McGILL LAW JOURNAL
Montreal
Vol. 23 1977 *No. 4*

The Transfer of Shares: Part VI of The Canada Business Corporations Act 1975

D. D. Prentice*

In advanced industrialized countries, wealth is characteristically non-tangible and largely takes the form of "promises".[1] Nowhere is this intangibility more clearly demonstrated than in corporate securities which have become one of the major sources of wealth in capitalist societies.[2] That most quintessential form of corporate security, the share, has repeatedly been defined as a bundle or congery of rights which a shareholder has against his company and, to a lesser extent, his fellow shareholders.[3] These rights are primarily found in the corporate constitution and partly in the relevant Corporations Act which, in some jurisdictions, clearly recognizes a shareholder's rights as contractual in nature.[4] Even in those jurisdictions which do not explicitly provide for this, the mechanisms

* Fellow, Pembroke College, Oxford.

1 See Pound, *An Introduction to the Philosophy of Law* rev. ed. (1954), 133: "Wealth, in a commercial age, is made up largely of promises".

2 *E.g.*, in 1973 the market value of company securities quoted on the London Stock Exchange was £148,170,576 million: see *The Stock Exchange Fact Book* (1973), 3. For a survey of the structure of wealth holding in the form of corporate securities see Royal Commission on the Distribution of Income and Wealth, Report No.2, *Income from Companies and its Distribution*, Cmnd. 6172 (1975) (U.K.) and for Canada see "Canada's Capital Market" in Shaw and Archibald (eds.), *The Management of Change in the Canadian Securities Industry*, Study One (1972).

3 *Archibald Howie Pty Ltd* v. *Commissioner of Stamp Duties* (1948) 77 C.L.R. 143, 157 (Austl.H.C.); *Borland's Trustee* v. *Steel Bros & Co.* [1901] 1 Ch.279, 288 (Ch.Div.).

4 See, *e.g.*, *Companies Act, 1948*, 11-12 Geo.VI, c.38, s.20 (U.K.); *Companies Act*, S.B.C. 1973, c.18, s.15.

available to a shareholder to enforce his rights have a contractual flavour to them.[5] Whatever the precise juridical nature of a shareholder's relationship[6] with his company, it is clear that because of his status, a shareholder has a collection of rights enforceable against his company and fellow shareholders.

One of these rights, and unquestionably one of the most important, is the right to transfer shares. It is this liquidity of the share — the ability to realize the value of the share expeditiously and without undue transaction costs — that constitutes one of its most attractive features as an item of property.[7] Commercial practice, in the form of stock exchange rules, underlines this aspect of share ownership by making it a condition of listing that such shares be free from any restriction on their transferability.[8] Also, where possible, the brokerage community has maximized this feature of the share.[9] Nevertheless, while transferability may be the norm, small private companies often impose restrictions of varying severity, primarily in order to obtain the benefits of a partnership structure and, in particular, to vest in the members of the company the right to control the admission of new members. The validity and operation of these restrictions will be discussed later.

It is proposed in this article to discuss the various legal problems which arise on the transfer of company shares, with particular attention being paid to Part VI of the *Canada Business Corporations Act*[9a] (hereafter referred to as the *C.B.C.A.*) which introduces Article 8 of the United States *Uniform Commercial Code* (hereafter referred to as the *U.C.C.*). A transfer of shares to be effective will give rise to three distinct sets of legal problems: (i) those pertaining to the relationship between the transferor and transferee; (ii) those relat-

---

[5] See generally Beck, "An Analysis of *Foss v. Harbottle*" in Ziegel (ed.), *Studies in Canadian Company Law* (1967), vol.1, 545, 585-89.

[6] As Laskin J. pointed out in *Edmonton Country Club Ltd* v. *Case* [1975] 1 S.C.R. 534, 552, (1974) 44 D.L.R. (3d) 554, 556, the differences flowing from the particular form of incorporation should not be exaggerated. Once a memorandum of association company has been incorporated, then "its contractual aspect is submerged in a statutory regime subjecting the company to public regulation".

[7] An aspect which was recognized early by the courts: see *In re Smith, Knight & Co.* (1868) 4 Ch.App. 20, 27.

[8] See, *e.g.*, the requirements for listing in Rules of the London Stock Exchange, App.34, Sch. VII A(2): "That fully-paid shares shall be free from any restriction on the right of transfer and shall also be free from all liens."

[9] See Select Committee on Company Law, *Interim Report*, Ont. (1972), ch.VI, dealing with "street form" certificates.

[9a] S.C. 1974-75-76, c.33.

ing to the transferor and the company; and lastly, (iii) those affecting the transferee and the company.[10] Hovering over this triptych will be the rights of the true owner if the transfer is made without his consent.[11] Although these problems will be examined in more detail later, an overview of Part VI of the *C.B.C.A.* may prove useful in order to appreciate more fully the legislative purpose underlying this part of the Act.

PART VI OF THE CANADA BUSINESS CORPORATIONS ACT 1975

Part VI introduces Article 8 of the *U.C.C.*[12] whose basic purpose is to render the securities[13] to which it applies negotiable; subsection 44(3) of the *C.B.C.A.* explicitly provides that a "security is a negotiable instrument". This constitutes a radical alteration in the previous nature of a share. Although the commercial community attempted, as far as was legally possible, to approximate shares to the position of negotiability,[14] in general, legal opinion held that they did not possess such features.[15] Even in the case where the transferor endorsed the transfer in blank, quasi-negotiability was only achieved under the old regime by use of the doctrine of estop-

---

[10] See Gower, *The Principles of Modern Company Law* 3d ed. (1969), 394-98.

[11] There will also be contractual relationships between the transferor and transferee and their respective brokers, and between the brokers *inter se.* These will not directly concern us here and will only be touched upon in passing.

[12] A number of articles have been published on the operation of article 8 of the *U.C.C.*, the most helpful being Folk, *Article Eight: Investment Securities* (1966) 44 N.C.L.Rev. 654; Folk, *Article Eight: A Premise and Three Problems* (1967) 65 Mich.L.Rev. 1379; Israels, *Article 8 — Investment Securities* (1951) 16 Law & Contemp.Prob. 249.

[13] The types of security subsumed within the ambit of Part VI are defined in subs.44(2) which is designed to cover those instruments which the financial community treats as securities. As has been pointed out in the American literature dealing with art.8 of the *U.C.C.*, the definition in this context is not as expansive as that under securities legislation: see, *e.g.*, *Re Western Ontario Credit Corp. and Ontario Securities Commission* (1976) 9 O.R. (2d) 93 (H.C.) in that the latter is designed to prevent investors from being defrauded: see Folk, *Article Eight: A Premise And Three Problems, supra,* note 12, 1387-88.

[14] See *supra,* note 9.

[15] Wegenast, *The Law of Canadian Companies* (1931), 560-63; *Chartered Trust & Executor Co. v. Pagon* [1950] 4 D.L.R. 761, 767-68 (Ont.H.C.).

pel.[16] As Spence J. stated, the question was whether "the plaintiff ... acted so as to preclude [himself] from setting up a claim to the certificates".[17] This attribution of negotiability to investment securities is designed to create a state of affairs where,

> [a]s against a purchaser for value without notice of a defense, the issuer must as far as possible be precluded from raising that defense; and one whose title is defective must be able nonetheless to convey a better title than he has, so that the purchaser for value without notice of a claim of ownership will not be subject to it.[18]

In other words, negotiability deals with two separate and distinct issues: (i) defences which an issuer[19] might raise against the holder of its securities and (ii) claims of ownership rights or interests which may be asserted against the transferee of a corporate security. This last aspect is central to any transaction involving a transfer of corporate securities and will be dealt with in more detail later. Its central tenet, however, must be clearly grasped: in situations of conflict between the interests of true owners and those of a *bona fide* purchaser, the interests of the latter will, on the whole, be preferred. The former issue, however, needs some elaboration at this juncture for a better understanding of how Part VI of the *C.B.C.A.* operates.

By reducing the scope of issuer defences, the issuer's ability to raise defences which go to the validity of the security against a holder of its security is limited. The result of this will be to enhance negotiability in that a holder will not run the risk of having the validity of his security challenged successfully by the company. Subsection 51(2) of the *C.B.C.A.* provides that a security is "valid" in the "hands of a purchaser for value without notice of any defect going to its validity". "Validity" in turn is defined[20] in terms of compliance with "the applicable law and the articles of the issuer". Thus, by subsection 51(2), once a security has found its way into the hands of a *bona fide* purchaser for value without notice then the issuer is precluded from contesting its validity.

---

[16] Wegenast, *supra*, note 15, 560-63. The position on this under English law is less clear although the submission of Gower that the owner should be estopped is both preferable in terms of principle and practical convenience: see Gower, *supra*, note 10, 406.

[17] *Aitken* v. *Gardiner & Watson* (1956) 4 D.L.R. (2d) 119, 131 (Ont.H.C.).

[18] Israels, *supra*, note 12, 249.

[19] "Issuer" is defined in subs. 44(2) of the *C.B.C.A.* In this article issuer and company (and their various synonyms) will be used interchangeably.

[20] *C.B.C.A.*, subs. 44(2).

The liability of an issuer, however, is not absolute since subsection 51(3) provides a company with a "complete defence" where the security is not "genuine", that is, counterfeit or forged.[21] But even the scope of this defence is constricted by a full-blooded statutory version of the principle formulated in *Lloyd* v. *Grace Smith & Co.*[22] Section 53 of the *C.B.C.A.* provides that,

> [a]n unauthorized signature on a security before or in the course of issue is ineffective, except that the signature is effective in favour of a purchaser for value and without notice of the lack of authority, if the signing has been done by
>
> (a) an authenticating trustee, registrar, transfer agent or other person entrusted by the issuer with the signing of the security, or of similar securities, or their immediate preparation for signing; or
>
> (b) an employee of the issuer or of a person referred to in paragraph (a) who in the ordinary course of his duties handles the security.

As "unauthorized" is defined so as to include not only its normal agency meaning, excess of actual authority, but also forgery,[23] it means that a company will be liable for the forgeries of those who might, in the normal course of events, come in contact with its securities either at the time of initial allotment or at the time of their subsequent transfer. It is important to note that the test is not one of apparent authority, that is, did the issuer create the appearance of authority in the agent to issue the securities, but merely one of fact, that is, does the person entrusted with signing fall within section 53.[24] The operation of this aspect of issuer defences can be illustrated by assessing its effect on three cases: *South London Greyhound Racecourses Ltd* v. *Wake*,[25] *Ruben* v. *Great Fingall Consolidated*[26] and *Toronto-Dominion Bank* v. *Consolidated Paper Corp.*,[27] all of which would have been decided differently had Part VI been operative.

---

[21] *C.B.C.A.*, subs. 44(2): "'genuine' means free of forgery or counterfeiting".

[22] [1912] A.C. 716 (H.L.).

[23] *C.B.C.A.*, subs. 44(2): "'unauthorized' in relation to a signature or an endorsement means one made without actual, implied or apparent authority and includes a forgery".

[24] Note, in particular, subs. 53(b) of the *C.B.C.A.* which makes a company liable for the acts of one who "in the ordinary course of his duties handles the security".

[25] [1931] 1 Ch.496 (H.L.).

[26] [1906] A.C. 439 (H.L.).

[27] (1962) 37 D.L.R. (2d) 424 (Que. C.A.).

South London Greyhound Racecourses Ltd v. Wake

In this case D and G, the director and secretary of the plaintiff company, without authority,[28] appended their signatures to a share certificate of the plaintiff company and issued it to Wake to secure the debt of another company of which they were also officers. When the fraud of D and G was discovered the plaintiff company sought both a declaration that Wake was not entitled to the shares and a court order that the register should be rectified accordingly. The court held against Wake. The seal had been affixed to the share certificate without the requisite authority of the directors and the matter in question was not something which fell within the apparent authority of either D or G. This case has been strongly criticized,[29] criticisms that are now beside the point since under section 53 the company would be considered bound by the acts of D and G who were manifestly persons authorized to handle the share certificates of the company.

Ruben v. Great Fingall Consolidated

Here the secretary forged the names of the company's directors to a share certificate and attached the corporate seal without authority. The court held the certificate to be a nullity and not enforceable against the company. Again the outcome of this decision would be different under Part VI.[30]

Toronto-Dominion Bank v. Consolidated Paper Corp.[31]

In this case B, a junior employee in the defendant company's transfer department, obtained possession of blank share certificates and completed them by forging the relevant details. They were then lodged with the plaintiff bank as security for a loan. When the forgery was discovered the defendant company denied liability and

---

[28] Under the articles of association of the plaintiff company the corporate seal could only be affixed pursuant to a resolution of the board of directors.

[29] Gower, *supra,* note 10, 166-68.

[30] *Cf.* the observations of Lord Macnaghten in *Ruben* v. *Great Fingall Consolidated, supra,* note 26, 444, that a decision against the plaintiff company would oblige companies to "lock up their seal and guard it as a dangerous beast". This remark misses the point in issue, namely, that the company is in the best position to guard against a misuse of the corporate seal and to guarantee that trustworthy corporate officials and agents are employed.

[31] See Dickerson, Howard and Getz, *Proposals for a New Business Corporations Law for Canada,* Information Canada (1971), vol.I, para.173 (hereafter referred to as *Proposals*).

the plaintiff brought an action alleging that the defendants had afforded B undue access to blank share certificates. For reasons which need not detain us here the plaintiff was unsuccessful. Under section 53 the situation would now be different, since B (although a junior employee of the company) had been authorized to handle the securities, the company would not be able to deny the validity of the allotment. The result would have been the same under section 53 even had the fraud been perpetrated not by an employee of the company but by an employee of its transfer agent.

Effectively, section 53 renders the issuer accountable for the acts of its employees or others entrusted with the task of handling its securities, accountability taking the form of validating the security in the hands of all *bona fide* purchasers for value without notice and not merely *subsequent* purchasers. As indicated previously, this will greatly enhance the negotiability of corporate securities. There are also sound policy reasons for imposing on the issuer the responsibility for guarding against defective issues. All the issuer has to do is to ensure that the appropriate corporate procedures are followed and that trustworthy employees or transfer agents are employed. Purchasers are not in an adequate position to do this, nor to protect themselves against the failure of the issuer to do so.

One last point on the curtailment of issuer defences requires some comment. It may be that the inability of a company to challenge the validity of a given share certificate will result in an "overissue", that is, the company issuing more securities of a class than it has authority under its constitution to issue.[32] For example, the validation of the shares, where the fraud of the corporate agent is akin to that in *Toronto-Dominion Bank* v. *Consolidated Paper Corp.*, could easily bring about this state of affairs. In this situation Part VI leaves a number of options open to the issuer. It can alter its constitution to authorize the issue (but cannot be compelled to do so) and if it does so then the overissued securities are "valid from the date of their issue".[33] If the company declines to adopt this course then the purchaser entitled to a valid certificate "may"[34]

---

[32] *C.B.C.A.*, subs. 44(2): " 'overissue' means the issue of securities in excess of any maximum number of securities that the issuer is authorized by its articles or a trust indenture to issue". And see Folk, *Some Problems Under Article 8 of The Uniform Commercial Code* (1964) 5 Ariz.L.Rev. 193, 207-11.

[33] *C.B.C.A.*, subs. 48(2).

[34] The use of the verb "may" leaves it open as to whether the issuer has the option of following this procedure. It would be preferable if it could be

compel the company to purchase a similar security if it is "reasonably available"[35] for purchase. Where this latter option is not available the purchaser is entitled to "damages" equal to the price the last purchaser for value paid for the invalid security.[36] However, this aspect of Part VI, like Article 8 of the *U.C.C.*,[37] has received some merited criticism. Not only is the language of the overissue section unclear in its purpose,[38] but there appear to be no good reasons for not validating the overissue. Fears for the dilution of existing holdings, or of the manipulation of corporate capital, seem unrealistic in this context.

The other aspect of negotiability dealt with by Part VI is the expedition and simplification of the transfer process, the limitation of the extent to which the owner of securities can impeach the title of a *bona fide* purchaser for value without notice,[39] and the curtailment of the extent to which defects in the title of a holder of a security travel with the instrument. This aspect of Article 8 of the *U.C.C.* has been summarized as having the following objective:

> [T]o facilitate a transferee's becoming a bona fide purchaser (which limits the duty of the transferee to investigate the transferor's title, and which gives the transferee immunity from defects in the issue of the security or in the title of previous holders); and ... to expedite the transfer process by limiting clearly the issuer's duty of enquiry and stipulating the issuer's duty to register transfers.[40]

It is this aspect of Part VI which will primarily concern us here. In analyzing the effect of Part VI and of other relevant legal rules on the transfer process, the discussion of the transfer transaction will be divided into three parts: (i) the transferor-tranferee relationship, (ii) the issuer-transferor, relationship,[41] (iii) the issuer-transferee relationship.

---

compelled to do so at the option of the purchaser, and this would seem to be the object of the subsection.

[35] *C.B.C.A.*, para.48(1) (a).

[36] *C.B.C.A.*, para.48(1) (b).

[37] For criticism of the *U.C.C.* provisions similar to Part VI see generally Folk, *supra*, note 32.

[38] See *supra*, note 34.

[39] By subs. 44(2) of the *C.B.C.A.* "*bona fide* purchaser" is defined as a "purchaser for value in good faith and without notice of any adverse claim who takes delivery of a security in bearer form or of a security in registered form issued to him or endorsed to him or endorsed in blank". This definition will be the one followed in the remainder of this article.

[40] *Proposals, supra*, note 31, vol.I, para.173.

[41] Unless otherwise stated this article will deal with shares in "registered form", a definition of which is to be found in subs. 44(4) of the *C.B.C.A.* Bearer form securities are defined in subs. 44(5); the important aspect of

TRANSFEROR-TRANSFEREE RELATIONSHIP

A contract for the sale of shares will give rise to certain obligations on the part of transferor.[42] The basic purpose of the transaction is to make the transferee the legal owner of the shares and under the pre-Part VI regime the transferee had to be registered in the books of the company in order to guarantee his legal title.[43] From this rather self-evident proposition concerning the purpose of the contract the courts evolved a number of rules. The transferor was obliged to hand over the relevant share certificates, to complete the appropriate form of transfer[44] and to do nothing which would impede the registration of the transferee as the owner of the shares.[45] Although a transferor did not warrant that the transferee would be registered as owner, the whole purpose of the exercise was to achieve the registration necessary to guarantee the title of the transferee. Without such registration, his title could be defeated by a person with a prior equity[46] or with a subsequent equity who had been registered.[47]

While Part VI basically continues these obligations it deprives the fact of registration in the books of the company of much of its significance. The obligations assumed by a transferor are spelt out in subsection 59(2): a transferor warrants that "the transfer is effective and rightful", that "the security is genuine and has not been materially altered", and that "he knows of nothing that might impair the validity of the security". The warranty of the transferor, that the transfer is "effective and rightful",[48] entails, in all probability, an undertaking that the transferee "can obtain registration of transfer".[49] This then represents a departure from the previous

---

this definition being that they must be in bearer form according to the terms of their issue and cannot be so converted by reason of any subsequent endorsement.

[42] For the pre-Part VI position see Wegenast, *supra,* note 15, 587-88.

[43] *Société Générale de Paris* v. *Walker* (1885) 11 App.Cas. 20, 30 (H.L.); *Smith* v. *Walkerville Malleable Iron Co.* (1896) 23 O.A.R. 95; *Longman* v. *Bath Electric Tramways Ltd* [1905] 1 Ch.646 (C.A.).

[44] As *Re Letheby and Christopher Ltd* [1904] 1 Ch.815 (C.A.) indicates, the courts interpreted this obligation in a flexible manner.

[45] *Boultbee* v. *Wills & Co.* (1908) 15 O.L.R. 227 (Div.Ct); *Hooper* v. *Herts* [1906] 1 Ch.549 (C.A.).

[46] *Smith* v. *Walkerville Malleable Iron Co., supra,* note 43.

[47] *Société Générale de Paris* v. *Walker, supra,* note 43.

[48] *C.B.C.A.,* para.59(2) (a). Registration is only really of importance where the endorsement is unauthorized: see *C.B.C.A.,* subs.64(1).

[49] Folk, *Article Eight: A Premise And Three Problems, supra,* note 12, 1401. Although, as Folk points out (at 1401), it is doubtful if this will cause any great difficulties in practice.

positions where the obligation on the transferor was not to hinder or impede registration in the name of the transferee. To effect a transfer under the Part VI regime a transferor of shares will be obliged to deliver to the transferee the requisite share certificate, to supply the necessary endorsements[50] "either on the security or on a separate document"[51] and to provide "any other requisite that is necessary to obtain registration of the transfer".[52] This will be sufficient to vest title in the *bona fide* purchaser for value without the further act of registration except in one situation, where the endorsement has been forged. Registration is deprived of any substantial significance. Delivery becomes the focal point for determining the moment at which title passes once negotiability is established. Thus, under Part VI there is an attempt to "fuse the property interest in the shares so far as is possible with possession of the certificate registered in the name of the holder, or endorsed to him, or in blank".[53]

The impact of Part VI on the relationship between transferor and transferee has made the concepts of endorsement and delivery central to any transfer transaction. Part VI spells out in some detail how they fit into the transfer process and it is proposed to examine them *seriatim.*

Endorsement

Where a security in registered form is delivered without the requisite endorsements[54] the transferee by virtue of section 60 is given the right to compel the transferor to provide them. Although the transfer is "complete upon delivery" (between the parties to the transaction) endorsement is a critical step in the transfer process since a purchaser becomes a *bona fide* purchaser "only as of the time the endorsement is supplied".[55] Thus, adverse claims will run

---

[50] *C.B.C.A.*, s.60.

[51] *C.B.C.A.*, subs.61(3). This means that a cautious transferor can deliver the security and the endorsement separately.

[52] *C.B.C.A.*, subs.69(1). The obligation does not pertain where the transfer is not for value "unless the purchaser pays the reasonable and necessary costs of the proof and transfer", subs.69(1).

[53] Israels, *Investment Securities As Negotiable Paper — Article 8 Of The Uniform Commercial Code* (1957-58) 13 Bus.Law. 676, 682. This feature of negotiability is further highlighted by s.70 of the *C.B.C.A.* which provides that no seizure of a security is effective until it has been actually reduced into the possession of the person making the seizure.

[54] Endorsement may be either special or in blank: see *C.B.C.A.*, subss. 61(4), (5), (6).

[55] *C.B.C.A.*, s.60.

against a transferee until the necessary endorsement is supplied, whereupon he acquires the status of *bona fide* purchaser.

To be effective the endorsement must be executed by an "appropriate person"[55a] and section 61 defines in detail who is an appropriate person for this purpose. The most obvious person falling into this category is the person "specified by the security or by special endorsement to be entitled to the security".[56] The concept of appropriate person is further elaborated in section 61 in order to deal with the transfer of shares registered in the name of a fiduciary, joint owners where one has died, persons who cannot sign because of death, incompetency or incapacity and, the "authorized agents" of all the above categories of person.

As was stated earlier, the transferee has a specifically enforceable right to have any necessary endorsement supplied.[57] However, if he does not wish to pursue this remedy he can "reject or rescind" the contract if the transferor fails within a reasonable period[58] of time to comply with his request for an endorsement.[59] Thus, as against a defaulting transferor, the transferee can adopt the remedy (specific performance or rescission) which is most advantageous to him, provided that he gives the transferor the option of repairing his breach in failing to provide an endorsement.

Delivery

The second component to an effective transfer (to give the transferee a *bona fide* purchaser status) under Part VI is delivery, which has its accepted commercial meaning of a "voluntary transfer of possession".[60] Where delivery is actually made to the transferee or his agent then few difficulties arise from the use of this concept. Where, however, shares are traded on the exchange and, in particular,

---

[55a] *C.B.C.A.*, subs.61(3).

[56] *C.B.C.A.*, para.61(1) (a).

[57] *C.B.C.A.*, s.60.

[58] Part VI contains no definition of "reasonable time". It is defined in *U.C.C.*, art.1-204(2) as follows: "what is a reasonable time for taking any action depends on the nature, purpose and circumstances of such action".

[59] *C.B.C.A.*, subs.69(2). This section gives a general right of rescission where the transferor, after a request from the transferee, fails to supply any "requisite that is necessary to obtain registration of the transfer of a security", subs.69(1). Accordingly, mere failure to supply an endorsement without any request would appear not to be a repudiatory breach.

[60] *C.B.C.A.*, s.62. In order to be a *bona fide* purchaser the transferor must take delivery: *C.B.C.A.*, subs.44(2). For the definition of delivery see *C.B.C.A.*, subs.44(2).

where a clearing house arrangement is used, it would be unduly burdensome and unrealistic to require this type of delivery. It would also be wholly unsuitable where a central depository system was in operation.[61] Part VI attempts to deal with these various problems.

As well as providing that delivery is effected where the relevant share certificate has been transferred to the transferee or his agent, section 66 provides that delivery takes place where:[62] (i) the purchaser's broker obtains possession of a security specifically endorsed or issued in the name of the purchaser; (ii) the purchaser's broker confirms the purchase and identifies in his records a specific security as belonging to the purchaser and informs him of this; and (iii) a third party in possession of "an identified security" acknowledges that he holds it for the purchaser. The seller satisfies the obligations placed on him to make delivery, in "a sale of a security ... made on an exchange or otherwise through brokers", by making delivery to his own broker[63] who in turn fulfils his obligations by making delivery to the buying broker or by "effecting clearance of the sale in accordance with the rules of the exchange on which the transaction took place".[64] These latter provisions highlight what is a characteristic of Part VI, namely, the placing of responsibility on the members of the financial community to see that transfers are effectively carried out.[65]

Even where a transfer is formally correct, the transferee in any contract for the sale of shares always runs the risk that the transferor is unable to transfer title to the type of securities that he has contracted to sell. The greater the extent to which the trans-

---

[61] The *Proposals* made specific provision for this situation, (vol.I, para.173; vol.II, para.6.29) but these were not adopted in Part VI. See also the A.B.A. Committee on Stock Certificates of the Section of Corporation, Banking and Business Law, *Proposed Revision of Article 8 Of The Uniform Commercial Code* (1975); Aronstein, *A Certificateless Article 8? We Can Have It Both Ways* (1976) 31 Bus.Law. 727; *Stock Exchange (Completion of Bargains) Act 1976*, 1976, c.47 (U.K.) which makes provisions for the stock exchange to introduce a new computerised settlement and stock transfer system. The nature of this system is set out in Parliamentary Debates (H.C.), Standing Committee G, 23 June, 1976.

[62] See also *C.B.C.A.*, subs.67(2).

[63] *C.B.C.A.*, para.67(1) (a).

[64] *C.B.C.A.*, para.67(1)(b).

[65] On this aspect of Part VI see also subs.66(4) which provides that notice of an adverse claim after a broker takes delivery shall not affect the broker or his client, but that a purchaser can demand from his broker a certificate "as to which no notice of an adverse claim has been received".

feree's title can be impeached due to defects in the title of the transferor then to that extent the negotiability of the security is curtailed. A primary characteristic of negotiability is that the holder of a security can obtain a better title to it than the person from whom he acquired it.[66] In addition, where the defects of title of the transferor travel with the shares, then the more cumbersome the transfer process will become since the transferee, as a necessary and prudent precaution, will investigate in some detail the title of the transferor. The major threat to the transferee's title will arise where (i) the transfer is a forgery; (ii) the transfer is unauthorized; or (iii) there are adverse claims against the transferor's title.

Forgeries

The pre-Part VI law on this was quite clear; a forged transfer was a nullity[67] and the true owner could assert his title to the shares and have his name restored to the share register.[68] In this situation the transferee's name would be removed from the share register and a company would not be estopped from doing so merely because it had issued a fresh share certificate in his name.[69] The primacy accorded to the true owner's interest applied even where he was neglectful in, for example, failing to reply to a communication from the company that a transfer of his shares had been registered,[70] a situation where his claim of ownership and the protection of his interest were scarcely meritorious.

Part VI continues, in a slightly diluted form, this policy of protecting the interests of a true owner of securities. By section 64 and subsection 68(2) the true owner can assert his title and recover possession of his security against a *bona fide* purchaser in

---

[66] McLoughlin, *Introduction to Negotiable Instruments* (1975), 29; *Proposals, supra,* note 31, vol.I, para.173.

[67] *In re Bahia and San Francisco Ry Co.* (1868) L.R. 3 Q.B. 584; *Stuart* v. *Hamilton Jockey Club* (1911) 18 O.W.R. 493.

[68] *Stuart* v. *Hamilton Jockey Club, ibid.*

[69] *Simm* v. *Anglo-American Telegraph Co.* (1879) 5 Q.B.D. 188. In certain limited circumstances a company could be estopped from denying the title to shares of a person to whom it had issued a share certificate on the registration of a forged transfer: See Gower, *supra,* note 10, 383-84.

[70] *Barton* v. *L. & N.W. Ry* (1889) 24 Q.B.D. 77; *Welch* v. *Bank of England* [1955] Ch.508 (Ch.Div.). This flows from the fact that Anglo-Canadian law has never developed a satisfactory doctrine with respect to damages caused by a negligent failure of an owner of property to protect it: see *Ingram* v. *Little* [1961] 1 Q.B. 31, 73-4. The reasoning underlying the cases on proprietary estoppel has never been applied in this area.

a situation where the endorsement is "ineffective" or "unauthorized"[71], provided the *bona fide* purchaser has not "received a new, reissued or re-registered security on registration of transfer".[72] Where a *bona fide* purchaser is registered on a forged transfer then the true owner will have to rely on his rights against the company for improperly registering the transfer.[73] In other words, Part VI shifts, to a limited extent, the risk of loss caused by forged transfers onto the shoulders of the issuer to protect a transferee who has received a new certificate on registration. The underlying rationale for substituting the liability of the issuer or transfer-agent for that of the transferee in this situation has been stated to be that (i) the issuer or transfer agent will be more likely to detect forgeries if anyone can, and (ii) if the forgery can pass muster with the transfer agent, the purchaser who receives a new certificate should keep it.[74] The latter reason is not particularly convincing, but the former clearly underlines the responsibility of the issuer and its transfer agent to prevent the circulation of forged share certificates.

It would also appear that in transfers involving forgery the rule, exemplified in cases such as *Sheffield Corp.* v. *Barclay*,[75] has been abrogated. Under this rule a person who submits a forged transfer for registration is liable to indemnify the company for any damage suffered as a result of its registration. Now, under subsection 59(1), where a *bona fide* purchaser is registered and receives a share certificate evidencing this fact, he warrants "only that he has no knowledge of any unauthorized signature in a necessary endorsement". The consequence of this was clearly spelt out in the report which preceded the *C.B.C.A.*:

---

[71] S.64 refers to the "ineffectiveness" of the endorsement, whereas subs. 68(2) refers to both an "unauthorized" and "ineffective" endorsement. Both would appear to have the same meaning. The only apparent reason for separating these sections in the way that Part VI does is because s.68 also deals with "wrongful" transfers.

[72] *C.B.C.A.*, subss.64(1) and 68(2). By paras.64(1) (a) and (b) the true owner cannot assert his rights if he has ratified, or is otherwise estopped, from denying the unauthorized endorsement.

[73] *C.B.C.A.*, subs.64(2).

[74] Folk, *Article Eight: Investment Securities, supra,* note 12, 693. As will be seen later the issuer will have a remedy under the signature guarantees, subs.65(1).

[75] [1905] A.C. 392 (H.L.); *Starkey* v. *Bank of England* [1903] A.C. 114 (H.L.); *Bank of England* v. *Cutler* [1908] 2 K.B. 208; *Guaranty Trust Co. and Denison Mines Ltd* v. *James Richardson & Son* [1963] 2 O.R. 347 (H.C.). For a review of these cases see Atiyah, *Misrepresentation, Warranty and Estoppel* (1971) 9 Alta L.Rev. 347, 358-66.

> Forgery entitles the corporation to refuse to register a transfer, but if the corporation does register the transfer of a certificate presented by a purchaser for value without notice of an adverse claim, the corporation cannot recover the security or seek indemnity from the transferee.[76]

This observation, and subsection 59(1), of course, only refer to the liability of the *bona fide* purchaser who obtains registration and, as *Guaranty Trust Co. and Denison Mines Ltd* v. *James Richardson & Son*[77] illustrates, the obligation of indemnity is normally sought against the presenting broker. But by subsection 59(5) a broker only gives to the issuer[78] the warranties provided for in section 59 which would appear to entail that he warrants only that "he has no knowledge of any unauthorized signature in a necessary endorsement".[79] Nor would it appear that the *bona fide* purchaser is liable in conversion where he obtains registration and a fresh certificate on a forged transfer, for otherwise this would vitiate the scheme of Part VI which is specifically designed to give protection in this situation.[80] Where a transferee on a forged transfer has not obtained registration then he will be liable to the true owner and arguably the *prima facie* remedy of the true owner is to call for the delivery of the certificate.[81]

Oddly, no similar immunity against possible liability in conversion is extended to a broker or agent who acts on behalf of the transferee, a situation specifically dealt with in Article 8-318 of the *U.C.C.* As the comment to this article states, it was inserted to "negate the liability of agents, including brokers, and of bailees, for innocent conversion ...".[82] The absence of any equivalent provision under Part VI means that an agent acting on a fraudulent transfer could be liable in conversion where the principal is not,

---

[76] *Proposals, supra,* note 31, vol.I, 56.

[77] *Supra,* note 75.

[78] By *C.B.C.A.,* para.76(1) (b) this would include any transfer agent since an "authenticating trustee, registrar, transfer agent or other agent of an issuer" is given the same "rights" as the issuer.

[79] *C.B.C.A.,* subs.59(1). This would result in a curtailment of the common law liability: see, *e.g.,* the dictum of Lord Davey in *Sheffield Corp.* v. *Barclay* [1905] A.C. 392, 403, (appr. in *Guaranty Trust Co. and Denison Mines Ltd* v. *James Richardson & Son, supra,* note 75) that a person who presents a transfer to the registering authority "not only affirms it is genuine, but warrants that it is so".

[80] *C.B.C.A.,* subs.64(1).

[81] *C.B.C.A.,* subs.68(2).

[82] *U.C.C.,* Official Comment (1962). *Cf.* the Ontario *Business Corporations Act,* R.S.O. 1970, c.53, s.89.

something which in principle appears feasible.[83] Nor may this be such an undesirable thing. The selling broker can insure against liability and, what is more important, he will take steps to ensure that a satisfactory transfer is being effected. Even in those jurisdictions in the United States where article 8-318 of the *U.C.C.* is applicable, this, to a certain extent, is already the case due to the requirement that a broker to be protected must show that he has some knowledge of the customer for whom he is acting.[84] The policy of Part VI appears to be a more robust version of this development.

Unauthorized Transfers

To a certain extent this category of defective transfers overlaps with the former category of forgeries, as forgeries are manifestly unauthorized. But Part VI draws a distinction between "the transfer that is wrongful because the endorsement is 'unauthorized' and the tranfer that is wrongful for reasons other than an 'unauthorized' endorsement"[85] and it is essential to keep this distinction in mind. It is transfers that are wrongful in the latter sense (transfers by agents who *exceed* their authority and transfers by fiduciaries in breach of trust) with which we are presently concerned.

Where a transfer is for some reason "wrongful", for example, the owner endorses the security in blank for one purpose but the agent uses it for another, then the owner can recover possession of the security "against anyone except a *bona fide* purchaser".[86] In other words, in this situation the *bona fide* purchaser is protected without the need, as in the situation of unauthorized endorsements, to be registered. In this situation Part VI treats the lack of authority to make delivery as being less serious than an unauthorized endorsement; it gives priority to "its policy of promoting free transfer of securities over the interests of the true owner"[87] and relegates

[83] *Cf. Broom* v. *Morgan* [1953] 1 Q.B. 597; Bowstead, *Agency* 13th ed. (1968), 330. It is clear that an agent can be liable in conversion where his principal is also liable: see *Service* v. *Advance Rumely Thresher Co.* [1919] 2 W.W.R. 646.

[84] See *The "Know Your Customer" Rule Of the NYSE: Liability Of Broker-Dealers Under The UCC and Federal Securities Laws* [1973] Duke L.J. 489, 514-25.

[85] Folk, *Article Eight: Investment Securities, supra,* note 12, 684. On this distinction compare subs.68(1) of the *C.B.C.A.* with subs.68(2). "Wrongful", is defined in subs.44(2).

[86] *C.B.C.A.,* subs.68(1).

[87] Folk, *Article Eight: Investment Securities, supra,* note 12, 694.

the claims of the true owner to an action against the defaulting trustee or agent.

A transfer can also be unauthorized in the sense that it involves a fiduciary transferring shares held in trust in circumstances where it is improper for him to do so. The general policy objective of Part VI in this situation is also to protect the issuer and transferee where a transfer in breach of trust has been effected. This again enhances the negotiability of securities by relieving the issuer and transferee of any obligation to verify that a fiduciary-transfer is consonant with the trust instrument.[88] As far as the transferee is concerned, this policy is partly implemented by subsection 61(10) which provides that the failure of a trustee to comply with the relevant controlling instrument, or with the law of the jurisdiction governing the fiduciary relationship, does not result in the endorsement being unauthorized. In other words, such a transfer will not trigger off section 64 which requires the *bona fide* purchaser to be registered in order to protect his title where the endorsement is unauthorized.

Adverse Claims

The title of a transferee may be impeached when third parties have adverse claims against the shares. Obviously, this overlaps with the former category since improper transfers by a fiduciary give rise to rights in the beneficiary to impeach the transfer. However, adverse claims will arise in situations other than improper transfers by a trustee, for example, the shares may be mortgaged.[89] Again the negotiability of investment securities will be enhanced to the extent that adverse claims against a transferee are restricted. Part VI details the situations where this is so and limits the extent to which adverse claims can be raised against a transferee. However, since we are dealing with the *bona fide* purchaser without notice, this in itself will greatly limit the extent to which adverse claims can be raised.

Of limited importance with respect to this matter is subsection 57(1) which provides that a transferee is deemed to have notice of an adverse claim if the security is endorsed for "some ... purpose not involving transfer" (for example, surrender or collection) or if the security is in bearer form and is stated to be the property

---

[88] See also *C.B.C.A.*, subss.68(1) and (2).

[89] See, *e.g.*, *Fry* v. *Smellie* [1912] 3 K.B. 282; *France* v. *Clark* (1884) 26 Ch.D. 257.

of someone other than the transferor.[90] Probably the most important and common situation where adverse claims can arise is, as was pointed out above, where a fiduciary transfers shares in breach of trust. In this situation the fact that a transferee knows that the beneficial interest is vested in a third party does not impose on him a "duty to inquire into the rightfulness of the transfer"[91] and such knowledge will not *ipso facto* constitute notice of an adverse claim. However, a transferee will be deemed to have notice of an adverse claim where he knows that the consideration is to be used for, or that the transaction is for, the personal benefit of the fiduciary or is otherwise in breach of trust.[92] The effect of this is to relieve transferees of any duty to protect a trust beneficiary's interest except where the self-dealing of the fiduciary is obvious. This would entail that the more liberal view of the constructive trust mechanism, in so far as it implicates third parties in a breach of trust as construotive trustees, will not apply in this context.[93] Now before a third party is affected by a fiduciary's breach of duty on a transfer of shares he must have what is tantamount to actual knowledge of the breach. A person who has an adverse claim against a share can protect himself by filing notice of his claim with the company.[93a]

TRANSFEROR AND COMPANY

When the requirements of an effective and proper transfer have been completed it will be in the interests of the transferor to register the transfer as expeditiously as possible. So long as the transfer remains unregistered then, *vis à vis* the company, the transferor remains the owner and is subject to all the liabilities

---

[90] The same rules apply to any broker acting for a transferee: *C.B.C.A.*, subs.57(1).

[91] *C.B.C.A.*, subs.57(2). For the pre-Part VI position where there were competing equities between trust beneficiaries and a transferee, see *Shropshire Union Railways and Canal Co.* v. *The Queen* (1874) L.R. 7 H.L. 496; Holden, *The Law and Practice of Banking* 5th ed. (1971), vol.2, 176-77.

[92] *C.B.C.A.*, subs.57(2).

[93] See generally, Nathan and Marshall, *Cases and Commentary on The Law of Trusts* 6th ed. (1975), Hayton (ed.), 376-79; *Competitive Insurance Co.* v. *Davies Investments Ltd* [1975] 1 W.L.R. 1240, [1975] 3 All E.R. 254 (Ch.Div.); *Consul Development Pty Ltd* v. *D.P.C. Estates Pty Ltd* (1975) 49 A.L.J.R. 74.

[93a] For a more detailed discussion of adverse claims see text, *infra*, p.586.

attendant upon the ownership of the shares.[94] As between the transferor and tranferee, once all the requirements of a valid transfer have been completed the title to the shares vests in the transferee.[95] However, the company is not affected by this. It has been the policy of Anglo-Canadian law to permit a company to rely exclusively on the register of shareholders to indicate to whom the shares belong. This policy is continued in section 47 which provides that before "the presentment for registration of transfer of a security" the company may treat the registered owner as absolute owner irrespective of "any knowledge or notice to the contrary"[96] or of any description in its register otherwise.[97] Accordingly, it can be seen that for different reasons both the transferor and transferee will have an interest in having the transfer registered as promptly as possible.

The registration of corporate securities, however, is something within the jurisdiction of the company; both parties will, therefore, be dependent on the company registering the transfer. As part of the overall objective of expediting the transfer process, Part VI spells out in some detail the obligations of an issuer when a transfer is lodged for registration. In particular, it prescribes and circumscribes the range of enquiries to be made by the issuer in this situation. Where a transfer is lodged for registration, section 71 requires an issuer to register the transfer if:

> (a) the security is endorsed by the appropriate person...;
> (b) reasonable assurance is given that the endorsement is genuine and effective;
> (c) the issuer has no duty to enquire into adverse claims or has discharged any such duty;
> ...
> (e) the transfer is rightful or is to a *bona fide* purchaser ... .[98]

---

[94] *City of Glasgow Bank In Liquidation: Buchan's Case* (1879) 4 App.Cas. 547, 549 (H.L.). *In re Westmorland Bank, ex.p. Allison* (1869) 12 N.B.R. 514 (C.A.).

[95] Gower, *supra,* note 10, 396; *C.B.C.A.*, s.60.

[96] *C.B.C.A.*, para.47(1) (a). This is subject to the situation where a company is deemed to have constructive notice of adverse claims, subs.72(7). This will be dealt with later.

[97] *C.B.C.A.*, para.47(1) (b). See also subs.47(4) which basically relieves a company of having to see to the performance of any duty owed by the registered owner to a third party.

[98] *C.B.C.A.*, para.75(1) (e). For possible difficulties, which are probably more theoretical than real, arising out of this subsection see Folk, *Article Eight: Investment Securities, supra,* note 12, 706-8.

Of the above requirements the two most important are those relating to the assurances which the issuer may require as to the rightfulness and effectiveness of the endorsement and notice of adverse claims. The important concept of "appropriate person" has previously been discussed.[98a]

Assurance that endorsement effective[99]

Subsection 72(1) sets out the assurance which an issuer can demand before it registers a transfer of shares. These assurances go both to the genuineness and to the effectiveness of the endorsement; in other words, that it is not a forgery and that the person executing it is an appropriate person to do so. From the issuer's point of view the importance of these assurances is that they provide protection against a wrongful registration which results in the issuer being liable to the true owner yet unable to expunge the transferee from the register of members. This, for example, would arise where the issuer registers a forged transfer to a *bona fide* purchaser.[100] The assurances which Part VI enables the issuer to require on a transfer fall into two broad categories:[101] (i) signature guarantees and (ii) evidence of an agent-transferor's authority or evidence of "appointment or incumbency" to a particular office where this is appropriate.

Signature guarantee

By subsection 72(1), an issuer, on the presentment of a transfer of securities for registration, can require "a guarantee of the signature of the person endorsing". In the scheme of Part VI this is a requirement of some importance. The significance of the equivalent provision in the *U.C.C.* has been spelt out as follows:

> Since Code rights and liabilities turn in large part upon the signature guarantee, it is obviously of great importance, especially to transfer agents but also to selling brokers, that the guarantee itself is genuine and that the guarantor is sufficiently responsible financially to meet any liabilities, which are potentially quite large, that might arise out of the particular transaction.[102]

Where such a guarantee is given, the guarantor warrants the genuineness of the signature, that the signer was an appropriate

---

[98a] See text, *supra,* p.575.

[99] This sub-heading is the margin note to *C.B.C.A.*, subs.72(1).

[100] See *C.B.C.A.*, subss.64(1), 64(2) and 74(2).

[101] *C.B.C.A.*, s.72.

[102] Folk, *Article Eight: A Premise And Three Problems, supra,* note 12, 1407.

person to make the endorsement, and that he had legal capacity to do so.[103] It is important to note that the guarantor does not warrant the "rightfulness of the transfer in all respects".[104] Such an *endorsement guarantee* can be given voluntarily by a person seeking the registration of a transfer but the issuer may not require such a guarantee as a condition to granting registration of the transfer.[105] Obviously, a signature guarantee to be of any value to the issuer will have to be made by a person in whose commercial reputation the issuer can confidently place some trust. To this effect, subsection 72(2) defines a "signature guarantee" as a guarantee by a person "reasonably believed by the issuer to be responsible" and the issuer may adopt "reasonable standards" to determine who is and who is not a responsible person for this purpose.[106]

Evidence of appointment or incumbency

Where an endorsement is by an agent or some other fiduciary then the issuer can require assurances regarding their capacity to act. With respect to the agency situation, the issuer can require "reasonable assurance of authority to sign";[107] in the case of a transfer by a fiduciary, "evidence of appointment or incumbency"[108] for which the issuer can set up reasonable standards.[109] Where an issuer solicits documents to enable it to carry out such investigation it will not be affected by constructive notice of the contents of any document solicited "except to the extent that the contents relate directly to [the] appointment or incumbency"[110] in question. This is an important provision. It underscores what is one of the major purposes of Part VI, the limiting of the extent to which an issuer will be affected by notice of adverse claims unless the statutory procedure for bringing them to the notice of the issuer has been complied with.

---

[103] *C.B.C.A.*, subs.65(1).

[104] *E.g.*, where shares are mortgaged but the owner-mortgagor retains possession of them and subsequently sells them. See subs.65(2) of the *C.B.C.A.*: "A person who guarantees a signature of an endorser does not otherwise warrant the rightfulness of the particular transfer".

[105] *C.B.C.A.*, subs.65(3).

[106] *C.B.C.A.*, subs.72(3).

[107] *C.B.C.A.*, para.72(1) (a).

[108] *C.B.C.A.*, para.72(1) (b). Joint fiduciaries are dealt with in para.72(1) (c). See also *C.B.C.A.*, subs.72(4) which defines what is "evidence of appointment or incumbency".

[109] *C.B.C.A.*, subss.72(4) and (5).

[110] *C.B.C.A.*, subs.72(6).

By spelling out in detail the types of assurances that the issuer can require it is hoped that the transfer process will be routinized and expedited. This policy objective would be frustrated if the issuer could require additional, or more rigorous, assurances than those set out in Part VI. As a discouragement, the issuer is deemed to have constructive notice of the contents of any documents which it unreasonably requires as a condition of registering a transfer. Subsection 72(7) provides:

> ... If an issuer demands assurance additional to that specified in this section [evidence of appointment or incumbency or agent's authority] ... and obtains a copy of a will, trust or partnership agreement, bylaw or similar document, the issuer is deemed to have notice of all matters contained therein affecting the transfer.

It is this use of the constructive notice doctrine which, it is hoped, will deter an issuer from requiring documentation in excess of that to which it is entitled.

Adverse Claims

The issuer must also be concerned with adverse claims against the shares. The report preceding the introduction of the *C.B.C.A.* asserted that one of the objectives underlying Part VI was to expedite "the registration process by clarifying and limiting the duty of the corporation and its agents to enquire into ... possible adverse claims of third parties".[111] As part of this policy Part VI continues the tradition of Anglo-Canadian law in relieving the issuer of any knowledge that its shares are held on trust. In commenting on section 117[112] of the English *Companies Act, 1948*[112a] (which basically prevents the company from being attached with the knowledge that its shares are held on trust), Buckley states that it was designed[113] "(1) to relieve the company from taking notice of equitable interests in shares, and (2) to preclude persons claiming under equitable titles from converting the company into a trustee for them".[114]

---

[111] *Proposals, supra,* note 31, vol.I para.166. For a definition of "adverse claim" see *C.B.C.A.,* subs.44(2).

[112] S.117 provides: "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".

[112a] 11-12 Geo.VI, c.38.

[113] Lindon (ed.), *Buckley on the Companies Acts* 13th ed. (1957), 299.

[114] There would appear to be an exception to this where a company deals for its own purposes with shares subject to trust: *Rainford* v. *James Keith and Blackman Ltd* [1905] 1 Ch.296 (Ch.Div.); *The Birbeck Loan Co.* v. *Johnston* (1902) 3 O.L.R. 497 (Div.Ct); var.6 O.L.R. 258 (C.A.).

A similar policy is adopted by section 47 which provides that a corporation may treat as absolute owner (before the "presentment for registration of transfer" of any shares) the person in whose name the shares are registered irrespective of any knowledge to the contrary or notice of the fact that shares are held in some fiduciary capacity.[115] Although the general purpose of Part VI is to limit the extent to which companies can be affected by notice of adverse claims, a regime which completely failed to provide the owner of such an interest with the means of protecting it would be less than satisfactory. It would greatly limit the utility and value of shares as items of property since they are frequently used as collateral. Of course, it is not unreasonable to expect a holder of an interest in shares to protect such interest by obtaining possession of the shares; immobilizing the share certificate is probably his most effective form of protection. Accordingly, Part VI places the onus squarely on the shoulders of the holder of an adverse interest to take positive steps to protect it; an issuer is only under a duty to inquire into adverse claims if (a) it receives written notice of the claim, (b) it is given reasonable time to act on the notice before any proposed transfer is effected and (c) details relating to the security are given.[116] The issuer can discharge its duty of enquiry by any reasonable means which include informing an "adverse claimant" that a security has been lodged for transfer and that it will be transferred within thirty days unless the issuer is served with a restraining order or is provided with an indemnity bond sufficient to protect the issuer and all others from any loss flowing from "complying with the adverse claim".[117]

Where notice of an adverse claim has been given to the company but no court order or indemnity bond is forthcoming, then the issuer, after a lapse of thirty days, would appear to be free to register the transfer without threat of any liability. In this situation the adverse claimant, which could include the true owner, would be estopped from contesting the rightfulness of the transfer against the company. This marks a significant alteration of the previous legal position and departs from a number of unsatisfactory decisions which had relieved a shareholder of any obligation to protect his interest even where he had been informed by the company

---

[115] See also *C.B.C.A.*, subs.72(3).

[116] *C.B.C.A.*, subs.73(1).

[117] *C.B.C.A.*, subs.73(2).

that a transfer of shares registered in his name had been lodged for registration.[118]

The manner in which these adverse claim provisions operate and the general policy of Part VI in promoting negotiability by equating "possession of a duly endorsed security certificate ... with ownership",[119] are illustrated by *Dean Witter & Co.* v. *Educational Computer Corporation (Pa.)*.[120] This case involved an action by a broker to obtain registration and damages for the issuer's delay[121] in registering a transfer. The defendant had refused to register the transfer on the grounds that the customer for whom the broker was acting had previously obtained a transfer of the shares by representing that the certificate had been lost.[122] The plaintiff, however, claimed to be entitled to be registered under article 8-401 of the *U.C.C.*[123] The court held for the defendant company on the gounds that the plaintiff was not a *bona fide* purchaser for value because a legend appended to the share certificate indicated that the shares were not being held for the purpose of resale.[124] If, however, the plaintiff had been a *bona fide* purchaser he would have been entitled to be registered since he possessed the share certificate. In addition, the court observed that notice of an adverse claim did not "exempt the issuer from the duty to transfer...

---

[118] *Barton* v. *London and N.W. Ry* (1889) 24 Q.B.D. 77; *Welch* v. *Bank of England* [1955] Ch.508 (Ch.Div.).

[119] *Proposals, supra,* note 31, vol.I, para.171(a).

[120] 369 F.Supp. 757 (E.D.Pa. 1974).

[121] Action can also be brought against the transfer agent where it has been responsible for the failure to register. *C.B.C.A.*, s.76 imposes obligations with respect to the transfer of shares on transfer agents that are similar to those imposed on the issuer, thus overcoming any difficulties, such as privity or showing a duty of care, that a transferor might encounter in bringing such an action. This remedy is useful where the issuer has become insolvent: see *Kenler* v. *Canal National Bank,* 489 F.2d 482 (1973).

[122] This is an abbreviated version of the facts.

[123] See *C.B.C.A.*, s.71.

[124] Note that the definition of adverse claim in subs.44(2) includes a claim that the "transfer was or would be wrongful". In *Dean Witter & Co.* v. *Educational Computer Corp. (Pa.), supra,* note 120, the defect in the transfer was that the share certificate representing the securities had been previously reported to be missing and a replacement had been issued. This, of course, had little to do with the legend on the securities which deprived the plaintiff of its *bona fide* purchaser status. Because of this, the point has been made that "*bona fide* purchaser status can be defeated by notice of a claim which was never litigated ...", Mann, *Investment Securities* (1974-75) 30 Bus.Law. 885, 889.

shares".[125] The issuer was obliged to notify the adverse claimant of the proposed transfer so that corrective action could be taken. What this appears to imply is that there is an onus on the issuer to take some action to clarify the situation; it cannot adopt a passive posture leaving the parties to sort out the problem.[126] If, of course, the true owner does not reply within the thirty day period set out in subsection 73(2) then the issuer is free to register the transfer.

Restrictions on the transfer of shares

Restrictions on the transferability of the issuer's shares are a matter of considerable importance to the transferor, the transferee and the issuer. Many companies, mainly to obtain the supposed advantages of a partnership structure, will have a provision in their constitution restricting transferability. While it is clear that companies can impose restrictions there is some uncertainty under Canadian law concerning the permissible scope of such restrictions.

If any such limitation exists it is clear that it operates within a very narrow compass since Anglo-Canadian courts have not seen fit to fetter the autonomy of companies in this area. The courts have tended to emphasize the contractual nature of the shareholder's interest as opposed to its proprietary aspect.[127] As Professor Gower has pointed out, "English law has always regarded shares of stock as creatures of the company's constitution and therefore as essentially contractual choses in action".[128] The most common form of restriction is that which gives directors an unfettered discretion to refuse to register transfers of shares and "no one has even argued that such a far reaching restriction ... is invalid".[129]

In Canada, however, this quiescent attitude has not prevailed and the validity of such restraints was challenged in *Edmonton*

---

[125] *Dean Witter & Co.* v. *Educational Computer Corp. (Pa.)*, *supra*, note 120, 761.

[126] *Kanton* v. *United States Plastics Inc.*, 248 F.Supp. 353 (1965).

[127] See the well-known *dictum* of Holmes J. in *Barrett* v. *King*, 63 N.E. 935 (1902): "Stock in a corporation is not merely property. It also creates a personal relation analogous otherwise than technically to a partnership. Notwithstanding decisions under statutes ... there seems to be no greater objection to retaining the right of choosing one's associates in a corporation than in a firm."

[128] Gower, *Some Contrasts Between British and American Corporation Law* (1956) 69 Harv.L.Rev. 1369, 1377.

[129] *Ibid.*, 1378.

Country Club Ltd v. *Case.*[130] Here the question before the court was the validity of a provision in the articles of association conferring on a majority of the directors power to refuse to register a transfer of shares "in their absolute discretion". Dickson J., speaking for the majority, upheld the validity of the restriction on the grounds of precedent, the Alberta *Companies Act*[131] which impliedly condoned such restrictions, and on the facts: there was no evidence that in the past the directors had made abusive use of their discretion to refuse such registration. What is of interest is not the orthodox majority opinion, but the dissent of Laskin J. who considered absolute discretionary restrictions on the transfer of shares to be invalid. To be valid such restrictions would have to stipulate "some standard which would be amenable to judicial control".[132] Laskin J. reached this conclusion on the grounds that "shares in a public company are a species of property and as such are entitled to the advantage of alienability free from unreasonable restrictions ...".[133] The general purport of Laskin J.'s dissent is to emphasize the proprietary aspects of the share with the result that a company's freedom to restrict the transferability of its shares is curtailed. Isolated *dicta* in cases dealing with letters patent companies provided Laskin J. with some tentative support, but only for the limited proposition that *absolute* restrictions on transfer will be struck down; the cases do not articulate any standard of reasonableness for determining the permissible scope of any given restriction.

In *Canada National Fire Ins. Co.* v. *Hutchings,*[134] the Privy Council in dealing with a company incorporated under a special Act of Parliament[134a] held that a restriction in the company's by-laws, which gave the directors an absolute veto with respect to the transfer of shares, was void. Other authorities support this

---

130 *Supra,* note 6.

131 R.S.A. 1942, c.240; now R.S.A. 1970, c.60.

132 *Edmonton Country Club Ltd* v. *Case, supra,* note 6, 551.

133 *Ibid.,* 552.

134 [1918] A.C. 451 (P.C.). See also *Re Good and Jacob Y Shantz Son & Co.* (1911) 23 O.L.R. 544 (C.A.); *In re Imperial Starch Co.* (1905) 10 O.L.R. 22 (H.C.); *Montgomery* v. *Beardmore & Toronto Hunt Ltd* (1929) 36 O.W.N. 99 (Ont.S.C.). The various problems raised by these cases were referred to but not disposed of by the Privy Council in *Ontario Jockey Club* v. *McBride* [1927] A.C. 916, 924 (P.C.). Under the *C.B.C.A.* the power of the directors to pass by-laws (subs.98(1)) does not involve the right to pass by-laws relating to restrictions on the transfer of shares (paras.6(1) (d), 167(1) (m)).

134a Part II of the Dominion *Companies Act,* R.S.C. 1906, c.79 was incorporated into this Act.

approach with respect to provisions in the by-laws of letters patent companies.[135] Although, on this point, it is hard not to agree with the observations of Laskin J. that it is difficult to appreciate how "the form of incorporation can have such a remarkable effect upon the permissible scope of a power to regulate or prescribe conditions for the transfer of stock in a public company".[136] However, the position of Laskin J. is a voice crying in the wilderness and it is too late in the day to challenge the validity of restrictions, even of the widest purport, on the transfer of shares. Also, whatever uncertainties exist with respect to the valid scope of restrictions on transfer in letters patent companies, it is doubtful if they cause any undue inconvenience. Sufficient permissible and adequate devices remain available to the corporate draftsman to curtail substantially transferability and shareholders are always free, *via* a valid shareholders' voting agreement, to limit voluntarily their right to transfer their shares.

In addition, as a matter of policy, it is doubtful that the position of Laskin J. is the most satisfactory, although the arguments for and against are finely balanced. In the United States, where "unreasonable restraints" are prohibited, great difficulty has been experienced in articulating the appropriate standards of reasonableness and, more recently, the courts have moved in favour of allowing the corporate draftsman greater freedom to restrict the transferability of shares.[137] It is not to be gainsaid that restrictions on transferability can operate to prejudice the interests of minority shareholders, but this is merely one aspect of the minority oppression problem and is better remedied by a comprehensive statutory provision.

Another aspect of the validity of transferability restrictions is whether or not a company can alter its constitution to curtail this. Without elaborating in great detail the rules pertaining to the propriety of corporate consitutional alterations, the answer would appear to be in the affirmative. *Prima facie*, there can be no objection to an alteration which restricts the hitherto existing right of a shareholder to transfer his shares.[138] In dealing with this issue the courts adopt the rather stoical attitude that,

---

[135] See Wegenast, *supra*, note 15, 536-42.

[136] *Edmonton Country Club Ltd* v. *Case*, *supra*, note 6, 553.

[137] O'Neal, *Close Corporations: Law and Practice* 2d ed. (1971), ch.7.

[138] See *Allen* v. *Gold Reefs of West Africa* [1900] 1 Ch.656 (C.A.); *Shuttleworth* v. *Cox Bros. & Co.* [1927] 2 K.B. 9.

> [t]his is one of the contractual contingencies upon which a shareholder holds his shares, *viz.* that a majority may against his will, and, perchance, his interest, place restrictions upon his right of transferring his shares.[130]

Such an alteration would, of course, have to be *bona fide* in the interests of the company, but, considering the subjective nature of the test and the level of abstraction at which it is applied, few alterations would run afoul of it.[140] While an alteration to the corporate constitution to restrict the transferability of shares would not, *prima facie*, run afoul of the rules developed by the courts to circumscribe the exercise of such majority power, it would trigger off the appraisal remedy recently introduced by the *C.B.C.A.* Paragraph 184(1) (a) provides that where a shareholder dissents from an amendment[141] to a company's articles "to add, change or remove any provisions restricting or constraining . . . the transfer of shares" then, provided the dissenting shareholder complies with the stipulated procedure,[142] he can compel the company to purchase his shares at a fair value.[143] This right is not, however, an absolute

---

[130] *Leiser* v. *Popham Bros. Ltd* (1912) 6 D.L.R. 525, 527 *per* Clement J. (B.C.S.C.). See also *Tu-Vu Drive-In Corp.* v. *Ashkins*, 391 P. 2d 828, 831 (1964) to the effect that a shareholder "acquires his shares subject to the power of the corporation to alter its contract with him pursuant to statutory authority".

[140] See, *e.g.*, the observations of Lord Evershed M.R. in *Greenhalgh* v. *Arderne Cinemas Ltd* [1951] Ch.286, 291 (C.A.), on what constitutes the "interests of the company". It reaches such a level of abstraction as to be almost meaningless. It may be that the courts are adopting a slightly different attitude to majority shareholder power, see *Clemens* v. *Clemens Bros.* [1976] 2 All E.R. 268 (Ch.Div.), but this decision is not free from difficulties (see comment by Prentice (1976) 92 L.Q.R. 502). A more satisfactory approach would be to ask the question whether or not the alteration has prejudiced the economic interests of the petitioning shareholder and, if so, then the onus should be on the majority to justify it.

[141] The amendment will be effected under *C.B.C.A.*, s.167 (see in particular para.167(1) (m)) and the various classes of shares are protected by *C.B.C.A.*, s.170 (see in particular para.170(1) (h)).

[142] See *C.B.C.A.*, subss.184(4)-(9). Basically the shareholder must:

(i) signify his dissent before the resolution (subs.184(5));
(ii) inform the company within twenty days after he has been informed of the resolution (or twenty days after he hears of it) that he wishes to exercise his right to have his shares purchased and give details of the shares held (subs.184(7));
(iii) within 30 days of giving such notice forward his share certificate to the company for endorsement (subs.184(4)).

It is not possible for a dissenting shareholder to have the best of both worlds and redeem only part of his holdings (subs.184(4)).

[143] The fair value is to be computed as of the date immediately prior to the adoption of the resolution effecting the alteration, and any change in

one in that a company cannot be compelled to acquire a dissenting shareholder's shares where there are reasonable grounds for believing that the corporation is, or would be after the purchase, insolvent.[144] Nevertheless, in this situation the dissentient is put in a preferential position upon liquidation, ranking after creditors but before all other shareholders.[145] He can also withdraw his notice of dissent if he so wishes.[146]

Although Part VI makes no alteration to the law relating to the validity of the scope of transferability restrictions, it does, however, contain certain provisions relating to their enforceability. Subsection 45(8) of the *C.B.C.A.* provides:

> If a security certificate issued by a corporation or by a body corporate before the body corporate was continued under this Act is or becomes subject to
>
> (a) a restriction on its transfer other than a restraint under section 168,[147]
>
> (b) a lien in favour of the corporation,
>
> (c) a unanimous shareholder agreement, or
>
> (d) an endorsement under subsection 184(10),[148]

---

value attributable to a prospective alteration is to be excluded (*C.B.C.A.*, subs.184(3)). See *Re Wall & Redekop Corp.* (1974) 50 D.L.R. (3d) 733 (B.C.S.C.) where the court had to deal with the fair value concept in subs.228(5) of the *Companies Act*, S.B.C. 1973, c.18. The court pointed out that at least three methods of computation were available:

(i) market value of the shares on the stock exchange;
(ii) the net asset value or the amount to be obtained on a hypothetical liquidation;
(iii) the investment value of the shares on a capitalization of the earnings of the company.

The court held that it was not sufficient merely to regard the market value of the shares, but that a shareholder was entitled to be paid for his proportionate interest in the company as a going concern. See also *Application of Delaware Racing Assoc.*, 213 A.2d 203 (1965); *Inflation Accounting*, Ch.4 in Report of the Inflation Accounting Committee 1975, Cmnd 6225.

[144] *C.B.C.A.*, subs.184(26) where insolvency is given both its bankruptcy and commercial meanings.

[145] *C.B.C.A.*, para.184(25) (b).

[146] *C.B.C.A.*, para.184(25) (a). For a somewhat perverse, but highly interesting article on the appraisal remedy, which demonstrates the old adage that the best is the enemy of the better: see Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker* (1962) 72 Yale L.J. 223.

[147] This basically enables a company to ensure that its control is Canadian: see *C.B.C.A.*, Regulations, ss.55-62.

[148] This subsection relates to the endorsement of securities held by a shareholder who has determined to make use of the appraisal remedy under s.184; see *supra*, note 142.

> Such restriction, lien, agreement or endorsement is ineffective against a transferee of the security who has no actual knowledge of it, unless it or a reference to it is noted conspicuously on the security certificate.

The purport of this section is clear and needs little comment; unless the restriction on transfer (or the other stipulated impairments of title) are noted or referred to conspicuously[149] on the share certificate, then they will not be effective against a transferee who has no actual knowledge[150] of their existence.

Subsection 45(8) goes farther than the equivalent provision in Article 8 of the *U.C.C.* in one important respect. It applies to restrictions contained in a unanimous shareholders' agreement.[151] Such an agreement is included by the *C.B.C.A.* because it is, for all intents and purposes, given the status of a constitutional document, thus recognizing that where such agreements exist it is unrealistic to distinguish them from the corporate constitution proper. A transferee of shares subject to a unanimous shareholders' agreement of which he has notice is deemed to be a party to that agreement[152] and in this way the doctrine of privity is circumvented.[153]

The courts have not struck down restraints on transferability because they fail to live up to some abstract standard of reasonableness. Rather, the courts' unswerving hostility has normally manifested itself in the restrictive manner in which they interpret such restraints. The starting point for the courts is to treat all shares as being inherently transferable[154] and to require clear evidence that the transferability of any given share has been curtailed.[155] The extent to which the courts are willing to enforce this policy in favour of transferability is reflected in the cases

---

[149] For a definition of conspicuous see *U.C.C.* §1-201(10).

[150] On actual notice see *Dean Witter & Co.* v. *Educational Computer Corp. (Pa.)*, *supra*, note 120.

[151] Defined in *C.B.C.A.*, s.2 and subs.140(2). It can restrict "in whole or in part, the powers of the directors to manage the business and affairs of the corporation".

[152] *C.B.C.A.*, subs.140(3).

[153] See *Re Belleville Driving and Athletic Assoc.* (1914) 31 O.L.R. 79 (A.D.). It also has considerable ramifications for the enforceability of "buy and sell" agreements and other such devices.

[154] This was recognized from an early date: see *Davis* v. *Bank of England* (1824) 2 Bing 393, 407-408. For more recent judicial statements of the rule see *Re Smith and Knight* (1868) 4 Ch. App. 20; *Re Panton and the Cramp Steel Co.* (1904) 9 O.L.R. 3; *Delavenne* v. *Broadhurst* [1931] 1 Ch.234 (Ch.Div.).

[155] The same restrictive interpretation has been placed on pre-emptive rights provisions: see *Delavenne* v. *Broadhurst, ibid.; Roberts* v. *Letter "T" Estates Ltd* [1961] A.C. 795 (P.C.).

dealing with transfers to "men of straw"; in the absence of any restriction a shareholder can transfer his shares to an impecunious transferee, provided the transfer is unconditional.[156] Where the corporate constitution does contain a restriction on the transfer of shares then the scope of the restriction is solely a matter of construction. In response to this there have evolved a number of rules which exist in that twilight zone between rules of law and mere interpretative guides.[157]

(a) Wherever two interpretations on the scope of a restriction are possible, the courts will select that one which limits the scope of the restriction. Thus in *Re Pool Shipping Co.*[158] the articles of association contained a provision which vested an absolute discretion in the directors to refuse to register a transfer of shares. During an issue of bonus shares which were renounceable, a shareholder to whom such shares were allotted renounced them. The question was whether the shares were subject to the transferability restriction contained in the articles of association. The court held that they were not because the restrictive provisions only applied to the transfer of shares belonging to a "registered holder" whereas here the court was dealing with the "substitution of a nominee in the place of the person to whom, in the first instance, the shares were proposed to be allotted".[159] The arid technicality of this reasoning speaks for itself, but it does exemplify the general judicial hostility to transfer restrictions.

The merits of this policy are open to question since it can frustrate the purpose for which such restrictions are introduced,[160] a purpose (the obtaining of the benefits of the partnership structure) which has been judicially approved.[161] While there is much to be said for promoting a policy of free transferability with respect to publicly traded shares, similar arguments are hardly ap-

---

[156] See, *e.g.*, *Re Discoverers Finance Corp., Lindlar's Case* [1910] 1 Ch.312 (C.A.).

[157] See, *e.g.*, Laskin C.J.C.'s views on the "interpretation" of the effect of exemption clauses in *B.G. Linton Construction Ltd* v. *Canadian National Ry* [1975] 2 S.C.R. 678, (1974) 49 D.L.R. (3d) 548.

[158] [1920] 1 Ch.251 (Ch.Div.).

[159] *Ibid.*, 256. See also *Re Bentham Mills Spinning Co.* (1879) 11 Ch.D. 900 (C.A.).

[160] See the decision of Scrutton L.J. in *Re Bede Steam Shipping Co.* [1917] 1 Ch.123 (C.A.).

[161] *Moodie* v. *W. & J. Shepherd (Bookbinders) Ltd* [1949] 2 All E.R. 1044, 1050 (H.L.); *A.G.* v. *Jameson* [1905] 2 I.R. 218 (C.A.); aff. [1904] 2 I.R. 644 (K.B.).

propriate in the case of private companies where shareholders expect transferability restrictions. The preferable policy would be to give effect to such restrictions and not to frustrate them.[162]

(b) Secondly, and somewhat similarly to the first point, where directors are given the right to refuse to register a transfer of shares on certain designated grounds then a refusal to register on other grounds will be invalid. In such a situation directors would be arrogating to themselves powers which they did not rightfully possess.[163] Thus, where directors were given a power to refuse registration to a transferee to whom they had personal objections, it was held that they could not refuse where their objections were that the transfer was merely a ploy to increase the voting power of the transferor.[164]

(c) Thirdly, where the provision restricting the transfer of shares requires a positive decision by the directors, a transfer will be registrable if the directors fail or are unable to act. In this context a "mere failure to pass a resolution is not a formal active exercise of the right to decline".[165] Thus where directors fail to act, are deadlocked, or are unable to establish a quorum because a director purposely absents himself from board meetings, a transfer will have to be registered.[166]

There is also authority for the proposition that the directors must exercise their power to refuse registration within a reasonable period of time after a request is lodged and failure to do so will

---

[162] Gower, *supra,* note 10, 393 states that the "courts will not carry a literal construction of the regulations so far as to defeat their obvious purpose". In some of the earlier cases, however, the courts came perilously close to doing just this: see *Re Pool Shipping Co., supra,* note 158.

[163] The same rule would apply where shareholders attempted to restrict a transfer on grounds not stipulated in the corporate constitution. This is not a case where any argument along the lines of an inherent power residing in shareholders could be invoked: see, *e.g., Re Bede Steam Shipping Co., supra,* note 160.

[164] *Moffat* v. *Farquhar* (1878) 7 Ch.D. 591 (Ch.Div.); *Re Stranton Iron and Steel Co.* (1873) L.R. 16 Eq. 559.

[165] *Moodie* v. *W. & J. Shepherd (Bookbinders) Ltd, supra,* note 161, 1050.

[166] The powers of the directors in this situation pass to the shareholders in general meeting in accordance with the principle in *Barron* v. *Potter* [1914] 1 Ch.895 (Ch.Div.); *Foster* v. *Foster* [1916] 1 Ch.532 (Ch.Div.). The reason for this is that the doctrine would probably violate the fundamental right of a shareholder to transfer his shares and, in effect, would extend the restriction. Also, reasoning based on the residual power of the shareholders should have little application where the power of the board is vested in it by statute: see, *e.g., C.B.C.A.,* subs.97(1).

result in their power of refusal falling into abeyance. In *Re Swaledale Cleaners Ltd*[167] the board of directors failed to act for over four months and then declined to register the transfer. The court held that this delay was unreasonable and also, more importantly, that by this delay the directors (and *ipso facto* the company) had lost their right of refusal.[168] Where the directors' delay is inadvertent or unavoidable then the ruling in *Re Swaledale Cleaners Ltd* could be unduly harsh. Providing directors with an incentive to act expeditiously where they can do so is one thing. Providing them with such an incentive where they cannot is quite another.[169]

Whether or not the reasoning in *Re Swaledale Cleaners Ltd* is applicable to transfers under Part VI is problematic. Provision is made for the situation where the issuer delays unreasonably in registering a transfer and this merely gives the person presenting the transfer a remedy in damages.[170] Arguably this exhausts the rights of a person injured by such an unreasonable delay, but this cannot be completely accurate. Where the company has no right to refuse to register, then, presumably, the person seeking registration has a right under the general law to a specific performance order compelling the company to register the transfer.[171] On this reasoning there remains the possibility that *Re Swaledale Cleaners Ltd* could apply to transfers covered by Part VI. There is nothing in Part VI which directly prevents it from doing so and, in fact, subsection 71(1) speaks in terms of the issuer's duty

---

[167] [1968] 1 W.L.R. 1710 (C.A.), [1968] 3 All E.R. 619.

[168] S.78 of the *Companies Act*, 1948 11-12 Geo.VI, c.38 (U.K.) requires the board of directors to inform the transferee (but not the transferor) of any refusal to register a transfer within two months from the time the transfer was lodged for registration. This played a part in the court's decision, but only in the sense that the court considered it difficult to imagine a situation where a delay of more than two months would be reasonable. *Cf. Re Gairdner Clarke & Doherty and Northern Life Assurance Co.* (1923) 25 O.W.N. 278 (Kelly J. in chambers).

[169] The same rule would appear to apply where the directors exercise their discretion on an improper principle: see *Re Bell Bros Ltd* (1891) 65 L.T. 245, 249: "Having had an opportunity of exercising their power, and having attempted to exercise it upon a wrong principle, I think the power is gone, and that the right to transfer remains absolute."

[170] *C.B.C.A.*, subs.71(2).

[171] *Cf.* the situation under *C.B.C.A.*, subs.69(1), which gives the transferee the right to compel the transferor to supply him with any "requisite" that is necessary to obtain registration. But this relates only to matters with respect to which the availability of a specific performance order might be doubtful and has no direct bearing on the general availability of the remedy.

to register a transfer provided the formalities of a valid transfer have been satisfied.

(d) The power of the directors to refuse to register a transfer of shares, like all powers vested in the board, must be exercised according to fiduciary principles. The directors must exercise their power *bona fide* in the interests of the company and not for any collateral purpose. The problem with this rule is the difficulty of proving a want of good faith on the part of the directors. This is not only because of the subjective nature[171a] of the rule and the imprecision of the "interests of the company" concept,[172] but also because the courts (i) have placed the burden of showing a want of good faith on the party alleging it[173] and (ii) will not oblige the directors to give reasons for their refusal to register any given transfer nor draw any adverse inferences if they fail to do so. As an Irish judge rather laconically stated "the law allows the directors to hold their tongues".[174] The rigour of this rule is somewhat qualified by the caveat that if the corporate constitution permits the directors to refuse to register a transfer on limited grounds then the directors will be obliged to stipulate the ground on which

---

[171a] It may be that the *C.B.C.A.* has imported objective standards into the exercise of directors' powers (*C.B.C.A.*, para.117(1) (a)) a trend which would be in keeping with recent judicial developments: see *e.g.*, *Clemens* v. *Clemens Bros Ltd, supra,* note 140; *Howard Smith Ltd* v. *Ampol Petroleum Ltd* [1974] A.C. 821 (P.C.), *Wollersteiner* v. *Moir* [1975] 2 W.L.R. 389 (C.A.). Whether or not the use of the phrase "interests of the company", which is not compelling, will operate to effect a change in judicial attitude to involvement in corporate affairs, only time will tell. That such a development is to be commended cannot be gainsaid. On this see generally Howard, *Directors and Officers in the Context of the Canada Business Corporations Act,* Meredith Memorial Lectures (1975), 143-44.

[172] See the observations of Lord Evershed M.R. in *Greenhalgh* v. *Arderne Cinemas Ltd, supra,* note 140. To this should be added the comments of Latham C.J. in *Peter's American Delicacy Co.* v. *Heath* (1939) 61 C.L.R. 457, 481-82 (Austl.H.C.) where he points out that it is meaningless to talk in terms of the interests of the company where the company is split into factions. In other words, what the courts have done with the "bona fide in the interests of the company" formula is to create a rule which obscures the nature of the underlying conflict with which the rule was designed to cope.

[173] See, *e.g.*, *Australian Metropolitan Life Assurance Co.* v. *Ure* (1923) 33 C.L.R. 199, 206 *per* Knox C.J. (Austl.H.C.): "[T]he onus is on the applicant ... to establish that the directors have not acted honestly or bona fide in what they believe to be the interests of the Company in exercising their power of rejection, and no inference unfavourable to the directors is to be drawn from their refusal to give reasons for their decision".

[174] *In re Dublin North City Milling Co.* [1909] 1 I.R. 179, 184.

their power to refuse was based.[175] Normally, however, the corporate constitution will exempt them from even this.

It is clear that the present position puts considerable power in the hands of directors to abuse covertly their discretion in refusing to register a transfer of shares, a power made all the greater by the absence of any rules prescribing the scope of restrictions. Futhermore, the courts have been reluctant to draw adverse inferences even from the most suspicious of circumstances. In *Re Smith and Fawcett Ltd*[176] two sole shareholder-directors each held 4001 shares in the company. One of the directors died and the devisees of his shares applied to have them registered in their names. The director who received the application exercised his discretionary power and refused to register all the 4001 shares, offering to register only 2001 shares and to purchase the remainder himself. On these facts the court refused to draw the inference that the director was acting in bad faith in attempting either to purchase the shares at an undervalue or to obtain overall majority control of the company. It is submitted, however, that on the facts of *Re Smith and Fawcett Ltd* there was some evidence that the director was attempting to acquire the shares at an undervalue and this, at least, should have shifted the onus onto the director to show that he acted properly.

There are straws in the wind which indicate that in a case like *Re Smith and Fawcett Ltd* the courts might in the future adopt a much less tolerant and acquiescent attitude to directors who refuse to register a transfer of shares. This is partly due to the fact that the courts have belatedly recognized that the phrase "*bona fide* in the interests of the company" lacks precision, particularly where the company is "Balkanized". As Lord Wilberforce said, this phrase

> may... become little more than an alibi for a refusal to consider the merits of the case, and in a situation such as this [*i.e.* where the company is factionalised] it seems to have little meaning other than "interests of the majority".[177]

In *Re Swaledale Cleaners Ltd*[178] Danckwerts L.J. opined that a blank refusal by the board to register a transfer of shares would constitute *prima facie* grounds for winding up a company on the just

---

[175] See *Duke of Sutherland* v. *British Dominions Land Settlement Corp.* [1926] Ch.746 (Ch.Div.); *Berry & Stewart* v. *Tottenham Hotspur Football and Athletic Co.* [1935] Ch.718 (Ch.Div.).

[176] [1942] Ch.304 (C.A.).

[177] *Ebrahimi* v. *Westbourne Galleries Ltd* [1973] A.C. 360, 381 (H.L.); see also *supra*, note 172.

[178] *Supra*, note 167, 1716.

and equitable grounds. This view was endorsed by Lord Cross who stated in *Ebrahimi* v. *Westbourne Galleries Ltd* that "if the directors did not wish to give evidence and submit to cross-examination the company would have to be wound up".[179]

The observations of Danckwerts L.J. and Lord Cross were made with reference to *Re Cuthbert Cooper and Sons Ltd*[180] where Simonds J. considered that a refusal by directors to register a transmission of shares, where such power of refusal was clearly conferred by the articles of association, was something for which there was no redress. Provided the directors acted in a legally proper manner and used their power for a legally proper purpose, shareholders (or aspirant shareholders) could not complain of a harsh exercise of that power. While the excessively legalistic basis on which Simonds J. premised the legal relationship between shareholders can be criticized,[181] it is more difficult to criticize the substantive outcome of the case. Can it not be postulated with a high degree of confidence that one of the normal attributes of the incorporated partnership is that the members should have a right to select their co-adventurers and that this is what restrictions on the transfer or transmission of shares are primarily designed to achieve? There is no evidence that either Danckwerts L.J. or Lord Cross would cavil at this proposition; all that they required was that directors give reasons for the exercise of their discretion. This, however, leaves open the question of what is a proper reason for refusing to register a transfer of shares. On this neither judge gave much guidance and the cases are, in general, of little help beyond the proposition that directors in exercising their power must not be predominantly or solely motivated by considerations of self-interest. The serviceability of this rule in a situation such as that in *Re Smith and Fawcett Ltd* is problematic in light of the *dicta* that directors can be guided by considerations of the suitability of prospective members as co-adventurers[182] and, in the case of a private company, it is hard to see why this should not be so. This, of course, leaves the transferor and transferee somewhat up in the air, and in the case of transmissions the deceased's estate is left holding an asset of doubtful value since the rights of ownership cannot be effectively utilized.

---

[179] *Supra,* note 177, 385.

[180] [1937] Ch.392 (Ch.Div.).

[181] See Prentice, *Winding Up on the Just and Equitable Ground: The Partnership Analogy* (1973) 89 L.Q.R. 107, 118-20.

[182] Boyle (ed.), *Gore-Browne on Companies* 42d ed. (1972), 357.

The question is what, if any, remedy should be provided in this situation. While it can be plausibly argued that we should not be overly concerned with this plight of the transferor or transferee, as all they are being made to do is comply with the corporate constitution, the same stoical attitude is not appropriate in the case of the transmission of shares. By failing to provide a remedy in this situation the law is recognizing covertly a system of private compulsory acquisition without compensation. If this seems an excessively colourful characterization of the situation one has merely to dwell on the petitioners' position in *Re Jermyn Street Turkish Baths Ltd*[183] to test its accuracy. Also, in the transferor-transferee situation the lack of freedom to transfer the shares can facilitate minority oppression. Accordingly, it is submitted that the courts should at least have the means available to deal with a situation where the refusal of the directors to register a transfer of shares is unduly harsh. A number of solutions are possible.

The least draconic remedy from the point of view of the directors is that found in clause 20(2) of the English *Companies Bill, 1973*. This sub-clause provided that,

> [w]here an application is made to a company for a person to be registered as a member in respect of shares which have been transfered or transmitted to him by act of parties or operation of law, the company shall not refuse registration by virtue of any discretion in that behalf conferred by the articles unless it has served on the applicant, within the period of twenty-eight days beginning with the day on which the application was made, a notice in writing stating the facts which are considered to justify refusal in the exercise of that discretion.

The problem with this sub-clause is that it does not go far enough. While it does remove the veil of secrecy that often surrounds the decisions of directors it provides no real solution for the situation where the directors starkly state that they will be unable to work harmoniously with the proposed transferee.

A more robust, and on balance preferable, solution is that provided by section 47 of the *C.B.C.A.* which introduces the novel concept of "constructive registered owner". Subsection 47(2) provides that,

> ... a corporation whose articles restrict the right to transfer its securities shall, and any other corporation may, treat a person as a registered

---

[183] [1971] 1 W.L.R. 1042, [1971] 3 All E.R. 184 (C.A.). While the merits in that case were all in favour of Mrs Peskoff, the petitioners ended up being locked into a company from which they received no return on their investment and with respect to which the only possible purchaser was Mrs Peskoff. Having survived the action alleging oppression in the management of the company there was little need for her to behave generously.

security holder entitled to exercise all the rights of the security holder he represents, if that person furnishes evidence as described in subsection 72(4) to the corporation that he is

(a) the executor, administrator, heir or legal representative of the heirs, of the estate of a deceased security holder;

(b) a guardian, committee, trustee, curator or tutor representing a registered security holder who is an infant, an incompetent person or a missing person; or

(c) a liquidator of, or a trustee in bankruptcy for, a registered security holder.

Thus in certain circumstances, trustees in bankruptcy, personal representatives and other stipulated fiduciaries may participate in corporate management even though not registered as such. The limited reach of this section should be noted; it does not deal with all situations where there has been an *inter vivos* transfer but basically covers only those involving forced transfers and situations where shares are held for an incompetent or an infant.

The solution to the restriction on transfer problem embodied in subsection 47(2) would have provided a solution to some cases which have arisen where the courts have appeared unable or unwilling to provide a remedy. For example, the trustee in *Re K/9 Meat Supplies (Guildford) Ltd*[184] would, under paragraph 47(2) (c) of the *C.B.C.A.*, have been able to exercise the rights vested in the bankrupt in that case. But it is submitted that the solution in section 47 is both too broad and too narrow. It is too narrow in that it only covers a restricted category of situations and thus fails to recognize fully the oppressive potential present in any transfer situation where the transferability of shares is limited. It is too broad in that it compels a company to recognize as members persons whom it would prefer to exclude even where the grounds for exclusion appear meritorious. However, the force of this argument is blunted by the fact that the *C.B.C.A.* accords constitutional status to a unanimous shareholders' agreement which could provide for the compulsory purchase of a member's shares in situations falling within subsection 47(2). Accordingly, the shareholders can arrange for an alternative to the forced statutory marriage embodied in subsection 47(2). The justification for this section, that it "prevents a gap in the continuity of legal administration of the corporation's business",[185] is unconvincing. Firstly, this may not necessarily be true and this problem is more neatly

[184] [1966] 1 W.L.R. 1112 (Ch.Div.). This case was criticized in *Ebrahimi* v. *Westbourne Galleries Ltd, supra,* note 177, 387 *per* Lord Cross.

[185] *Proposals, supra,* note 31, vol.I, para.160.

solved by requiring a company to have a plurality of directors.[186] Secondly, this argument fails to recognize the legitimate interests of a company in controlling the admission of new members.

The third and probably most satisfactory solution is to provide the owner with the right to petition the court to have his shares compulsorily acquired by the majority where the company refuses to register a transfer. This could be achieved by extending the concept of oppression embodied in any general oppression remedy[187] and this would certainly be an improvement on the present situation.[188] The argument against such a remedy is that it might enable a shareholder to extricate himself from a bargain which he has freely entered into and also, that it might put unfair financial pressures on the company or his fellow shareholders. While the first of these arguments has some merit,[189] it is based on the rather unrealistic belief that because the company is a thing of perpetual duration then the relationship between shareholders should also be perpetual. The financial hardship aspect of the matter could be dealt with by an appropriate court order.[190]

ISSUER-TRANSFEREE RELATIONSHIP

Most of the aspects of the issuer-transferee relationship have already been touched upon in the previous section. The obligation of the issuer to register a transfer, and the circumstances in which it is excused from doing so, affect both the transferor and transferee equally.[191] The protection provided to the issuer against an improper transfer has also already been dealt with. To recap, the issuer is entitled to require a signature guarantee[192] but, as we have seen, it cannot require an endorsement guarantee that warrants not only the genuiness of the siguature but also the rightfulness of the transfer.[193] Also, the issuer can require assurances that the

---

[186] See, *e.g., Minutes of Evidence taken before the Company Law Committee* (Lord Jenkins, Chairman), Cmnd 1749, 836, paras.4059-62.

[187] See *C.B.C.A.*, s.234. Arguably, para.234(2) (c) would cover a situation where directors unreasonably refuse to register a transfer of shares.

[188] The present solution seems to be either compulsory liquidation or registration of unwanted members; see, *e.g., Ebrahimi* v. *Westbourne Galleries Ltd, supra,* note 177.

[189] See, *e.g., Re Suburban Hotel Co.* (1867) 2 Ch.App.737.

[190] See, *e.g., C.B.C.A.*, para.234(3) (f).

[191] *C.B.C.A.*, subs.71(1) merely speaks in terms of the obligation to register where "a security in registered form is presented for transfer".

[192] *C.B.C.A.*, ss.72 and 65.

[193] *C.B.C.A.*, subs.65(3).

endorsement is effective[194] which is normally only a problem where the transfer is made by an agent or a fiduciary. The basic result of these rules is that an issuer will not be "liable to the owner or any other person who incurs loss as a result of the registration of a transfer of a security"[195] if the necessary endorsements are provided and the issuer was under no duty to enquire into adverse claims. All these aspects of the transfer process have already been noted, and, as we have seen, their general purpose is to restrict the enquiries that the issuer must and can make in order to expedite the transfer process. Lastly, the rule in *Sheffield Corporation* v. *Barclay*[196] appears to have been abrogated, although a person who presents a security for registration of transfer does make certain warranties.[197]

CONCLUSION

If the experience of the United States with Article 8 of the *U.C.C.* is any guide then Part VI of the *C.B.C.A.* should achieve its objective of making securities negotiable and fulfilling adequately the needs of the commercial community. The minor departures from Article 8 which Part VI introduces, in particular the constitutional effect given to unanimous shareholder agreements,[198] can only be seen as an improvement. There, of course, remains the question of the constitutionality[199] of Part VI of the *C.B.C.A.*, but this is something beyond the purview of this article.*

---

194 *C.B.C.A.*, subs.72(1).
195 *C.B.C.A.*, subs.74(1).
196 *Supra*, note 79.
197 *C.B.C.A.*, subs.59(1).
198 See *C.B.C.A.*, subs.45(8).
199 See *Proposals, supra*, note 31, vol.I, paras.15, 16 & 169.

* Professor R. McLaren of the University of Western Ontario read an early draft of this article and made a number of helpful suggestions for improvements. For its blemishes I, of course, remain responsible.