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A Proposed Uniform Act Making Investment Instruments Negotiable

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A PROPOSED UNIFORM ACT MAKING INVESTMENT INSTRUMENTS NEGOTIABLE

The proposal that public and private investment securities should be made negotiable by statute has been looked upon favorably for many years.\(^1\) No particular effort has been made to define the "securities" in question, but, in general, corporate bonds, equipment trust certificates, interim receipts, deposit certificates and other similar paper not within, at least, not comfortably within, the Negotiable Instruments Law, the Stock Transfer Act or one of the acts dealing with warehouse receipts or bills of lading, have been meant. The particular kind of negotiability\(^2\) to be provided for, likewise, has had very little overt attention. Indeed, it does not appear that much thought has been given to the economic consequences to ensue from making still further additions to the category of negotiable instruments. The process, one of incubation, has thus followed up to now a perfectly normal, and in a sense thoroughly haphazard, course. It is time, particularly as regards investment money paper, to reduce at least the more important issues to the concreteness of a draft act. This, not with even a fugitive idea that the period of gestation may be shortened, but in order that the next stage, that of detailed discussion, may develop normally.

The reasons for restricting legislation at this time to money paper, as distinguished from commodity paper, are perhaps more obvious than substantial. The one deals with rights in and to tangible things; the other merely evidences obligation, in fact may not convey title to a particular chose in action and be negotiable, as the law now stands. But a case can easily be made for the negotiability of interim and deposit certificates, for example, possibly as well as for instruments payable in money.\(^3\) The present importance of the distinction lies in the fact that we now have legislation, the Negotiable Instrument Law, which deals generally with money instruments, including bonds.\(^4\) But that act was

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\(^1\) See Steffen and Russell, *The Negotiability of Corporate Bonds* (1932) 41 Yale L. J. 799, in which most of the literature on the point is cited.

\(^2\) Since negotiability is not something in and of itself, but a mere category, and one which over the years has changed materially in content, it is probably accurate to speak of kinds of negotiability. The expression "attributes of negotiability" would perhaps be more expressive but it assumes what is not true in fact, i.e., that there is but one true negotiability and that it never changes.

\(^3\) In fact much of the discussion in recent years has been concerned with the case of Manhattan Co. v. Morgan, 242 N. Y. 38, 150 N. E. 594 (1926), in which the New York court held that interim certificates for bonds to be delivered "if and when issued" were not negotiable under the Negotiable Instruments Law. See (1926) 35 Yale L. J. 877.

\(^4\) *Brannan*’s Negotiable Instruments Law (5th ed. 1932) 88.
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drawn with an eye principally to the bills, notes, and checks of trade, very strict requisites of form being prescribed. The consequence is that many provisions desirable to long term paper either are not used or, if used, raise serious question as to the negotiability of the instrument in which they appear. And certain instruments, as equipment trust certificates, tax anticipation or assessment bonds payable out of a particular source, are definitely not negotiable. Registered bonds and notes, likewise, are not negotiable under the act, not being payable to order or bearer.

While the Negotiable Instruments Law may serve as a starting point, it is evident at once that some means must be devised to set apart the investment instrument for special consideration. A possible course would be to abandon all thought of attempting to prescribe requisites of form, so that anything labelled "bond," for example, would be a bond, and negotiable. Much this course was adopted by the Stock Transfer Act in the case of share certificates. So with the negotiable bill of lading, since, except for the requirement of the word "order," the form was left to be worked out by other agencies. No doubt such a course in the case of investment paper would eliminate much litigation, some of it needless, but it would be abandoning a rather effective though drastic sanction looking to fair business practice. Rather, it would seem, only those changes in the Negotiable Instruments Law definition should be made at this time which are clearly needed to sanction the long term security instrument, recognizing it as an instrument still closely related to the promissory note.

The direct way of getting at the matter, thus, would seem to be to amend the Negotiable Instruments Law in the few particulars needed to make it include investment paper. In fact, some two years ago a group of amendments suggested for the purpose was submitted by the writer to a committee of the Commissioners on Uniform State Laws and in general approved by it. However, at the Grand Rapids meeting of the

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5 Negotiable Instruments Law § 3.
7 Uniform Stock Transfer Act § 22. "Certificate means a certificate of stock in a corporation organized under the laws of this State or of another State whose laws are consistent with this Act."
8 The ancestry of the bond, as of the debenture, is not clear, but on one line at least it shows direct relationship to the merchant's promissory note. On the other, it comes, no doubt, from the common law specialty deed. For illustration, see In re Blakely Ordnance Co., L. R. 3 Ch. App. 154 (1867), with which compare In re Natal Investment Co., L. R. 3 Ch. App. 355 (1868).
9 See Handbook of the National Conference of Commissioners on Uniform State Laws and Proceedings (1931) 219, 248. This committee has had the matter of amending the Act under consideration for several years.
Conference of Commissioners in August, 1933, rather substantial opposition to the whole project of amending the Negotiable Instruments Law developed, as a result of which the committee was directed to canvas the possibility of reshaping its proposed amendments into a bill or bills which could be recommended as supplementary rather than amendatory legislation.

This move was a wise one as regards investment paper. Under the amendments as they were presented last year,10 neither the equipment trust certificate nor the registered bond would have been brought within the Act nor was the coupon given any further aid. Fortunately, the way is now open to prepare an integrated group of provisions which can be recommended for adoption as a separate title within the Act, more or less as promissory notes and checks are now treated. From the drafting angle the advantages of this scheme are obvious, since there will be no need to reenact the large number of provisions in the Act, for example, those concerning value, signatures, delivery, tender, and alterations, which, as originally adopted, were quite appropriate to investment paper. At the same time, investment paper can now be as fully and satisfactorily treated as if a wholly separate bill were to be proposed.11

Registered bonds perhaps deserve a special word, since there may be misgivings as to the propriety of naming them in company with other paper long recognized as being negotiable. The fact of the matter, however, is that machinery for registration and transfer, almost indispensable to the long term instrument, should not be thought to have much to do with negotiability. The share certificate has in effect been made an instrument running to order and negotiable in spite of book transfer requirements, and bonds clearly offer no greater obstacles. Indeed, before the Negotiable Instruments Law was adopted, the courts had already gone far toward recognizing registered bonds as negotiable instruments transferable by indorsement12 and, since its adoption, many courts have achieved results on common law principles approximating negotiability.13 They cannot well go the whole way now, however, in the face of the "order-bearer" requirement of the statute.

10 Id. (1933) 154.
11 See Beutel, The N. I. L. Should not be Amended (1932) 80 U. of Pa. L. Rev. 368, 385, where the point that the various commercial acts should be so drawn as to make up a harmonious body of law is forcefully presented.
12 See, for example, D'Esterre v. Brooklyn, 90 Fed. 586 (C. C. E. D. N. Y. 1898); De Voss v. Richmond, 18 Gratt. 338 (Va. 1868).
The purpose in making registered bonds fully negotiable is to combine ready transferability with the greater safety to be had by use of the order instrument. After all, the bearer bond is, financially speaking, a particularly hazardous instrument and this without the basic justification found in the case of the bank note, where the velocity of transfer must be much higher. Of course, safety alone could be achieved by the simple expedient of issuing bonds hereafter in order form, a practice which, however, shows no signs of developing. But registration serves the further, and not inconsistent, purpose, of protecting the issuing company or its transfer agent, since in many situations only the book record need be consulted. The important additional advantage to the investor lies in the fact that upon transfer, as clearly upon exchange, the new holding can be freed of prior defenses and equities, much as if the original instrument had been paid and a new instrument issued. This machinery is invaluable, particularly in view of the long life of the average investment instrument.

It is evident that registration, except as it may be analogized to payment, is wholly foreign to the Negotiable Instruments Law. The registered money instrument is in this respect closely akin to the share certificate. Moreover, it would seem that the few provisions necessary concerning registration should be drawn in harmony with any similar provisions in the Stock Transfer Act. That act, however, was drawn primarily to afford protection to the bona fide purchaser, not much regard being had to the position of the transfer agent. Accordingly, one precaution after another has been added by the transfer agents for their own protection until transfer machinery has become overloaded and on occasion notoriously slow moving. This has gone so far that clearly some effort must now be made by clarifying the situation of the transfer agent, or by some shifting of burden, to bring about a more efficient administration.

Enough has been said to suggest the scheme of the proposed legislation. It remains to present a draft of specific provisions. Since the act breaks up readily into three parts, the first having to do with requisites of form, the second with negotiation and the third with transfer and discharge, these will be set out in order with comment in each case. The first group of provisions follows:

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14 The policy argument in favor of this move is set out in considerable detail in Steffen and Russell, supra note 6, at 764.

TITLE V
Investment Instruments

ARTICLE I

1 Section 1. Definition. An investment instrument in the form of a note, bond, debenture, equipment trust certificate or similar instrument for the payment of money, issued as one of a series or as an interest in a debenture stock, or any coupon issued in connection with the same for the payment of interest, is, within this article, an unconditional promise in writing signed by the maker engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to order or to bearer, and is a negotiable instrument within this Act.

Except as herein otherwise provided, the provisions of this Act applicable to a promissory note apply to an investment instrument.

1 Section 2. When Promise is Unconditional. An unqualified promise to pay, may be unconditional, within the meaning of this article, although coupled with a statement, or a reference to a separate writing for a statement, of any limitations upon the holder's rights or of any limitations or conditions upon the maker's obligations, to which it is subject, but no such limitation or condition shall affect the rights of a holder in due course (except as) unless the import of the condition or limitation appears on the face of the instrument, or, in the case of a coupon, upon the instrument representing the principal obligation.

An investment instrument may be negotiable although expressed to be payable out of a particular fund or limited to a particular source, described therein.

1 Section 3. Determinable Future Time. Acceleration. An investment instrument may be payable at a fixed or determinable future time although expressed to be accelerable, either absolutely or at the option of the holder, upon the happening of a contingency specified upon the face of the instrument.

An investment instrument may be negotiable although expressed to be payable upon a contingency specified therein, whether or not it is certain to happen.

1 Section 4. Additional Provisions not Affecting Negotiability. An investment instrument, otherwise negotiable, may contain a promise on the part of the maker to do any act or make any payment in addition to the payment of the instrument without its negotiable character being affected, provided such promise is apparently intended primarily to afford security for the payment of the instrument or to assure to the holder the full realization thereof free of costs, expenses or taxes.

1 Section 5. Money, Medium of Payment. The maker of an investment instrument engages to pay a sum certain in money, when his engagement to pay is expressed in terms of the money authorized by any government, or of any specified valuation of such money, irrespective of where the instrument is payable.
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The negotiable character of an investment instrument is not affected by the fact that it designates a particular medium in which payment is to be made, if that medium is in circulation as money under authorization of any government at the time when the instrument is made.

The foregoing five sections all have to do, in a sense, with definition, but the really critical words are those in line 3 of Section 1: "issued as one of a series," for in other respects the section follows the definition of the promissory note given in Section 184 of the Negotiable Instruments Law. Whether these words will suffice to draw a line between investment paper and the bills, notes and checks of that law generally is no doubt a question. They are aided by the enumeration of "note, bond, debenture, equipment trust certificate or similar instrument for the payment of money" which, by giving the street name of the instruments intended, serves better to identify them. It might be desirable to go farther and specify that they must have at least a year to run before maturity, so as to emphasize the fact that long term paper is intended, or to provide that they must have been issued "by a corporation" and "under or secured by an indenture." But it is doubtful that the first would be particularly valuable and, of course, it is almost wholly arbitrary. The second, clearly, would be altogether too limiting, since not all investment instruments are issued by corporations nor are they all issued in connection with an indenture, though something of the latter sort could always be prepared for the purpose if need be.

It is true, nevertheless, that the word "series," undefined, is a slender thread on which to hang the legislation proposed. Support might

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16 The clause, "as an interest in a debenture stock," in Section 1, line 3, is suggested in the event that a practice of issuing instruments in odd amounts to subscribers should develop here, as in England. Instruments so issued are equally within the purposes of the legislation proposed. For the distinction between debentures and debenture stock see Palmer, Company Law (13th ed. 1929) 301.

17 These "notes" are the Gold Notes, Refunding and Tax Anticipation Notes.

18 The Hofstadter Act, which was adopted in New York in 1926 to provide certain aspects of negotiability to interim receipts and equipment trust certificates, was amended in 1930 to apply also to "corporate" bonds. These were defined as follows: "The term 'corporate bond' means any bond, debenture, note or other written corporate obligation, forming part of a series of similar bonds, debentures, notes or other written corporate obligations, issued under or the payment of which is secured by a mortgage or deed of trust of real or personal property or both, or issued under or secured by a collateral trust agreement or any other indenture identified or described in such obligation; and any certificate of a trustee, whether or not so issued or secured, forming part of a series of similar trustee's certificates, which evidences the right to a share or part of any specified corporate obligation or obligations and the security relating thereto, if there be any such security; and any interest coupon appertaining to any of the foregoing described instruments." N. Y. Personal Property Law (1930) art. 8, §260 (3). For a criticism of this provision, see Note (1930) 40 Yale L. J. 261, and of the Act, Note (1926) 26 Columbia Law Rev. 884.

19 It is interesting to note in this connection, though it affords no help, that the line between checks and bills of exchange drawn upon a bank is even more tenuous.
be gained by providing that all instruments of a series should have a common maturity and, possibly, that they should be issued in equal denominations. The clause could then read: "issued as one of a series of equal denominations and having a common maturity." By so doing the batch of notes commonly taken by the conditional vendor or the "loan shark," though in one sense issued in a series, would be clearly excluded as they ordinarily are drawn to mature one after the other at regular intervals. The "equal denomination" provision would be of less apparent value, and might cause difficulty, particularly since it is not unusual for an issue to be put out in more than one denomination. But, even should some few unintended instruments cross the line into investment instrument territory, it is believed no particular harm would be done. Tentatively, therefore, it is suggested that "series" alone be used to mark the line.

It is not likely that the "unscrupulous lender," as distinguished from the "innocent investor," will seek to bring his paper within the investment category. Clearly Section 2 would be of no use to him whatever, for it sanctions conditions and limitations upon the maker's promise, as upon the holder's rights, both things quite foreign to small loan economy. In fact, some explanation is needed to justify such a step as regards long term investment paper, since it frankly reverses the position of the Negotiable Instruments Law on the point. Under that act a promise "subject to" the happening of a contingency is not only conditional, but uncertain as to time of payment as well, both matters making the instrument not negotiable. The instrument payable upon a contingency certain to happen, more by accident than for substantial reason, has been made an exception. But the instrument payable upon a contingency not sure to happen, like the instrument payable out of a special fund, has long been not negotiable, results dictated by, or at least consistent with, the traditional view that the negotiable instrument must be so drawn as to serve as a substitute for money.

This "substitute for money" concept is one requiring some discrimination in application. The fact is that the bank note not only is

"A check is a bill of exchange drawn on a bank payable on demand." Negotiable Instruments Law § 185. It is clear, nevertheless, as a business matter that a demand bill drawn upon a bank under a letter of credit, for example, is not a check, though the legal definition does not point out the distinction.


Negotiable Instruments Law § 4(3).

See Waterman, The Promissory Note as a Substitute for Money (1930) 14 Minn. L. Rev. 313.
negotiable but has itself long since become money, so that with the check, which also meets the standard, we now have an adequate paper currency, apart from other forms of commercial paper. There surely is no need, therefore, to be controlled today by the money formula in the case of long term investment paper. Moreover, the conditional investment instrument, far from favoring the maker at the expense of the holder (this, in addition to the uncertainty feature, was the basic reason for excluding conditions from money paper) actually functions the other way. Limitations upon the holder's rights, which are typically provisions forbidding separate suit on the part of individual holders to the prejudice of the other holders, strengthen the paper, rather than the converse. So too with the "subject to" clauses in corporate bonds, their purpose being to enhance the practical security available to all holders as a group, by tying mortgage and bond together. Yet, the difficulties inhering in these situations under the Negotiable Instruments Law have been such as to cause the demand in recent years for further legislation.

While these illustrations are innocent enough, it is recognized that the broad language of the section, as proposed, offers room for many other types of conditions, possibly opening the door to sharp practice. When the substance of Section 2 was considered as a proposed amendment to Section 3 of the Negotiable Instruments Law, the draftsman, after approving the references to security instruments, as above, chose to limit the further application of the provision to two of the principal situations causing trouble: first, the government or special district bond, payable out of assessments or taxes and accordingly not negotiable.23 The attempt to do this directly by providing that bond and mortgage should be construed as one instrument is unquestionably fatal to negotiability. King Cattle Co. v. Joseph, 158 Minn. 481, 198 N. W. 798, 199 N. W. 437 (1924). The Hofstadter Act in New York, see supra note 18, is a case in point. In addition, California in 1923 and Nevada in 1934 amended Section 184 of the Negotiable Instruments Law by adding the following to the definition of the promissory note: "but the negotiability of a promissory note otherwise negotiable in form, secured by a mortgage or deed of trust upon real or personal property, shall not be affected or abridged by reason of a statement therein that it is so secured, nor by reason of the fact that said instrument is so secured, nor by any conditions contained in the mortgage or deed of trust securing the same." The first part of the California statute is harmless enough, since the mere recital that an instrument is secured does not affect its negotiability. The second part probably fails to meet the situation. It is one thing to refer to a mortgage containing conditions and quite another to draw the instrument so that it is in terms subject to those conditions, except, indeed, as enforcement of the security would be subject to conditions. In effect, the provision does no more than to codify the case of Enoch v. Brandon, 249 N. Y. 263, 164 N. E. 45 (1928), discussed in Steffen and Russell, supra note 1, at 807. See Handbook of the National Conference of Commissioners on Uniform State Laws and Proceedings (1933) 154.
able under the present act; 26 and second, the estate or business association bond, similarly in danger of being declared not negotiable because payable only out of particular assets. 27 It is believed the broader language of the proposed Section 2 is preferable, if for no other reason, in order to allow room for growth in the investment field. To narrow the provision as suggested would, for example, exclude even the equipment trust certificate, 28 which is so worded as to be payable by the trustee out of rentals if, as and when received,—a highly conditional promise and yet an extremely stable security. So too, the coupon upon the bond redeemable at the maker's option would seem necessarily to be conditional and not negotiable. The provision of the Section, lines 5 to 9, requiring that the import of any condition must appear upon the face of the instrument to be effective as against a holder in due course, should afford the necessary protection to purchasers. 29

The next two sections, 3 and 4, while appearing unduly to strengthen the hand of the lender, have already been considered and in substance favored as general amendments to the Negotiable Instruments Law. 30 In fact it is doubtful that either is strictly essential in the case of bonds. Acceleration provisions, of the sort permitted under Section 3 have long been used in investment paper, as, indeed, have the many security clauses intended to be sanctioned under Section 4. And neither appears to have given much difficulty in the courts, 31 the first no doubt because it is so obvious that some such protection is needed to guard the investor against the varying hazards that can arise during the life of an investment instrument, and the second because, even the courts prone in the case of short term paper to enforce the "courier without luggage" concept of the negotiable instrument to the exclusion of the present act, appear to regard the bond as something different; bonds have traditionally been encumbered with luggage and nevertheless been held negotia-

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28 This is now held not negotiable. Fidelity & Deposit Co. of Md. v. Andrews, 244 Mich. 159, 221 N. W. 114 (1928).

29 To an extent, further danger of overreaching can be obviated by the machinery set up under the Federal Securities Act or the blue sky legislation in force in many states.

30 See Handbook of the National Conference of Commissioners on Uniform State Laws and Proceedings (1933) 156, 158. The second paragraph of Section 3, above, which is necessary to the equipment trust certificate, has not been passed upon by the committee.

31 See the discussion, and cases cited, in Steffen and Russell, supra note 1, at 822.
ble. Even the undertaking on the part of the maker to pay taxes or expenses in connection with an issue, provisions also sanctioned by the proposed Section 4, have given no difficulty in the case of bonds. So that while not making new law in the case of investment paper, both Sections 3 and 4 are probably desirable as a matter of codification, though of course if adopted as general amendments to the Negotiable Instruments Law they need not be again adopted here.

The money provision, Section 5 above, is likewise fully as important to notes and bills of exchange, particularly the latter, as it is to bonds. The aim is simply to recognize, at least so far as negotiability is concerned, that the persons engaged in commerce and finance should be permitted to conduct their transactions in that medium which they deem most satisfactory. It has long been recognized that the Sterling draft is negotiable, though payable in this country, the characteristic legal fiction being indulged that it is payable in that amount of legal tender dollars which would purchase the given amount of Sterling on the day of maturity. But when the medium, specifically stated, is Sterling also, there has been some disposition to say that Sterling is a commodity so far as our money system is concerned and the instrument, accordingly, not negotiable. In large measure this reflects an unduly nationalistic attitude. But whatever the considerations of national policy may be, the way to enforce them is not by a blanket provision that foreign money paper, payable in such currency, is always and necessarily not negotiable.

32 The language of Section 4, lines 5 and 6, sanctioning additional promises "apparently intended primarily to afford security," was suggested originally by Professor Williston.
33 See, for example, Chavelle v. Washington Trust Co. 226 Fed. 400 (C. C. A. 9th, 1915); Higgins v. Hocking Valley Railway, 188 App. Div. 684, 177 N. Y. Supp. 444 (1st Dept., 1919). In the case of notes, however, there has been considerable disposition to hold that such tax provisions render the instrument uncertain and not negotiable. See Mechanics Bank v. Johnson, 104 Conn. 696, 134 Atl. 231 (1926), discussed Note (1926) 36 YALE L. J. 267.
34 "See Thompson v. Sloan, 23 Wend. 71, 75 (N. Y. 1840): "A note payable in pounds, shillings, and pence, made in any country, is but another mode of expressing the amount in dollars and cents, and is so understood judicially."
The court in Thompson v. Sloan, 23 Wend. 71 (N. Y. 1840), held such an instrument not negotiable, saying: "The objection is, that the note was made, endorsed, and payable here, in a foreign commodity [Canada money], which the payee was entitled to demand specifically; and to reject gold and silver current in the United States."
35 With the case reversed, as when, following the war, dollar obligations payable in dollars were used in Germany, it was very clear that no objection as to their negotiability should be raised. So with foreign currency bonds payable here in foreign currency. In such case, since the court would probably give a damage judgment upon default, rather than specific performance, the importance of the provision turns on the conversion date selected. Foreign money obligations, payable in the foreign country, are converted here as of the day of judgment [Deutsche Bank v. Humphrey, 272 U. S. 517 (1926)], thus preserving as long as
It is thus evident that no very startling innovations are necessary, at least in the case of the unregistered instrument. Except for Section 2, sanctioning the conditional instrument, the case is practically one of codification. Tax Free clauses, and Acceleration, Sinking Fund, Conversion and Redemption provisions, though increasing the length and seeming importance of a bond to the point that its relationship to the merchant's promissory note is scarcely credible, do not affect its negotiability. Registration is a different matter, though the mere presence in a bearer bond of a provision for registration does not affect negotiability. The sections making registered paper payable to order and regarding its indorsement and negotiation follow:

Section 6. Registered Instrument Payable to Order. Payee. An investment instrument is payable to order within this article where it is drawn payable to the order of a specified person or to him or his order or to a specified person in whose name it is registered. The person in whose name an investment instrument has been registered, or, if it has been registered more than once, the last person in whose name it has been registered, is the payee of the instrument.

Section 7. When Maker may treat Registered Holder as Owner. Nothing in this article shall be construed as forbidding the maker of an investment instrument by appropriate stipulations in the instrument, 1. To recognize the exclusive right of a person registered on its books as the owner of the instrument to receive interest and to vote as such owner, or 2. To receive any notice in connection with the instrument or the security therefore, and, no such stipulation shall impair the negotiability of the instrument.

Section 8. Indorsement. The signature of an indorser, without additional words, when written on the back of an investment instrument, or an assignment of a registered investment instrument or a power of attorney to sell, assign or transfer the same, signed by an indorser, and whether written upon the instrument or upon a separate paper accompanying the instrument.

possible the foreign currency risk, the medium in which the parties chose to deal. There is no inherent reason why the court could not give a judgment in terms of the foreign currency, but failing that, the result adopted most nearly approximates specific performance. By parity of reasoning, the judgment date also should control in the case of the foreign money obligation payable here in a specified foreign currency. Of course, as indicated above, where the parties have not specified a medium of payment, conversion is had as of the maturity date. Hicks v. Guinness, 269 U.S. 71 (1925); Note (1930) 39 YALE L. J. 1204.

See, for example, Dickerman v. Northern Trust Co., 176 U.S. 181 (1900); Bank of California v. National City Co., 141 Wash. 243, 251 Pac. 561 (1926); Paepcke v. Paine, 253 Mich. 636, 235 N.W. 871 (1931). And a holder in due course of such an instrument does not lose any rights by procuring it to be registered in his name [Thomas v. De Moss, 202 N.C. 646, 163 S.E. 759 (1932)], though it may be regarded, in certain respects at least, as having become non-negotiable.
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6 instrument, is a qualified indorsement. In any such case the instrument is
7 indorsed although it has not been delivered.

1 Section 9. Negotiation apart from Separate Indorsement. The title of a
2 holder of a registered investment instrument, and of any person claiming
3 through such holder, deriving from an indorsement not written upon the
4 instrument, shall cease and determine if, at any time prior to the surrender
5 of the instrument to the maker in order for payment, transfer or exchange,
6 it shall be negotiated apart from such indorsement to a holder in due
7 course without notice of such prior negotiation.

1 Section 10. Negotiation upon Issuance. The issuance by the maker of
2 an investment instrument payable to a specified person in whose name it is
3 registered, whether the instrument forms part of a new issue or is issued
4 upon the purported transfer or exchange of an outstanding instrument, or
5 the re-issuance so registered of an instrument presented for transfer, is a
6 negotiation thereof, when the instrument comes to the person in whose
7 name it is registered.

8 Where the instrument so negotiated to the payee is taken under such
9 conditions that the payee is a holder in due course, he holds the instrument
10 free of any equities or defects of title on the part of any broker, banker or
11 other person who had a part in marketing the instrument and may enforce
12 payment of the instrument, according to its terms, for the full amount
13 thereof against all parties liable thereon.

1 Section 11. Purchase after Maturity, etc. A holder who takes an invest-
2 ment instrument after maturity or after it has been accelerated or called
3 for redemption, whether or not the holder has notice thereof or of the dis-
4 honor of the instrument, if it has been dishonored, and who has in other
5 respects taken the instrument under the conditions provided in Section 52
6 of the Act, is a holder in due course, with all of the rights of such holder.

The foregoing sections are likewise by no means revolutionary in
character, though they touch upon a considerable number of legally de-
batable points. The first paragraph of Section 6 is taken almost literally
from Section 8 of the Negotiable Instruments Law, the important new
wording being: "or to a specified person in whose name it is registered." These
words alone serve to bring the registered instrument within the
Act as an order instrument and, necessarily, capable of negotiation by in-
dorsement. Much the same thing was done in the Stock Transfer Act
when share certificates, although issued to a named person without the
words "or order," were made transferable by indorsement.38 There are,

38 § 1 of the Uniform Stock Transfer Act, stating how share certificates may be
transferred, compares closely with § 30 of the Negotiable Instruments Law, defining
negotiation, and is equally subject to the criticism levelled against that section, i.e.,
that the possibility of a negotiation by someone other than a holder, as for example,
a remitter, was not provided for. The projected § 10 is designed to resolve the
difficulty.
moreover, the same broad reasons of policy: the bona fide purchaser is given increased protection and at the same time, the investor has maximum protection against loss or theft.

The question of who is the payee upon a registered instrument, particularly where it has been transferred several times on the books of the company, is difficult. Of course, no doubt arises in the case of the first person to whom it is issued, and likewise, if upon transfer an entirely new instrument (i.e., a new paper) is issued in the name of the transferee, the original instrument being filed, the case is clear. The person to whom the writing is issued would in each case be the payee, and the usual admissions of the maker, as to the existence of the payee and his capacity to indorse, would obtain. The provision is drawn on the further thought, however, that even where successive registrations appear on the same instrument, each transfer is, in a sense, the payment or retirement of an instrument and the issuance of a new one in equal amount. This conception of book transfer will be discussed more in detail below in connection with Section 12, where a more serious issue is raised. It is enough for the moment to say that it works rather well here; there is every reason why the issuing company should satisfy itself of the existence and capacity of each holder registered on its books in some respect as owner; by the suggested provision each in turn would become a payee.

The extent to which the book record of registration may properly be recognized, without affecting the negotiability of the paper, is a much more debatable matter. The plan here adopted in Section 7 follows that of Section 3 of the Stock Transfer Act, that is, to reduce to a minimum the points upon which the book record of ownership should control. No particular question is raised as to interest payments, or as to voting rights, if they should become important, for the company is surely entitled to treat its books as controlling in such respects. The instrument holder, also, may on occasion prefer registration of the interest payment as a matter of safety, since bearer coupons, however convenient, are at best somewhat hazardous. From the purchaser's standpoint there is no objection to this, since he can procure book transfer to his own name before an interest instalment falls due. But an instrument registered as to principal, which may become a nullity if the company, acting on its book record alone, should pay the amount to the registered owner at maturity or upon earlier redemption, or if it should transfer the obligation to a new owner at the registered holder's bare request,

39 Negotiable Instruments Law § 60.
40 See the discussion in Steffen and Russell, supra note 6, at 770.
would cut a sorry figure.41 The section as presented contemplates that the instrument, duly indorsed, controls in this respect, regardless of purported book transfer or book transfer requirements.

Sections 8 and 9 are necessary in order to take account of the practice of transferring registered instruments by assignment or power of attorney, a separate writing merely attached to the instrument being ordinarily used. The Negotiable Instruments Law requirement is that an indorsement must be written on the instrument42 and there has been doubt in the cases whether an assignment, though written on the paper, should constitute an indorsement.43 Obviously some adjustment must be made. The assignment and power of attorney practice is deeply rooted, going back as it does more than a century to the time when it was employed as a device to circumvent the rule against the assignment of choses in action. It survives, as a matter of form, partly because of the antiquated conception of a transfer as something akin to a real estate title closing; some transfer agents still go through the useless ceremony of completing a blank assignment by filling in the name of an employee as agent to effect the transfer.

It is evident that much ritual could be stripped away today; the simple signature of the registered holder upon an instrument should suffice for all transfer purposes.44 But it is probably not possible to move so fast, nor perhaps desirable to do so. The assignment form of indorsement does serve at least one purpose today in negativing any possible responsibility on the part of the investor to pay the obligation in case the issuing company defaults.45 The same result, of course, could

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41 As a matter of fact transfer agents now require presentation of the instrument as a condition of transfer, so that no change in practice is contemplated. Under the Stock Transfer Act payments upon liquidation are made at the peril of the company when the certificate has not been accounted for. Bay City Bank v. St. Louis Motor Sales Co., 255 Mich. 261, 238 N. W. 241 (1931); see (1932) 41 YALE L. J. 918.

42 NEGOTIABLE INSTRUMENTS LAW § 31: “The indorsement must be written on the instrument itself or upon a paper attached thereto.” This language would seem to admit the separate power of attorney form of indorsement, provided only that it is “attached” to the instrument. But the cases have construed the provision, in accordance with the common law decisions, to mean merely that when the back of an instrument has become filled with indorsements an additional paper may be attached to provide space for further indorsements. Clark v. Thompson, 194 Ala. 504, 69 So. 925 (1915). But cf. Colona v. Parksley National Bank, 120 Va. 812, 92 S. E. 979 (1917).

43 See the cases cited in BRANNAN’S NEGOTIABLE INSTRUMENTS LAW (5th ed. 1932) 424.

44 It may be noted that the last sentence of the projected Section 8, lines 6 and 7, provides that an indorsement is effective even though it has not been delivered. This follows the similar Transfer Act provision (§ 20), in contradistinction to the Negotiable Instruments Law (§ 191), although it is doubted that any difference will result in case law.

45 This is established more by the absence of cases on the point than by any other factor. However, both here and in the case of share certificates so assigned,
be reached by the use of "without recourse," or similar wording, should that be necessary. Section 8, as here proposed, goes one step further by providing that all indorsements upon investment paper, whether of the assignment type or not, should be deemed made without recourse, a position built upon the habit of investors through long years to look for payment only to the issuing company and the security for the issue, if any. It would be in the nature of an anachronism to introduce the personal security of a prior holder at this date.

The real question as to indorsement is thus, whether a separate writing, whatever its form, should be sanctioned. One difficulty is obvious; the indorsement may become detached from the instrument after sale and the registered holder upon again gaining possession of the instrument may fraudulently indorse and sell it to a second purchaser. Section 9 follows Section 4 of the Stock Transfer Act in protecting the second purchaser in this situation. That result is no doubt justified in the interest of free negotiation, but it emphasizes a risk on the part of the first investor which could be avoided by the use of a special indorsement written upon the paper.

Of course the most apparent objection to the Negotiable Instruments Law plan of negotiation is that it might be impossible with long term paper to record the many transfers on the back of the paper. This is doubted, because bonds do not circulate rapidly. Moreover, an adequate book transfer service, as in the case of shares, would permit a bond to be surrendered upon transfer, or in any event after several transfers, so that an entirely new paper could be substituted in its place. Probably the vitality in the scheme of negotiation sanctioned by the Transfer Act in the case of shares, derives from the transfer agents, who do not want the responsibility of passing on a long series of indorsements. Though this is no more a burden than the responsibility assumed by a bank in paying indorsed paper, either as to amounts involved or the number of indorsements in question, the practice is so firmly intrenched that it probably cannot be unseated at this time. At least, it is well to recognize by the act, as has been done, that a simple indorsement would serve the holder as satisfactorily.

The two remaining sections, 10 and 11, have to do with the "holder in due course" status of the investor. The first is designed to avoid the unfortunate construction put by some courts upon Section 30 of the Negotiable Instruments Law. As the argument runs, the payee of an in-

the result squares with long established commercial understanding of the lack of obligation on the part of an assignor, except as he may warrant the genuineness of the instrument and his title to it as a qualified indorser. See NEGOTIABLE INSTRUMENTS LAW § 65.
instrument is an "immediate party" to whom it is "issued" and not "negotiated," from which position the conclusion is reached, by forced march, that the payee cannot be a holder in due course, but is subject to all defenses. The result is bad enough in the case of drafts and checks; it would be a good deal more serious if such a line of thought were to be carried over into the investment field to subject the subscriber in the case of a new issue to all of the possible claims and counter-claims which might arise between the issuing company and the various entities engaged in the marketing process, whether as agents, brokers or vendors. There should be no question but that defenses and equities growing out of this situation must be cleared away in favor of the bona fide purchaser.

The purpose of Section 10, thus, is acceptable enough, but Section 11, on the other hand, adopts what at first sight is questionable policy. It reverses the long-standing rule that negotiation must take place before maturity in order to qualify the purchaser as a holder in due course. The reason for the change lies in the differences between long and short term paper. In general, the present rule with respect to short term paper is a salutary one, since it tends to drive as much overdue short term paper as possible back for renewal, though the rule of some courts subjecting such paper to latent equities clearly goes too far. It prevents sluggishness in the stream of paper in current use. Incidentally, it is a protection to secondary parties, since considerable pressure is put upon early collection. No good business reason, moreover, is apparent for changing the present rule in the case of short term paper, and the law in this field is largely a business matter.

But the function of investment paper, and so also the status of its holder, is very different. Bonds do not serve to the same extent as a medium of exchange. There are no parties secondarily liable whose interests must be considered, since ordinarily only a qualified indorsement is used. Moreover, the investor is ordinarily not a free agent, able to force payment or renewal promptly. He is but one of many holders of the issue. The corporation is at a distance, and impersonal. Rights have to be worked out with others through a trustee, and long delay may ensue while the property is being reorganized. The suggestion is simply that in such case at least no unnecessary obstacles should be put in the way of the investor; the security should continue readily salable for what it may be worth. To this end it has long been urged that the purchaser after maturity should be given a position free of equities of title.

The cases are cited in Brannan's Negotiable Instruments Law (5th ed. 1932) 415, 487. For an analysis of the several situations in which the question becomes important in the case of bills and notes, see Turner, Revision of the Negotiable Instruments Law (1928) 38 Yale L. J. 25, 39.
on the part of prior holders. This much the person from whom bonds have been stolen should contribute to make the machinery run with less friction. The section as drawn goes farther, however, and would also cut away defenses on the part of the issuing company. The issuing company’s contribution in this, though apparently serious, is actually quite small, since it is only a rare bond which will not have come into the hands of a holder in due course long before default, thus eliminating any defense on the part of the company.

A further matter concerns the purchaser’s knowledge of the situation. Clearly it should not be important, so far as his status as a holder in due course is concerned, that he takes the instrument with knowledge of the fact that it is mature, or even that it has been accelerated or called for redemption. To hold otherwise would to a considerable extent deny validity to the argument here advanced. In the case of the matured instrument he cannot well escape knowledge of the fact of maturity. But Section 11, line 3, goes even further and makes it unimportant also whether he has knowledge that the maker has dishonored the paper after maturity, if such is the case. Again, in the case of perhaps most overdue bonds, it is a matter that the purchaser can scarcely avoid knowing, for otherwise the bond should have been paid and retired. So with the accelerated instrument, it is usually clear that the maker is in default in some particular or other, though possibly not constituting a dishonor. Assuming again, however, that the issue of importance in the case has to do with equities of ownership on the part of prior holders, it is not apparent that knowledge of dishonor, particularly where the entire issue is in default, has any bearing on the point.

So much for the negotiation aspects of investment paper. The important changes needed are relatively few, principally those necessary to accommodate the registered instrument, though Sections 10 and 11, concerning issuance, as a negotiation, and purchase after maturity, apply generally. But while it is one thing to indorse and negotiate an instrument, it is quite a different one to surrender it to the maker, or to his

48 Chafee, Rights in Overdue Paper (1917) 31 Harv. L. Rev. 1104. While the argument advanced in this paper is advanced as applying to all forms of negotiable instruments, its most forceful illustrations relate to bonds. Id. at 1148. See further, Morrison, Equities of Ownership and Equities of Defense in Overdue Paper (1931) 5 Tulane L. Rev. 287.

49 The redemption case, where the holder had no notice of default, was fairly clear at common law, it being held that the purchaser after call should be regarded as taking before maturity. Morgan v. United States, 113 U.S. 476 (1884). However, some courts have held that acceleration, on the other hand, matures the instrument and accordingly a purchaser after acceleration may not be a holder in due course. Hodges Bros. v. Wallace, 129 Wis. 84, 108 N.W. 212 (1906). But see Chicago Ry. Co. v. Merchants’ Bank, 136 U.S. 268, 286 (1890). In general, see Chafee, Acceleration Provisions in Time Paper (1918) 32 Harv. L. Rev. 747.
transfer agent, and receive back the same or a similar instrument registered in the name of a purchaser to whom it may be delivered. Strangely enough, although the latter transaction, generally known as a transfer, is extremely common, the Stock Transfer Act is almost wholly concerned with the former, that is, with the "negotiation" of the certificate; the rights of a purchaser of a "transferred" instrument are nowhere stated.\(^6\)

The next group of sections, therefore, designed to clarify the transfer situation as regards registered paper, are quite new, except as it has been possible to make use of provisions in the Negotiable Instruments Law concerning payment and discharge.\(^7\) The sections proposed are as follows:

1. **Section 12. Rights of Holder upon Exchange, Transfer or Registration.**
   
   The holder in due course of an investment instrument issued or reissued by the maker upon exchange, transfer or registration of an outstanding instrument holds the instrument free of any equity, defect or failure of title on the part of any holder or other person respecting the instrument presented for exchange, transfer or registration, as fully as if the instrument so issued or reissued were wholly new, and with all rights thereon and to share in any security therefore as fully as if the instrument were any other instrument of the series, but the person procuring exchange, transfer or registration, does not thereby acquire any greater title to the instrument than he had respecting the instrument presented for exchange, transfer or registration.

   The maker, by making payment, exchange, transfer or registration, admits to the person presenting the instrument for such purpose, the genuineness of his signature and his capacity to make an obligation to honor the instrument according to its terms.

2. **Section 13. Transfer etc. upon Forged or Unauthorized Indorsement.**
   
   A holder, whose indorsement upon an investment instrument may have been forged or made without authority, prior to the exchange, transfer or registration thereof by the maker, may, upon proof of such forgery or lack of authority and upon furnishing indemnity satisfactory to the maker, require the maker to return to him the instrument bearing such forged or unauthorized indorsement (if it has not been reissued), or to issue to him another instrument of like tenor and which shall have equal voting and con-

\(^6\) It might, perhaps, be urged that, when an instrument is presented to the transfer agent for transfer, it has in effect been sold to him, and that the agent, by issuing a new certificate, transfers or negotiates it further. But this would be a highly unrealistic picture of the transaction. Yet even on such assumption the transaction would not come within the Act, since the transfer agent in issuing the new certificate would not appear to be the owner of it, as defined in § 21 of the Act; and it is only the apparent owner who, according to § 1, can transfer title to it. It follows that, so far as the Act is concerned, no one knows what the rights of a purchaser are when he takes from a thief, not the stolen instrument, but one issued in his name upon a transfer at the request of the thief. Nor is it any more clear what the position of the transfer agent may be in such case.

\(^7\) *Negotiable Instruments Law* §§ 51, 88, 119.
version rights and shall share equally with other instruments of the series in any security therefore.

No action in conversion may be brought by the holder in such case against the maker, transfer agent or any person who may have dealt with the instrument, except he had knowledge of the holders' rights, until the transfer agent, after a reasonable time for investigation, not to exceed 30 days, shall have refused to return the instrument requested by the holder or to issue another in its place.

Section 14. Warranty upon Presentment, Indorsement and Delivery. A person who, as holder, without express stipulation to the contrary, indorses an investment instrument, or presents such an instrument for payment, exchange, transfer or registration, by such indorsement or presentment, warrants to the maker:

1. That he has a good title to the instrument; and
2. That he has no knowledge that any signature upon the instrument is forged or unauthorized or that it has been raised or otherwise materially altered;

and further, by such indorsement warrants to subsequent purchasers, and by delivery to a purchaser warrants to such purchaser, the matters and things mentioned in Section 65 of the Act as applying to persons negotiating public or corporation securities.

No warranty on the part of any person who shall so present, indorse or deliver an investment instrument extends to any instrument issued or reissued by the maker upon exchange, transfer or registration thereof, nor shall any warranty on the part of any person who shall so present, indorse or deliver such instrument, unless a holder or purported holder of the prior instrument, extend to such prior instrument.

Section 15. No Implied Warranty. A mortgagee, pledgee or other holder for security of an investment instrument who in good faith demands or receives payment of the debt for which such instrument is security, whether from a party to a bill of exchange drawn for such debt, or from any other person, shall not by so doing be deemed to represent or to warrant the instrument in any particular nor the validity or value of the obligation, if any, giving rise to it.

Section 16. Signature Guaranteed. A person who guarantees any signature upon an investment instrument, by the use of the words "signature guaranteed" or words of similar import, warrants to the maker, or to his transfer agent, as the case may be, upon payment, exchange, transfer or registration:

1. That the signature is the genuine signature of the person whose signature it purports to be and,
2. Where the signature is made by a person as officer, partner or other agent, that such person had full authority to and did execute the signature in such capacity, and
3. Where the signature is made by a person as executor, administrator or other fiduciary, that such person is the person appearing by a purported document or order of appointment as such fiduciary
and that such appointment has not been revoked or terminated to
the knowledge of the guarantor;
but no such warranty shall include any undertaking as to the purpose for
which payment, exchange, transfer or registration is requested or as to
the use to be made of any money or instrument to be received thereupon.

Section 17. Payment, etc. in Due Course. The payment, exchange, trans-
fer or registration of an investment instrument is made in due course
when made, in good faith, to or at the procurement of the holder, upon
surrender of the instrument to the maker, and without notice that the title
of the holder is defective, if such is the case; provided, in the case of pay-
ment, that it be made at or after maturity of the instrument or, if the in-
strument has been duly accelerated or called for redemption, at or after
such time.

Section 18. Discharge. The payment, exchange, transfer or registration
in due course of an investment instrument discharges the maker (and all
persons secondarily liable) upon the instrument presented in such case, ex-
cept that,
1. Where the instrument so presented later comes into the hands of
a holder in due course, the maker is not discharged as to such
holder and persons claiming through him, and
2. Where, upon registration, the instrument is reissued, the maker is
not discharged as to the person in whose name it is registered and
persons claiming through him.

The case presented by the foregoing sections is simple enough to
state, but the translation of it into legal terminology which will not
readily be misunderstood is something else again. Reduced to simple
terms, a transfer is visualized as a payment; the person in possession of
an instrument brings it to the transfer agent, the instrument and all
indorsements are checked over, and, if in order, a new writing registered
in the name of the holder or someone to whom he plans to deliver it is
issued. As has been pointed out by a leading authority in the transfer
field, this compares closely with what a bank does in paying a check, negotiable bank notes being issued as payment. Questions of title and
defenses upon the old instrument should be stripped away, insofar as
purchasers of the new instrument are concerned. That the original in-
strument had been altered or was a forgery, or was issued without con-

52 Christy, The Transfer of Stock (1929) 7: "Bearing in mind that a
corporation derives no profit from the transfer of stock on the books, we find that
the closest analogy to its duty in entering transfers is the duty of a bank in paying
deposits. A bank owes money to its depositors, and the payment of deposits on
the order of the depositor operates as a termination or shifting of the indebtedness.
A corporation owes a duty to its stockholders, the duty of recognizing their rights
as stockholders, and the entering of a transfer of stock on the books on the assign-
ment of a stockholder operates as a termination or shifting of such recognition." In
the case of registered bonds, the analogy is probably closer to payments made by
a bank of its own notes or certificates of deposit.
sideration, or a holder's indorsement was forged or made without au-
thority, are all matters which may be said to have been passed upon at
the transfer. As provided in Section 12, therefore, the instrument is-
sued upon transfer is wholly new as to defenses and defects of title per-
taining to the original instrument, but replaces the original as fully as
any one of the series, both as an enforceable obligation and insofar as
security and voting rights are concerned.

This matter of freeing the newly transferred instrument of defenses
and equities of title should cause no question, except possibly in one
situation. If a thief, in possession of a registered bond, forges the
holder's indorsement and exchanges the bond for a negotiable bearer in-
strument, it requires no citation of authority to say that the holder in
due course of the bearer instrument would be protected. He would pre-
vail even if the original bond had been forged or altered or issued in a
fraudulent transaction. Only where successive registrations, or trans-
fers, are recorded on the same instrument would there be doubt. In
such case, both the person whose name had been forged and the holder in
possession of the instrument would lay claim to it. Upon ordinary
bills and notes principles the holder whose indorsement was forged
would prevail, but this would ignore the practical situation and give
no significance to the transfer. It has seemed wiser to sustain the position
of the purchaser, even in this case, as causing less general disturbance to
transactions. Further, the purchaser will often have had no means of
passing upon the regularity of indorsements appearing on the instru-
ment prior to transfer, though this point is perhaps more rhetorical than
realistic. At all events, it is true that the transfer agent does and can
readily require assurances before making transfer, thus differentiating
the case from the ordinary bills and notes negotiation.

To an extent, this gain to the purchaser is at the expense of the per-
son whose indorsement has been forged, but actually the added risk need
not be serious. Ordinarily, whenever claim of forged indorsement is
made, there is a more or less extended period in which the validity of
the claim is in doubt. There is no good reason why the instrument re-
issued upon transfer, at least if in the hands of a bona fide purchaser,
should be tied up awaiting an outcome of this investigation, particularly
if any other means is available to resolve the difficulty. Section 13 was

53 Not even the payee as holder in due course question could be raised, since
the thief as bearer and holder of the new instrument would clearly be deemed to
have negotiated it to the purchaser.

54 NEGOTIABLE INSTRUMENTS LAW § 23: "When a signature is forged or made
without the authority of the person whose signature it purports to be, it is wholly
inoperative, and no right to retain the instrument . . . can be acquired through or
under such signature. . . ."
designed to meet this need, and to put the original holder in substantially as good position as before, by requiring the maker to return the original instrument, or to issue a new one if it had been reissued upon transfer. This will entail some delay and expense to the holder, but he is the one who lost the paper or in some measure trusted the person who forged the indorsement and the delay and inconvenience incident to having a new instrument issued can, therefore, quite properly be put upon him. Indeed, there is no way whereby he can wholly avoid this loss.

From the standpoint of the issuing company, as of the transfer agent, the opportunity to make specific restitution, meaning as it does the virtual elimination of the action of conversion, should prove a blessing. In recent years, with a falling securities market, use of this means of protecting property at all costs has approached the dimensions of a racket.\textsuperscript{55} As to the person who knowingly converts property, no doubt it should continue to be preserved. But to permit a holder to resort to litigation, more or less at his election, to force the purchase of his securities upon persons who acted in good faith and without knowledge or practical means of knowledge of his interest in them, is no longer defensible\textsuperscript{56}—that is, if other and less costly means are at hand to make good the holder's loss. A reasonably prompt return to him of the lost instrument, or one issued in its place, is surely all that the holder can fairly ask.

The result, of course, in event of specific restitution, is that the issuing corporation becomes liable upon two instruments where but one grew to begin with. The Stock Transfer Act, preoccupied as it is with "shares" and the certificate as something evidencing "title" to them, could not well go so far in favor of free negotiability—though there is

\textsuperscript{55} A great many cases could be cited. Two cases growing out of the failure of a New York brokerage house in 1929 will illustrate the point. Drug, Inc. v. Hunt, 168 Atl. 87 (Del. 1933); Pure Oil Co. v. Hunt, 188 N. E. 738 (Ohio, 1933). The broker had caused the issuing companies to issue replacement certificates on the fraudulent allegation that the originals were lost. The first case allowed the action in conversion against the issuing company, but the second construed the Transfer Act to require that a demand must first be made, reasoning that since under Section 1 title to a share certificate can only be transferred by indorsement, the action of the issuing company in putting out replacement certificates had not affected the plaintiff's position. While this latter result was probably not contemplated by the framers of the Transfer Act, it is at least not unreasonable. Of more immediate interest, it is good evidence that in the court's view the effort to dispose of these shares at their previous high prices was not entirely to be approved.

\textsuperscript{56} The effort to hold liable the broker handling converted securities in good faith has met with failure. Pratt v. Higginson, 230 Mass. 256, 119 N. E. 661 (1918), discussed in (1918) 28 YALE L. J. 175; Gruntal v. National Surety Co., 254 N. Y. 468, 173 N. E. 682 (1930). These cases, by sheer force of assertion, gave the broker the immunities of a purchaser in good faith, although obviously he was in no real sense a purchaser. The result, however, is at least further evidence that the common law conversion action is somewhat out of place as applied to transfer questions.
very respectable authority in case law for so doing. But the bond situation is simpler and, insofar as the obligation to pay is concerned, there is nothing inconsistent in treating both instruments as fully enforceable; neither purports to convey title to a specific obligation. The matter of voting and conversion rights and the question of how the two instruments should share in any security for the issue, however, presents a more complicated question. The position suggested, that of granting full recognition to both instruments, means that the other security holders will find the security diluted by just so much; upon liquidation, the new instrument would share equally with all of the old issue. In a sense, this is but applying the principles of insurance to the situation: losses are distributed among security holders generally in favor of full protection to the bona fide purchaser of an irregularly transferred instrument or, if you prefer, in favor of the holder whose indorsement was forged. The result is good business.

A question remains as to who should bear the ultimate loss to the issuing company, where both the original and the irregularly transferred instrument are enforceable. Clearly the transfer agent must first respond, depending on the agreement with the corporation. But what of the person presenting the instrument for transfer? It was Ames' notion, as regards share transfers, that the parties dealt strictly at arms length, a sort of caveat emptor as applied to the transfer situation, though it was granted that by a roundabout process, making use of conversion, constructive trust and subrogation concepts, recovery could be had on principle against the person making presentment. Section 14 gets at the matter directly, in accordance with the case law, by providing a warranty to the maker or transfer agent, by the person presenting the paper, and further, on the part of each person indorsing it. By so doing, the chief financial loss upon the transaction is shifted to the person taking the paper from the forger, where it has always fallen in Anglo-American law. The rationalization is that such person stands in the

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58 Since the corporation will often have an action over against the wrongdoer, or as provided by Section 14 above, against the persons presenting for transfer, the financial position of the corporation will often not be particularly affected. It might be desirable to require further that any recovery of the sort be paid over to the trustee and held as part of the general security for the issue. By so doing, the security position of the series, likewise, would not be seriously affected.
59 Ames, Forged Transfers of Stock: Another View (1904) 17 Harv. L. Rev. 543.
60 See, for example, Starkey v. Bank of England [1903] A. C. 114.
61 A similar provision has been suggested in the proposed Uniform Bank Collection Act as regards checks presented for payment. See HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS (1933) 215.
best position of all concerned to have avoided the loss in the first instance; he need not have bought the paper at all unless satisfied of its regularity.\footnote{Perhaps a better point is that, in many cases, the instrument will have been taken at such a discount or in a transaction involving such a profit to the purchaser as to pay him for the risk taken. No similar compensation is available to the drawee, or to the transfer agent.}

Perhaps Ames’ aversion to the notion of warranty in this situation grew out of a failure to consider exactly what the warranty should cover; for certain things, at least, the transfer agent must be held accountable. The plan of Section 14 is to put responsibility upon each party for the regularity of those things falling most clearly within his knowledge. The holder knows, or is made responsible to know, his title and, in addition, is held to say that he knows of no alteration or forgery upon the face of the instrument. Although the Negotiable Instruments Law makes no provision for a warranty to the drawee in the case of checks, the holder in most situations is absolutely responsible to the paying bank for alterations upon the face of the instrument.\footnote{As a consequence, upon payment of a raised instrument, the drawee may recover back the amount of the over-payment in an action for money paid under a mistake of fact. The exception is where the drawee first certified the check in its raised form and it was thereafter negotiated to a holder in due course. Two decisions, in recent years, have held that the drawee in such case must pay according to the tenor of the instrument as raised. National City Bank v. Bank of the Republic, 300 Ill. 103, 132 N. E. 832 (1922); Wells Fargo Bank & Union Trust Co. v. Bank of Italy, 292 Pac. 281 (Cal. App. 1930), \textit{aff’d}, 214 Cal. 156, 4 P. (2d) 781 (1931). The difficulty with this position is that, as the law now stands, the recourse of the drawee against the person procuring certification in such case is wholly uncertain, and possibly non-existent. By providing a warranty on the part of the person presenting the paper for certification, as is proposed in \S 5 of the Uniform Bank Collection Act, the result is acceptable enough.}

The printed bond, on the other hand, presents a very different situation for, unlike checks, which may be drawn in any terms at the drawer’s election, the details of a bond issue are fully known to the transfer agent. Even the payee’s name is known, since the record of registrations is kept by the transfer agent. It is not going too far, therefore, to charge the transfer agent with responsibility in that regard. Accordingly, by the admissions stated in Section 12, lines 13 to 16, these alteration risks are put upon the maker or his transfer agent upon payment, exchange, or transfer being made. So also, the risks incident to a forged or unauthorized signature upon the bond are placed upon the maker.\footnote{That the maker of an ordinary promissory note is held to know both the regularity of his signature and the amount and terms of his instrument upon payment is well established. See United States v. National Exchange Bank of Baltimore, 270 U. S. 527 (1926), discussed \(\Rightarrow\) (1926) 35 \textit{Yale L. J.} 1009.}

The result squares closely with the doctrine of \textit{Price v. Neal},\footnote{A considerable literature has grown up concerning this doctrine. See, for example, Aigler, \textit{The Doctrine of Price v. Neal} (1926) 24 \textit{Mich. L. Rev.} 809.} developed for bills of exchange, which has survived for nearly two centuries.
Sections 15 and 16 are relatively simple provisions. Probably the first is not even necessary, for it appears never to have been decided, despite the broad language of Section 65 of the Negotiable Instruments Law, that a collecting bank, in releasing money paper upon payment of a draft, should be deemed to have made any warranty in connection with the paper so released. The section as drawn follows Section 19 of the Stock Transfer Act, departing from it only so far as is necessary to make the exemptions from warranty square with what otherwise would be the undertaking in that regard. It is suggested as a cautionary measure. The second provision, however, is very much needed in order to fix definitely the scope of the widely used guaranty of signatures, whether or not the particular solution suggested is to be finally approved.

The difficulty here is that "signature guaranteed" is far from being self-explanatory. Probably in the case of the personal signature it is generally understood to mean what is provided above by Section 16(1). But even that is not wholly clear. In case an instrument registered in the name of John Jones is indorsed in the presence of a bank officer by a John Jones, the bank certainly means to do more than witness the signing. It guarantees the signature as that of a John Jones. But does it further warrant that the particular John Jones is the John Jones who owns the instrument? Reasonably, its warranty should carry that far. So with the corporation signature, the guaranty should cover not only the point that the right corporation signed, but that the par-

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66 The principal controversy has been with respect to bills of lading so released. See Springs v. Hanover National Bank, 209 N.Y. 224, 103 N.E. 156 (1913), in which the court held that a bank presenting a draft in good faith, with forged bills of lading attached, would not be liable for the forgery upon any theory of warranty. But in Fort Worth Elevator Co v. State Guaranty Bank, 93 Okla. 191, 220 Pac. 340 (1923), recovery was allowed on these facts under, or notwithstanding, § 34 of the Uniform Bills of Lading Act, which is substantially similar to § 12 of the Transfer Act. See, further, the comment by Professor Williston on what was meant by these provisions, in (1926) 26 COLUMBIA LAW REV. 330.

67 Under § 12 of the Transfer Act, a person collecting a draft with a share certificate attached, is excused from any warranty as to "the genuineness of such certificate, or the value of the shares represented thereby." But the warranties upon transfer (§ 11) also include an undertaking on the part of the transferor that "he has a legal right to transfer" the paper. It would seem to follow, therefore, that, if a collecting agent presents a draft with a stolen certificate attached, he may be held liable on this warranty although he acted in complete good faith. So with the further warranty of § 11, from which he is not exempted by § 12, that he knows of no fact impairing the validity of the certificate. Surely, a collecting agent is not to make any warranty as to such things.

ticular signing officer was duly elected and authorized to sign. This much at least it would seem the transfer agent should be permitted to require, not simply to protect the transfer agent, but that transfers can be put through with all reasonable dispatch.

Though some aid to transfer can be asked of third persons in this manner, the scheme clearly has limits. It is too much, for example, to expect the guarantor to warrant that the instrument is genuine; that is a matter peculiarly within the knowledge of the transfer agent. So also, when the particular use to be made of the transfer is unauthorized, even ultra vires, surely the warranty should not be held to cover such matters.

The more difficult question concerns the many situations where a fiduciary is involved, e.g., an executor or trustee, or a guardian or administrator. To what extent should “signature guaranteed” cover the regularity of the will or trust agreement, or of the appointment and qualification of the fiduciary, or of his powers in such capacity? These are matters requiring special investigation which it would seem the transfer agent alone must pass upon, even though the result entails a considerable delay in making transfer. Indeed, even if it were possible to require a guaranty so broad as to cover such matters, it no doubt would in the last analysis be worth very little. While no question will be raised in the simple guaranty situation, related as it is in some measure to the business of the guarantor, to load the signature guarantee much farther might completely break it down, as an ultra vires undertaking.

The final two Sections, 17 and 18, are designed to define more clearly the position of the transfer agent. The critical situation sought to be covered is that where a thief or finder in possession of blank indorsed paper procures an exchange or transfer, the holder’s indorsement being regular. If the thief sold the paper or if the instrument issued upon transfer or exchange were sold, the bona fide purchaser would no doubt be protected, the paper being negotiable. The rule long obtaining in the case of bills and notes, codified in Section 88 of the Negotiable Instruments Law, gives the maker substantially the same protection upon making payment to a thief or finder as a person would have who should buy the paper from him. All that is intended by these two

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69 It has recently been suggested that the Stock Transfer Act be amended to provide that “signature guaranteed” cover this point, as well as those mentioned in the projected Section 16 above. See HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS AND PROCEEDINGS (1933) 236.

70 The usual guaranty of prior indorsements by a collecting bank has given no difficulty since it apparently has become part of the business of banking. When a more unusual guaranty is given, however, it is ordinarily necessary to show rather definitely that the bank stood to benefit from the transaction, before its undertaking may be enforced. American Surety Co. of N. Y. v. Philippine National Bank, 245 N. Y. 116, 156 N. E. 634 (1927). This often would not be possible in the transfer situation.

sections, therefore, is to put exchange, transfer and registration on the same footing with payment. There should be little question of the desirability of the result. 72

**Conclusion**

The foregoing gives some conception of the form which an act to make investment instruments negotiable might well take; some features already are rather well defined. What additional provisions should be suggested? Two situations dealt with in the Stock Transfer Act have not been developed here. The first, providing that "shares" may not be attached until the certificate is seized or surrendered, 73 would seem to be unnecessary, for it has long been ruled that an obligation evidenced by an outstanding negotiable money instrument may not be garnished, except the instrument be taken up as well. 74 The other, setting up machinery whereby a court may require a new instrument to be issued in case the original is shown to have been lost or destroyed, 75 might be more useful, though this is doubted since voting rights, the substantial reason for the provision, are ordinarily not of vital importance in the case of bonds. Moreover, it is not clear that the policy of relegating a possible *bona fide* holder of the allegedly lost instrument to an ambiguous damage position, as is done in that act, is necessarily to be approved in the case of bonds.

A much more difficult problem concerns fiduciary transfers, barely touched upon in Section 16 above. While these form a relatively small part of all transfers, they cause a large part of the trouble. Possibly not much can be done to speed matters up in view of the wide variety of estate and tax statutes and provisions to be complied with. Moreover, as a matter of policy, there has always been a disposition to rule that one dealing with a fiduciary does so more or less at his peril, on the idea that such a course is necessary for the protection of the estate. 76 It is a fair surmise, however, considering the way transfer

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72 For the situation as to shares under the Transfer Act, see note 50, supra.
73 **Uniform Stock Transfer Act** § 13. The further exception, "or its transfer by the holder be enjoined," is difficult to approve, since a *bona fide* purchaser should be protected notwithstanding the fact that an instrument was sold in violation of an injunction order. See, in the case of notes, Winston v. Westfeldt, 22 Ala. 760 (1853).
74 See, e.g., Hussey v. Winslow, 59 Me. 170 (1870).
75 **Uniform Stock Transfer Act** § 17.
76 Even in the case of banks paying checks, the places where payment may be made to a fiduciary without responsibility for what he may do with the money have been won only after long controversy. See, for example, Empire Trust Co. v. Cahan, 274 U.S. 473 (1927), in which the court held that a collecting bank might safely deposit in an agent's personal account the proceeds of a check drawn by the agent to his own order. The situation is discussed in Note (1926) 35 *Yale L. J.* 854. And see Bischoff v. Yorkville Bank, 218 N.Y. 106, 112 N.E. 759 (1916)
practice has developed, that many precautionary measures have been adopted by transfer agents, which, though useful in rare cases, are much too onerous to be imposed upon all fiduciary transfers.

An example is the probate court certificate appointing a legal representative. To be completely protected the transfer agent, no doubt, would have to act nearly simultaneously with the appointment, as otherwise, transfer might be made after revocation. Since that is ordinarily impossible, it has been suggested that the certificate should be deemed good for a period, say, of six months, in the absence of any notice to the contrary. To adopt such a rule would amount simply to shifting the particular estate the risk that a representative might continue to act after his appointment had been revoked. Whether that result could be justified would depend on a balancing of interests, the importance of the risk on the one hand as compared with the extent to which transfer procedure, generally, could be relieved of burden on the other.

No attempt has been made to state the conditions to be complied with before an instrument is in order for transfer, that is, to state the situations where transfer can be required as of right. Probably the task is impossible in the case of the fiduciary transfer. But it is questionable whether it is desirable to go to the extreme of leaving the matter wholly to the courts, as was done by the Stock Transfer Act. Some difficulty has developed, for example, as to the right of a pledgee to require transfer, and litigation has been necessary to establish that the bona fide purchaser from a thief is entitled to transfer. A provision

(deposits of estate funds made with defendant by an executor in his personal account). Of course, in both these situations, since the representative had general authority to sign checks, and there was nothing to put the drawer on notice of any misuse of signing authority, no question was raised as to the regularity of the payment by the drawee.

At least as applied to share transfers. See Handbook of the National Conference of Commissioners on Uniform State Laws and Proceedings (1933) 234.

Though in a sense these are not comparable, it has been by some such process that the whole body of rules covered by the term "negotiability" has grown up, e.g., the risk of fraud is put upon the maker in favor of the holder in due course, because in the great majority of cases no actual defense of fraud will exist and it is too burdensome, therefore, to make all purchasers ascertain the facts at their peril. The same principle is working out even now in the bank collection cases, direct forwarding being sanctioned in the interest of speed and economy, although this puts an admittedly greater risk on an occasional forwarder than would be true if his items were to be collected through a correspondent. See Turner, Bank Collections—The Direct Routing Practice (1930) 39 Yale L. J. 468.


Turnbull v. Longacre Bank, 249 N. Y. 159, 163 N. E. 135 (1928).
might well be presented to cover these cases, if it were so drawn as to avoid a negative inference that transfer could not be had in other cases. Plainly the first effort, however, should be to clarify the situations in which transfer may be made safely, leaving it to further study to show whether a general provision purporting to cover all situations in which transfer can be required is feasible.

Again, the matter of stop notices, and claims by others than the registered holder, have not been directly considered. While one may well agree that the transfer agent is far more nearly akin to the bank of deposit than to the strict trustee,—the category in which the early share transfer cases put him—it does not follow that he should be permitted to look solely to the book record of ownership, as the many carefully drawn corporate provisions would have one believe. Indeed, as indicated above, such a result could not well stand along with full recognition of the rights of a bona fide purchaser of the instrument, entitled to transfer as of right. Even as to the adverse claimant, it is evident, if one is to follow the bank analogy, that the transfer agent must heed rather carefully the recital of claim. The chief relief afforded by the present proposals, therefore, lies merely in the fact that, with the instrument made negotiable, the situations in which stop notices will be important will be greatly reduced; in many cases the instrument will be in the hands of a holder in due course who can require transfer notwithstanding notices. It may be desirable to go farther.

Finally, the results here set forth surely justify the suggestion made at the beginning, that a good deal of thought, not to say labor, is needed before birth can be given to even a quasi-perfect Negotiable Investment Instruments Act. Should one take the so-called realists at face value, it would perhaps be better to bring about an abortion at once, since all is litigation and change anyway. But the thing cannot be dismissed so cavalierly. It is in the commercial field, where decisions have traditionally kept closer to hard-bitten fact than elsewhere, that there has been a steady growth of rather successful short enactments. Moreover, it is easily possible to avoid the case-law evil of broad conceptualism, which has given the realist his chief concern: negotiability as regards investment paper can be made of quite different stuff in part than

82 See, for example, State ex rel. Roberts v. Trimble, 316 Mo. 354, 289 S. W. 796 (1926), and the discussion in (1927) 36 YALE L. J. 875.
83 The general practice with respect to stop transfer notices has been to advise the claimant that his letter has been received and will be given attention, but no such absolute undertaking to stop transfer is given as the courts have decided applies in the case of stop payment notices given to banks. But even in the case of banks the rule is being relaxed, perhaps unwisely. Note (1930) 39 YALE L. J. 542, discussing the case of Gaits v. Windsor Bank, 251 N. Y. 152, 167 N. E. 203 (1929).
was used for the promissory note. Nor need one harbor the illusion that an act, once adopted, can never be changed, except by forced court interpretations, for, granted a trained group, such as the Conference of Commissioners on Uniform State Laws, with the interest and courage to re-shape their work from time to time, change can come quickly and in an orderly fashion as changed conditions require. Upon these terms the new act, if and when finally in shape, should be welcomed as one more segment in the general commercial code which is slowly being built.

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