of the *bona fide* holder would, of course, be as good if taken from the agent as from the principal, if the principal had invested the agent with the possession, which being the *prima facie* evidence of title, would warrant a third party in buying the stock.

But in order that the holder may get good title, he must not know of the agency, or if he does, he must have reasonable grounds for supposing that the transfer of the stock is within the scope of his authority. In other words, the relation between the principal and agent must be such, that the former is estop-
ped from denying the right of the agent to transfer.

If stock is given to an agent to raise money with, he cannot use it for his own benefit, and if he stipulate with the lender, that it shall also be a security which he, himself, owes the lender, the stipulation is void, and the lender cannot hold the stock for that purpose. (17 Hun 599.)

**Doctrine of Lis Pendens.**—It has been settled in this state that the doctrine of *lis pendens* has no more application to corporate stock, than to commercial paper. And this holding is no more than just, for certificates or stock are in daily use, as securities, and it is absolutely necessary that their transfer should be "unburdened with the shackles of a *lis pendens*" for if they were not, who would purchase if in the hurry and confusion of business, he had to stop and examine a clerk's record to see if his title was good. (57 N.Y. 616.)

**Summary and Conclusion.**—From a consideration of the subject, we find that the *bona fide* holder of corporate stock, as represented by certificates, is, when these certificates are endorsed and signed in blank, protected to nearly the same extent as a holder of commercial paper. That he may obtain a perfect title from a thief, a trustee, a pledgee, a bailee, or an agent. That although the courts seem reluctant to call these certificates negotiable, still they are negotiable; and as is said by
Mr. Cook, it is extremely probable, that, in the near future, they will attain a **negotiability greater than that of commercial paper** of the present day.