

may exercise its right to appear in court through its own solicitor and need not be represented by an United States Attorney.¹⁶⁰

Pursuant to section 25, it is provided that orders issued by the Commission may be reviewed by the United States Circuit Court of Appeals. In the absence of a specific request, hearings on the question of retaining certain reports as confidential are not provided for.¹⁶¹ Yet the issuer may appeal rulings, on such requests, to the Federal courts, inasmuch as they are judicial rulings affecting property rights. Although this may result in administrative inconvenience, it is necessary for the protection of the public.¹⁶² On the other hand, a ruling by letter from the Director of the Commission, denying an application to amend an application form, was held not to be an "order" under section 25 (a), giving the court jurisdiction in review.¹⁶³ Similarly, where the Commission brings proceedings to enjoin certain practices and then orders an investigation of respondent's stock, a cross bill by defendant to enjoin the investigation was not allowed¹⁶⁴ on the ground that the Commission's order was interlocutory and not reviewable by the court. It was also suggested that the proper court in which to seek such review was the Circuit Court of Appeals.

Conclusion

The interpretation of the Act has been marked by liberal rulings granting the investor a maximum of protection through dissemination of information and suppression of practices bordering on fraud and deceit. As far as compatible with the best interests of the public, the Commission has attempted to refrain from an overemphasis of the letter of the law which might unduly burden issuers and others subject to the Act. Realizing that restrictions for the suppression of undesirable practices fall heaviest on the honest dealer and broker, the Commission has endeavored to point the way towards a practical compliance with the spirit of the Act without disregarding its necessary safeguards. Provided with an elastic statutory plan, the interpreting agencies have adopted a sensible attitude towards the problem of creating a smoothly functioning machine for the regulation of securities markets and, yet, one flexible enough to give sufficient attention to the multitude of individual problems.

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NOTES

Liability of a Corporation for Registering an Unauthorized Transfer of Shares Standing in the Name of a Fiduciary

The striking increase of trading in corporate shares, during the past few decades, has rendered the rules governing their transfer a problem of growing significance. In view of its singular importance at present, there is need to redefine the liability of a corporation for registering on its books an unauthorized transfer of shares standing in the name of a fiduciary. The liability of a corporation for registering a transfer in cases where the assignment of the share certificate has been forged, or where the certificate has been lost or stolen, has

160. *S. E. C. v. Stock Market Finance Co.*, 79 F. (2d) 1010 (C. C. A. 2d, 1935) *cert. denied*, 295 U. S. 713 (1936); *S. E. C. v. Collier*, 76 F. (2d) 939 (C. C. A. 2d, 1935).

161. Rule UB 2.

162. *American Sumatra Tobacco Corp. v. S. E. C.*, 93 F. (2d) 236 (App. D. C. 1937).

163. *Third Ave. Ry. v. S. E. C.* 85 F. (2d) 914 (C. C. A. 2d, 1936).

164. *S. E. C. v. Andrews*, 88 F. (2d) 441 (C. C. A. 2d, 1937).

† Morris Pfaelzer II, a member of the third year class, collaborated in the writing of this Legislation.

been generally treated elsewhere¹ and, therefore, will not be considered in the present discussion.

For purposes of clarity throughout this discussion, let us assume a hypothetical situation involving the following parties: *S* is the original owner of shares of stock in the *C* corporation which *F*, a trustee or other fiduciary, now holds for the benefit of *B*, the beneficiary or equitable owner; the shares are registered on the books of the *C* corporation in the name of *F* as a fiduciary; *F* makes an unauthorized sale of the shares to *T*, a transferee or purchaser who has no actual notice of *F*'s breach of his fiduciary duty to *B*, and the *C* corporation transfers the shares into *T*'s name on its books; *B* now sues the *C* corporation. Clearly, *B* may recover damages from *F* in such a case for his breach of duty.² However, the common law dogma also permits *B* to recover from the *C* corporation on the theory that by transferring the shares without authority from *B*, the *C* corporation has been remiss with respect to a duty owed to *B*.³ The doctrine seems unreasonably harsh inasmuch as its effect is to burden the corporation with the responsibility for preventing a breach of *F*'s duties. The rule has been alleviated by the Uniform Fiduciaries Act in some twenty states and the District of Columbia.⁴ However, it appears that the strict common law doctrine prevails in nearly all of the remaining twenty-eight states.⁵ Before attempting an evaluation of the rule, it will be necessary to ascertain more clearly the exact nature of this duty.

The Corporation's Duty of Inquiry

The corporation's duty of inquiry has been described as the duty ". . . to use reasonable diligence in every case to ascertain whether or not a transfer of stock requested is duly authorized, to make those transfers that are so authorized, and to prevent those that are unauthorized; and for every breach of this obligation it is legally liable to the parties injured for the damage it thus inflicts."⁶ In the absence of notice, actual or constructive, that the equitable title is in one other than the registered holder of the share certificate, it is recognized that no duty is owed by the corporation to such an equitable owner.⁷ The extent of the duty, therefore, will be found to depend upon a determination of the facts sufficient to constitute notice of the fiduciary relation. In this regard, varied situations must be considered.

Where *F* appears on the corporate books as trustee for a named beneficiary, it is generally recognized that this is sufficient notice to put the corporation on

1. CHRISTY, TRANSFER OF STOCK (1929) c. 13; Thorndike, *Forged Transfers of Stock and the Sheffield Case* (1904) 17 HARV. L. REV. 373; Note (1928) 54 A. L. R. 353.

2. RESTATEMENT, TRUSTS (1935) § 205 *et seq.*

3. *Lowry v. Commercial Bank*, 15 Fed. Cas. No. 8581 (C. C. Md. 1848); *Geyser-Marion Gold Min. Co. v. Stark*, 106 Fed. 558 (C. C. A. 8th, 1901); *Marbury v. Ehlen*, 72 Md. 206, 19 Atl. 648 (1890); *Loring v. Salisbury Mills*, 125 Mass. 138 (1878); *Wooten v. Wilmington & W. R. R.*, 128 N. C. 119, 38 S. E. 298 (1901); *Bayard v. Farmers & M. Bank*, 52 Pa. 232 (1866); *Peck v. Providence Gas Co.*, 17 R. I. 275, 21 Atl. 543 (1892); *Caulkins v. Gas Light Co.*, 85 Tenn. 683, 4 S. W. 287 (1887); *West v. Tintic Standard Min. Co.*, 71 Utah 158, 263 Pac. 490 (1928); 12 FLETCHER, CORPORATIONS (Perm. ed. 1932) § 5546; Note (1913) 45 L. R. A. (N. S.) 1076.

4. 9 U. L. A. 62 (Supp. 1936).

5. Five additional states have statutes altering the common law rule. See *infra* note 65.

6. *Geyser-Marion Gold Min. Co. v. Stark*, 106 Fed. 558, 560 (C. C. A. 8th, 1901). See, generally, Patten, *The Rights and Duties of Corporations in Dealing With Stock Held in a Fiduciary Capacity* (1884) 18 AM. L. REV. 975; *Liability of Corporations in Transferring Stock Held in a Fiduciary Capacity* (1893) 6 NAT. CORP. REP. 483, 513, 539, 567, 619, 643.

7. See *Loring v. Salisbury Mills*, 125 Mass. 138, 150 (1878); *West v. Tintic Standard Min. Co.*, 71 Utah 158, 168, 263 Pac. 490, 493 (1928).

inquiry as to *F*'s authority to sell to *T*.⁸ However, where the notation is merely "*F*, trustee," without a statement as to the identity of the beneficiary, varying interpretations have resulted. By the weight of authority, the corporation is declared to have been placed on inquiry.⁹ Thus, the word "trustee" is regarded as a warning (1) that *F* is not the owner of the property, (2) that he holds it for the use and benefit of another and (3) that he has no right to dispose of it without the assent of *B*.¹⁰ The California court, however, has negatived this theory on the ground that if *F* was not intended to have the power to sell, his authority might readily have been limited by an additional clause in the share certificate.¹¹ In addition, the word "trustee" has been construed as a mere *descriptio personae*.¹²

Where the shares are transferred by "*F*, executor" or "*F*, executor of the *X* estate" the corporation is charged with notice of the will and is bound to observe its terms.¹³ But if the transfer is apparently according to the terms of the will, the corporation has no duty to inquire further and will not be liable if in fact the transfer was fraudulent.¹⁴ Where *F* is an administrator, the corporation is only obliged to inquire into the validity of *F*'s appointment as administrator.¹⁵ So also, where the shares are registered in the name of *F* as guardian of a ward, the corporation must ascertain, at its risk, the authority of *F* to transfer the shares.¹⁶

In general, the duty owed by a corporation to its shareholders in the case of transfers is said to be "ordinary diligence" rather than "suspicious watchfulness".¹⁷ However, regardless of the standard of care required of the corporation in making transfers, its liability for registering unauthorized transfers seems harsh in view of the fact that the corporation is liable also to the transferee if it refuses to register a rightful transfer.¹⁸ Thus, a corporation may easily be caught in an anomalous situation inasmuch as if it registers a transfer, it may subject itself to liability to *B*, whereas if it refuses the transfer, it may incur liability to *T*. In such a situation, it must offer *T* adequate cause for refusing the transfer and then pursue the degree of inquiry required to achieve

8. *Farmers & M. Bank v. Wayman*, 5 Gill 336 (Md. 1847); *Loring v. Salisbury Mills*, 125 Mass. 138 (1878); *Bayard v. Farmers & M. Bank*, 52 Pa. 232 (1866).

9. *Geysler-Marion Gold Min. Co. v. Stark*, 106 Fed. 558 (C. C. A. 8th, 1901); *Marbury v. Ehlen*, 72 Md. 206, 19 Atl. 648 (1890); *Shaw v. Spencer*, 100 Mass. 382 (1870); *Bohlen's Estate*, 75 Pa. 304 (1874).

10. *Geysler-Marion Gold Min. Co. v. Stark*, 106 Fed. 558, 561 (C. C. A. 8th, 1901).

11. *Brewster v. Sime*, 42 Cal. 139 (1871); *Thompson v. Toland*, 48 Cal. 99 (1874); *Fletcher v. Kidder*, 163 Cal. 769, 127 Pac. 73 (1912); *Northwestern Portland Cement Co. v. Atlantic Portland Cement Co.*, 174 Cal. 308, 163 Pac. 47 (1917).

12. *Thompson v. Toland*, 48 Cal. 99 (1874); see *Andrew v. City-Commercial Sav. Bank*, 205 Iowa 42, 46, 217 N. W. 431, 432 (1928).

13. *Lowry v. Commercial & Farmers' Bank*, 15 Fed. Cas. No. 8581 (C. C. Md. 1848); *Marbury v. Ehlen*, 72 Md. 206, 19 Atl. 648 (1890); *Wooten v. Wilmington & W. R. R.*, 128 N. C. 119, 38 S. E. 298 (1901); *Caulkins v. Gas Light Co.*, 85 Tenn. 683, 4 S. W. 287 (1887).

The trustee cases are frequently distinguished on the ground that executors and administrators normally have the power to dispose of property entrusted to their charge whereas trustees commonly have no such power. *Geysler-Marion Gold Min. Co. v. Stark*, 106 Fed. 558, 562 (C. C. A. 8th, 1901).

14. See *Patten*, *supra* note 6, at 976.

15. *Smith v. Nashville & D. R. R.*, 91 Tenn. 221, 18 S. W. 546 (1891). However, since the Rules of the New York Stock Exchange require the production by executors and administrators of all the documents requisite for fulfilling the duty outlined, this would not seem to burden corporate transfer agents unduly. These Rules are collected in *CHRISTY, op. cit. supra* note 1, at 719. Where *F* is an administrator c. t. a., no inquiry by the corporation is necessary.

16. *Webb v. Graniteville Mfg. Co.*, 11 S. C. 396 (1879).

17. *Peck v. Providence Gas Co.*, 17 R. I. 275, 23 Atl. 967 (1891).

18. *CHRISTY, op. cit. supra* note 1, § 263; Note (1934) 82 U. of Pa. L. Rev. 523.

immunity from liability to *B*. An evaluation of the rule, however, must necessarily involve a determination of the status of *T* in the hypothetical situation presented.

The Status of the Transferee

In most corporate charters and by statute in some states, it is provided that shares shall be transferred only on the books of the corporation.¹⁹ Strictly construed, this would indicate that *T* does not acquire the status of a shareholder until registration of the transfer has been made on the corporate books. However, the status of shareholdership, like many other legal concepts, involves a multitude of legal incidents. Generally, the rule is that, as between the parties to the transfer, an unregistered transfer is valid notwithstanding the statutory or charter provisions.²⁰ Thus, as against *F*, *T* is entitled to all the benefits²¹ and, conversely, must assume the duties accruing to the shareholdership. However, in all matters concerning the corporation and its internal management, the corporation is entitled to treat as shareholders only those persons whose names appear on the corporate books.²² Thus, under a given set of operative facts, *T* may, for some purposes, be treated as a shareholder before the transfer is registered while, for other purposes, he may not. It is evident, therefore, that statutory or charter provisions are not conclusive on the point.

In the hypothetical situation assumed, it was stated that *T* purchased share certificates from *F* without actual notice of *F*'s breach of his fiduciary duty. Clearly, if *T* pays value, believing *F* to be the owner, as a bona fide purchaser, he receives the property free of any claims of *B*.²³ On the other hand, where *T* has actual notice of *F*'s breach of duty, he takes the property subject to the rights of *B* and will incur liability to *B* if he disposes of it.²⁴ The same liability will attach when *T* has constructive notice of the breach of the fiduciary relationship.²⁵ In all the factual situations assumed with reference to the corporation's duty of inquiry in making transfers, some duty of inquiry was found to exist. It would seem advisable, therefore, to determine whether the same facts will also serve as constructive notice to the transferee.

Turning first to the case where *F* is described on the share certificate as "*F*, trustee," it is generally recognized that this fact constitutes sufficient notice of the existence of a trust.²⁶ However, "a purchaser of trust property is not

19. "Shares of stock in every corporation shall be deemed personal property and transferable on the books of the corporation in such manner and under such regulations as the by-laws provide. . . ." DEL. REV. CODE (1935) c. 65 § 16.

20. *Winter v. Montgomery Gas Light Co.*, 89 Ala. 544, 7 So. 773 (1889); *Law & Co. v. Cleveland*, 172 S. C. 200, 173 S. E. 638 (1934); *Gowans v. Rockport Irr. Co.*, 71 Utah 198, 293 Pac. 4 (1930); *Lowell, Transfer of Stock* (1884) § 89.

21. *Richter & Co. v. Light*, 97 Conn. 364, 116 Atl. 600 (1921).

22. *Hawkins v. Glenn*, 131 U. S. 319 (1889); *Brisbane v. Delaware L. & W. R. R.*, 94 N. Y. 204 (1883).

23. *Ames, Purchase for Value Without Notice* (1887) 1 HARV. L. REV. 1, 16; *Ballantine, Purchase for Value and Estoppel* (1921) 6 MINN. L. REV. 87, 92; *Kenneson, Purchase for Value Without Notice* (1914) 23 YALE L. J. 193.

24. RESTATEMENT, TRUSTS (1935) § 288; see *Scott, Participation in a Breach of Trust* (1921) 34 HARV. L. REV. 454.

25. RESTATEMENT, TRUSTS (1935) § 297, comment *a*: "A third person has notice of a breach of trust not only when he knows of the breach, but also when he should know of it; that is when he knows facts which under the circumstances would lead a reasonably intelligent and diligent person to inquire whether the trustee is a trustee and whether he is committing a breach of trust; and if such inquiry when pursued with reasonable intelligence and diligence would give him knowledge or reason to know that the trustee is committing a breach of trust."

26. 4 *BOGERT, TRUSTS AND TRUSTEES* (1935) § 902. Ordinarily, the registered name of the stockholder appearing on the corporate books must also appear on the face of the share certificate together with other pertinent facts. See, for example, *ILL. REV. STAT.* (Cahill, 1933) c. 32, § 21.

liable merely because at the time of the purchase he knew of the existence of the trust attaching to the property . . . it must appear also that he knew or ought to have known that the trustee was committing or contemplating the commission of a breach of trust."²⁷ Whether or not the transferee has such constructive notice will depend ultimately on the circumstances surrounding the transfer.²⁸ "If a reasonable inquiry shows that the transferor has apparently authority to make the sale. . . and there is nothing in the nature of the transaction to indicate a breach of trust, the transferee is not bound to inquire further."²⁹ But if *T* knows that *F* is making the transfer in payment of his individual indebtedness,³⁰ or for his own personal advantage,³¹ or is disposing of the property at much less than its actual value,³² he will be liable to *B* unless a reasonable inquiry would fail to disclose a breach of trust. In the absence of such circumstances, however, where *F* is described on the share certificate as "*F*, trustee," *T* will be regarded as a bona fide purchaser of the shares.

So also, where the shares are transferred by an executor or administrator of a named or unnamed decedent, the transferee will be regarded as a bona fide purchaser in the absence of any actual or constructive knowledge of fraud on the part of the executor or administrator.³³ Here also, what is constructive notice will depend on the surrounding circumstances. However, in the absence of facts which should arouse his suspicion, the transferee is protected. Compared to the purchaser from a trustee, his burden of inquiry is less inasmuch as it is the executor's primary duty to dispose of the assets and settle the estate.³⁴

With respect to the transferee, therefore, two conclusions may be drawn: (1) where *T* in purchasing shares from *F*, has notice of the fact that *F* is a fiduciary but does not know or have reason to know any facts which should serve to put him on inquiry as to the absence of *F*'s authority to sell, *T* secures both legal and equitable title free and clear from any claim of *B*; (2) although both statutes and corporate charters often provide that no transfer of shares shall be made except upon the books of the corporation, at least as between transferor and transferee, an unregistered transfer is effective and, in some instances, as in the case of attaching creditors of the transferor, an unregistered transfer is also effective as against third persons. The principles enunciated in the foregoing analysis should provide a basis for an evaluation of the strict liability imposed on the corporation for registering an unauthorized transfer.

Evaluation of the Rule

This rule, which never existed in England,³⁵ was first pronounced in this country in 1848 by Judge Taney in *Lowry v. Commercial & Farmers' Bank*.³⁶ This decision, indicating that a corporation would be liable for registering an

Regarding the mechanics of stock transfers and the rights and liabilities attendant thereto see Rice, *The Issuance and Transfer of Corporate Stock* (1936) 5 J. KAN. BAR ASS'N 125, 128; Behrends & Elliot, *Responsibilities and Liabilities of the Transfer Agent and Registrar* (1931) 4 So. CALIF. L. REV. 203.

27. Scott, *supra* note 24, at 455.

28. RESTATEMENT, TRUSTS (1935) § 297, comment a.

29. Scott, *supra* note 24, at 459.

30. Johnson v. Amberson, 140 Ala. 342, 37 So. 273 (1903); Cohen v. Parish, 105 Ga. 339, 31 S. E. 205 (1898); Smith v. Burgess, 133 Mass. 511 (1882).

31. Duncan v. Jaudon 15 Wall. 165 (U. S. 1872); Henshaw v. State Bank, 239 Ill. 515, 88 N. E. 214 (1909); Clemens v. Hecksher, 185 Pa. 476, 40 Atl. 80 (1898).

32. Baker v. Wood, 157 U. S. 212 (1895); Storrs v. Wallace, 28 N. W. 662, 61 Mich. 437 (1886).

33. Schell v. Deperven, 198 Pa. 600, 48 Atl. 813 (1901); Note, ANN. CAS. 1912-c 980.

34. Wood's Appeal, 92 Pa. 379 (1880); cf. *supra* note 13.

35. Hartga v. Bank of England, 3 Ves. 55 (Ch. 1796); Bank of England v. Parsons, 5 Ves. 665 (Ch. 1800); see Franklin v. Bank of England, 9 B. & C. 156 (K. B. 1829).

36. 15 Fed. Cas. No. 8581 (C. C. Md. 1848).

improper transfer of shares by an executor, was predicated upon the following concept: "The corporation is thus made the custodian of the shares of stock, and clothed with power sufficient to protect the rights of everyone interested, from unauthorized transfers; *it is a trust placed in the hands of the corporation* for the protection of individual interests, and like every other trustee, it is bound to execute the trust with proper diligence and care, and is responsible for any injury sustained by its negligence or misconduct."³⁷ The validity of this pronouncement, however, cannot be sustained.³⁸ The corporation is not and cannot be the custodian of the shares of stock. At most, the corporation is custodian of the transfer books which are kept not for the benefit of its shareholders but for the benefit of the corporation itself and its creditors.³⁹ Furthermore, it is difficult to perceive any trust relationship between the corporation and its stockholders with respect to shares of stock. Taney based his theory on the rule that, *as against the corporation*, an unregistered assignee has no title to the shares.⁴⁰ This may be conceded, but since title may pass as against everyone except the corporation without registration⁴¹ and since the corporation has no control over transfers other than to refuse transfers not authorized by the registered owner,⁴² there would seem to be little basis left for the theory. In addition, the situation of a corporation in registering an unauthorized transfer is totally different from the ordinary case where a third party participates in a breach of trust inasmuch as the corporation derives no benefit from registering the transfer, unauthorized or otherwise. Thus, in any case, there is little reward for the burden placed upon it.

Further criticism may perhaps best be effected by reference to an actual application of the rule. The leading case defining the rule of corporate liability for registering unauthorized transfers of shares is *Geysler-Marion Gold Mining Co. v. Stark*.⁴³ In that case, the shares held in trust were registered on the books of the defendant corporation in the name of "Felix J. Stark, trustee." The trustee fraudulently assigned the shares and the corporation registered the transfer. It was held that the word "trustee" on the corporate books was sufficient notice of the equitable interest of the plaintiff and that the corporation was liable for its negligence in registering the transfer. In response to the counsel's argument that the breach of trust was complete before registration of the transfer and that, consequently, the act of the corporation had not injured the plaintiff, the court declared that the purchaser also took with notice of the trust and, therefore, no title had passed to him until the transfer was registered.

The liability which is imposed on the corporation for registering unauthorized transfers arises out of the duty which, it is said, is owed the holder of the beneficial interest. A breach of this duty is negligence, but to impose liability, it must further appear that it has been the proximate cause of the loss to *B*.⁴⁴ However, it would seem impossible to reach this result and still be consistent

37. *Ibid.* (Italics supplied.)

38. "It seems to me extremely important not to throw any doubt on the principle that companies have nothing whatever to do with the relations between trustees and their cestui que trusts in respect of the shares of the company. If a trustee is on the company's register as a holder of shares, the relations which he may have with some other person in respect of the shares are matters in which the company has nothing whatever to do; they can only look to the person whose name is on the register." *In re Perkins*, 24 Q. B. D. 613, 616 (1890). See also Note (1918) 3 MASS. L. Q. 282, 284.

39. *Dennistoun v. Davis*, 179 Minn. 373, 229 N. W. 353 (1931); *CHRISTY, op. cit. supra* note 1, § 31.

40. *Lowry v. Commercial Bank*, 15 Fed. Cas. No. 8581 (C. C. Md. 1848).

41. *LOWELL, loc. cit. supra* note 20.

42. See *supra* note 18.

43. 106 Fed. 558 (C. C. A. 8th, 1901).

44. *Smith v. Nashville & D. R. R.*, 91 Tenn. 225, 18 S. W. 546 (1891).

with the reasoning employed in the *Geyser-Marion* case. Thus, to meet the argument that registration of the transfer was not the proximate cause of the loss, the court decided that *T* took with notice of the trust and, hence, the rights of *B* were not cut off prior to the registration of the transfer by the corporation.⁴⁵ However, the court did hold the corporation liable to *B* in damages for the full value of the shares. Since *B* had not been damaged prior to the registration, it must follow that the act of registering the transfer served to pass title *as between B and T*, whereas, as has already been indicated, the sole effect of registration is to pass title as between the parties to the transfer and the corporation.

Stated differently, the necessary but inconsistent implications of the rule may arise in either of two ways: (1) Both the corporation or its transfer agent and the purchaser or transferee have the same opportunity for ascertaining the existence of the trust. If *T* is treated as a bona fide purchaser of the shares, then at the outset we have established different rules as to what constitutes constructive notice of a breach of trust (a) as applied to the corporation and (b) as applied to the purchaser. Moreover, if *T* is a bona fide purchaser, he does not take subject to the trust and *B*'s equities are cut off before the corporation registers the transfer, since, as between *B* and *T*, title has already passed. Thus, the corporation's act in registering the transfer cannot be the proximate cause of *B*'s loss.⁴⁶ Thus, in the light of the conclusion arrived at previously, that *T* is a bona fide purchaser of the shares, a logical basis for holding the corporation liable to *B* for the loss of the shares would appear to be lacking. *B* should be left rather to his remedy against *F*.⁴⁷ (2) However, if *T* is not treated as a bona fide purchaser of the shares but rather as taking them subject to the trust, then *B*'s rights are not cut off and *B* suffers no loss for which he can hold the corporation liable unless we are prepared to say that registration of the transfer by the corporation has the effect of passing title between *B* and *T*. It seems inconsistent to allow *B* to recover the full value of his shares from the corporation since he may also have an action not only against *F* but also against *T*, the purchaser with notice of the trust. If *B* is allowed to recover from the corporation at all, his recovery should be limited to compelling the corporation to issue him a new certificate.⁴⁸

The clearest analogy to the liability of a corporation for registering an unauthorized transfer of corporate shares standing in the name of a fiduciary would seem to be that of a bank honoring checks drawn by a trustee on a trust deposit when the transaction is, in fact, in breach of trust. It is well settled in this situation also that the bank is liable for participation in a breach of trust if it in fact had *actual* notice thereof.⁴⁹ However, in cases of constructive notice, the harsh burden of inquiry imposed on a corporation in registering transfers of shares is absent.⁵⁰ In the absence of actual notice of the trustee's fraud, the

45. *Geyser-Marion Gold Min. Co. v. Stark*, 106 Fed. 558, 565 (C. C. A. 8th, 1901).

46. See *Dodd v. Hills*, 2 H. & M. 424, 427 (Ch. 1865).

47. *B*, of course, has an action against *F* for the breach of his duties as a fiduciary. RESTATEMENT, TRUSTS (1935) § 205 *et seq.*

48. As to damages for conversion of shares of stock, generally, see Note (1934) 82 U. OF PA. L. REV. 523. Although the beneficiary in the *Geyser-Marion* case prayed in one count to be reinstated on the books of the corporation as a shareholder, the court awarded money damages despite the fact that *T* was held not to be a bona fide purchaser.

49. *Board of Comm'rs v. Strawn*, 157 Fed. 49 (C. C. A. 6th, 1907); *Tesene v. Iowa State Bank*, 186 Ia. 1385, 173 N. W. 918 (1919); *Watts v. Board of Comm'rs*, 21 Okla. 231, 95 Pac. 771 (1908).

50. *Federal Heating Co. v. Buffalo*, 182 App. Div. 128, 170 N. Y. Supp. 515 (4th Dep't, 1918); *Interstate Nat. Bank v. Claxton*, 97 Tex. 569, 80 S. W. 604 (1904); 1 MORSE, BANKS & BANKING (5th ed. 1928) § 317.

burden of inquiry attaches only where the payment, under the circumstances, is "presumptively wrongful".⁵¹ Thus, where a depositor pays a personal debt to the bank by a check drawn on a fiduciary account, the bank is chargeable with notice of the breach of trust.⁵² But in the absence of circumstances from which the bank should know that the withdrawal is in breach of trust, it is under no affirmative duty to inquire concerning the trustee's authority.⁵³ Similarly, where a customer deposits with a broker, securities standing in the name of the customer as trustee, for the purpose of selling the securities and investing the proceeds, the burden of inquiry placed on the corporation registering transfers of shares finds no parallel. No liability attaches to the broker for participation in a breach of trust in the absence of actual notice of the trustee's fraud.⁵⁴

Finally, there is an important practical objection to the rule. For its own protection, a corporation must investigate the propriety of any transfer made by a fiduciary. In many cases, this would necessitate an interpretation of a deed of trust or a will.⁵⁵

Statutory Modifications

Despite its inconsistencies and harsh implications, the rule seems to have become well settled in this country before 1900.⁵⁶ Conflicting decisions exist only in California⁵⁷ and those few other states⁵⁸ where the mere addition of the word "trustee" or "executor" after the name of the registered shareholder was held not to be sufficient notice of the existence of a beneficial interest. The split, therefore, is not on the merits of the rule as a common law principle but rather on the more technical question of *notice* of the existence of a trust. The common law rule is supported by the *Restatement of Trusts* in the following language⁵⁹: "If a trustee in whose name are registered shares of stock, bonds, or other securities of a corporation transfers the securities in breach of trust and the corporation registers the transfer, it is liable for participation in the breach of trust if, but only if, at the time when it registered the transfer it had notice of the breach of trust." At first sight, this section would appear to alleviate the common law rule. However, "notice of the breach of trust" is explained by the reporter to mean that "if shares of stock are registered in the name of the trustee

51. Scott, *supra* note 24, at 475. See also Thulin, *Misappropriation of Funds by Fiduciaries: The Bank's Liability* (1918) 6 CALIF. L. REV. 171.

52. United States Fidelity & Guar. Co. v. Union Bank, 228 Fed. 448 (C. C. A. 6th, 1915); Rodgers v. Bankers Nat. Bank, 179 Minn. 197, 229 N. W. 90 (1930); Bischoff v. Yorkville Bank, 218 N. Y. 106, 112 N. E. 759 (1916).

53. "In certain cases, particularly in New York, the courts have gone very far in holding a depository bank chargeable with constructive notice of the depositor's misconduct. . . . The bank it is submitted should not be liable unless some officer or employee has actual knowledge of the depositor's misconduct or knowledge of facts so clearly indicating such misconduct as to show that the bank was guilty of bad faith." Scott, *supra* note 24, at 476, 481.

54. "The mere fact, however, that an account is opened with the broker in the name of a customer as 'trustee' does not put the broker upon inquiry as to the existence and terms of the trust; and if the broker does not know or have reason to know that the customer is a trustee and that he is committing a breach of trust, he is not liable." RESTATEMENT, TRUSTS (1935) § 326, comment b.

55. Grinnel, *Transfers of Stock in Illinois Corporations Held in Trust* (1922) 16 ILL. L. REV. 522, 523. As stated by an English court in rejecting the rule: "the consequence would be exceedingly alarming, if in all cases, where the . . . [corporation] is to take notice of the execution of the trust. The consequence would be that for every legacy in trust of stock, there must be a bill in Chancery." Hartga v. Bank of England, 3 Ves. 55, 58 (Ch. 1796).

56. LOWELL, *op. cit. supra* note 20, §§ 149-159.

57. See *supra* note 11.

58. See *supra* note 12.

59. RESTATEMENT, TRUSTS (1935) § 325.

followed by words indicating that he is trustee, the corporation is bound to inquire whether the trustee is committing a breach of trust in making the transfer, and is liable for participation in the breach of trust if such inquiry would indicate that the trustee was committing a breach of trust."⁶⁰ Clearly, therefore, the *Restatement of Trusts* has adopted the majority common law rule.

The unpopularity of the rule is evidenced by the number of statutes passed both in this country and abroad expressly avoiding the doctrine or severely limiting its requirements. In *Simpson v. Molson's Bank*⁶¹ a Canadian bank had registered an unauthorized transfer of shares by a trustee under a will. The Privy Council liberally construed the Act incorporating the bank, which provided that the bank was not bound to see to the execution of any trust, and held that in the absence of any actual knowledge of a breach of trust, the bank was not liable for registering the transfer. The Companies Consolidation Act passed in 1908 provided that "No notice of any trust, expressed, implied, or constructive, shall be entered on the register, or be receivable by the registrar, in the case of companies registered in England or Ireland."⁶² In the United States the first state to avoid the rule by statute was Pennsylvania.⁶³ This statute differed from its English predecessor and provided simply that the corporation should not be liable for a wrongful transfer in the absence of actual notice, in writing, of the breach of trust.⁶⁴ Other states have adopted similar statutes.⁶⁵

The most important statutory change was effected by Section 3 of the Uniform Fiduciaries Act providing that the corporation shall not be liable unless the transfer was made with actual knowledge of the fiduciary's breach of duty or "*with knowledge of such facts that the action in registering the transfer amounts to bad faith.*"⁶⁶

Of course, a problem still remains as to the interpretation of the last clause. However, it is evidently less stringent than the burden of inquiry imposed by the *Restatement of Trusts*. Although the Fiduciaries Act had been adopted by

60. *Id.*, comment c.

61. (1895) A. C. 270.

62. 8 EDW. VII, c. 69, § 27 (1908). See also 8 VICT. c. 16, § 20 (1845). "The company shall not be bound to see to the execution of any trust, whether express, implied, or constructive, to which any of the said shares may be subject; and the receipt of the party in whose name any such share shall stand in the books of the company . . . shall . . . be a sufficient discharge of the company for any dividend or other sum of money payable in respect of such share, notwithstanding any trusts to which such share may then be subject, and whether or not the company has had notice of such trusts; and the company shall not be bound to see to the application of the money paid upon such receipt."

63. PA. STAT. ANN. (Purdon, 1930) tit. 20, § 3151. Pennsylvania has also adopted the Uniform Fiduciaries Act. PA. STAT. ANN. (Purdon, 1930) tit. 20, § 3313.

64. The early Pennsylvania statute was as follows: "All certificates of stock . . . hereafter . . . issued by this commonwealth, or by any . . . corporation, shall be transferable by the legal owner thereof, without any liability on the part of the transfer agents of the commonwealth, or . . . corporation permitting such transfers, to recognize or see to the execution of any trust, whether expressed, implied, or constructive, to which such stocks or loans may be subject, unless when such transfer agents . . . charged with the duty of permitting such transfer to be made, shall have previously received actual notice in writing, signed by or on behalf of the person . . . for whom such stock or loans appear by the certificate thereof to be held in trust, that the proposed transfer would be a violation of such trust."

65. CAL. CIV. CODE (Deering, 1931) § 328b; DEL. REV. CODE (1935) c. 98, § 3859; ILL. REV. STAT. (Cahill, 1933) c. 140a, § 3; KY. STAT. (Carroll, 1936) c. 128, § 4707; 2 MASS. GEN. LAWS (1932) c. 203, § 21; Md. LAWS 1927, c. 671; OHIO GEN. CODE ANN. (Throckmorton, 1935) § 8623-33.

66. 9 U. L. A. 145 (1932). (Italics supplied.) The Act is discussed in Legis. (1933) 81 U. OF PA. L. REV. 863.

five states as early as 1923,⁶⁷ as yet, no cases have arisen under Section 3.⁶⁸ However, the obvious harshness of the common law rule, its apparent inconsistency and, especially, its effect in retarding the progress which has been made under the Uniform Stock Transfer Act in furthering the transferability of share certificates,⁶⁹ indicate a prophecy that the courts will find the Uniform Fiduciaries Act to have limited the common law rule to those cases where the corporation, in registering the transfer, had actual notice of the fiduciary's breach of duty.

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67. Colorado, Nevada, New Mexico, North Carolina and Pennsylvania adopted the Act in 1923. 9 U. L. A. 146 (1932).

68. The only case arising in a state which had adopted the Uniform Fiduciaries Act was *West v. Tintic Standard Min. Co.*, 71 Utah 158, 263 Pac. 490 (1928). However, § 3 was not applied since the unauthorized transfer took place in January, 1925, and the Act was not operative until May 12, 1925.

69. See the Commissioner's Notes, 6 U. L. A. 2 (1922).