Corporations—Liability of Corporation to Actual Owner of Shares for Dividend Payment to Apparent Record Owner, Lindner v. Utah Southern Oil Co., 283 P.2d 605 (1955)

COMMENTS

Corporations—Liability of Corporation to Actual Owner of Shares for Dividend Payment to Apparent Record Owner

Lindner v. Utah Southern Oil Co., 3 Utah 2d 302, 283 P.2d 605 (1955)

In 1931, X, a shareholder of record of defendant corporation, assigned his share certificates to plaintiff. Neither party notified defendant of the transfer, hence no change of ownership was recorded on the corporate books. Between 1931 and 1951, when plaintiff disposed of the shares, dividends were declared by defendant but were not paid either to plaintiff or the record owner. In 1949, Y, claiming that he became owner of the shares through purchase of the assets of an insolvent brokerage firm,[1] and that the certificates had been lost, applied to the defendant for the issuance of new certificates. On Y's presentation, in accordance with the corporate by-laws,[2] of an affidavit and an indemnity bond to protect the corporation in case the original certificates were still outstanding, together with an assignment of interest from the administratrix of X's estate, defendant recorded Y as the owner of the shares, issued him new certificates, and paid him the accrued dividends. When notified that plaintiff possessed the original certificates, defendant, while admitting a duty to recognize the validity of such certificates, resisted plaintiff's claim to the accrued dividends. The Supreme Court of Utah, analogizing the transaction to cases involving forged or stolen certificates, held that the corporation was not justified in paying dividends to its apparent record owner, and that plaintiff was entitled to the dividends.[3]

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1. Brief for Appellant, p. 4, Lindner v. Utah Southern Oil Co., 3 Utah 2d 302, 283 P.2d 605 (1955).

2. Section 5 of the corporate by-laws provided:

> Any person claiming that a certificate of stock is lost or destroyed shall make an affidavit or affirmation of that fact and advertise the same in such manner as the board of directors may require, and shall, if the board of directors so requires, give the corporation a bond of indemnity, in form and with one or more sureties satisfactory to the board, in at least double the value of the stock represented by said certificate, whereupon a new certificate may be issued of the same tenor and for the same number of shares as the one alleged to be lost or destroyed, but always subject to the approval of the board of directors.

Brief for Appellant, p. 6, Lindner v. Utah Southern Oil Co., 3 Utah 2d 302, 283 P.2d 605 (1955). Compare the above provision with UNIFORM STOCK TRANSFER ACT § 17.

3. Lindner v. Utah Southern Oil Co., 3 Utah 2d 302, 283 P.2d 605 (1955), *reversing* 2 Utah 2d 74, 269 P.2d 847 (1954).

The Uniform Stock Transfer Act, effective in forty-seven states,[4] was promulgated for the specific purpose of giving to stock certificates some of the attributes of negotiability normally attaching to bills and notes.[5] Under its provisions, passage of "title" is accomplished by a physical delivery of the certificate either endorsed in blank or accompanied by a separate document containing a written assignment.[6] Because a corporation may not be notified of a transfer accomplished by either of the above methods, a transferor may be the record owner of stock even though he has previously disposed of the certificates and is not the actual owner of the shares. To meet the commercial necessities of such a situation, and to give the corporation a measure of protection in dealing with its stockholders, Section 3 of the Act provides that a corporation is justified in paying dividends to the record owner of the shares.[7]

In the principal case the defendant corporation contended that, after recording Y on the corporate books as the owner of the shares, the payment of the accrued dividends to Y was justified since he was the "record owner" as that term is used in Section 3 of the Act.[8] Obviously, however, Section 3 does not protect the corporation's payment of dividends to the record owner in all situations. For example, a corporation is clearly not protected in paying dividends to its record owner after receiving notice of an assignment of the shares,[9] nor in paying dividends to a person who becomes record owner as a result of forging the endorsement on the certificates.[10] Similarly, it would seem that a payment of dividends to a person who becomes "record owner" by misrepresentation of his ownership and loss of the share certificates should not be considered as a payment to the "record

4. Hereinafter referred to in the text as the Act. The statutes in the various states, and the date of their enactment, are listed in UNIFORM STOCK TRANSFER ACT 6 (Cum. Supp. 1954). Pennsylvania has adopted the UNIFORM COMMERCIAL CODE.

5. UNIFORM STOCK TRANSFER ACT § 1 (Commissioners' Note):

The transfer of the certificate is here made to operate as a transfer of the shares. . . . The reason for the change is in order that the certificate may, to the fullest extent possible, be the representative of the shares. This is the fundamental purpose of the whole act, and is in accordance with the mercantile usage. The transfer on the books of the corporation becomes thus like the record of a deed of real estate under a registry system.

6. UNIFORM STOCK TRANSFER ACT § 1.

7. UNIFORM STOCK TRANSFER ACT § 3:

Nothing in this act shall be construed as forbidding a corporation, (a) To recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner. . . .

8. Brief for Appellant, p. 8, Lindner v. Utah Southern Oil Co., 3 Utah 2d 302, 283 P.2d 605 (1955).

9. See, *e.g.*, Homestake Oil Co. v. Rigler, 39 F.2d 40 (9th Cir. 1930); Baar v. Fidelity & Columbia Trust Co., 302 Ky. 91, 193 S.W.2d 1011 (1946); Central Nebraska Nat'l Bank v. Wilder, 32 Neb. 454, 49 N.W. 369 (1891); Turnbull v. Longacre Bank, 249 N.Y. 159, 163 N.E. 135 (1928); Steel v. Island Milling Co., 47 Ore. 293, 83 Pac. 783 (1906).

10. Herbert Kraft Co. Bank v. Bank of Orland, 133 Cal. 64, 65 Pac. 143 (1901); Pratt v. Taunton Copper Co., 123 Mass. 110 (1877).

owner" as provided in Section 3 of the Act. Thus, the ultimate decision in the case should not be based on the provisions of this section.

The court in the instant case predicated the corporation's liability for the accrued dividends on two bases: (1) that since plaintiff had "title" to the shares, Y could receive nothing through the purported "assignment"[11] from the administratrix of X, the original record owner, and thus Y's position was equivalent to that of a forger or a thief;[12] and (2) that the corporation was "not free from negligence" in making payment to Y, since it could have protected itself merely by paying the dividends to the original record owner or his estate.[13] Neither ground appears to be an adequate foundation for the decision. While Y's position might be roughly analogous to that of a forger or thief in not having "title" to the shares, the whole context of the Act, especially Section 3, indicates that the location of "title" is not determinative of the corporation's right to pay dividends.[14] Equally unsubstantial is the court's suggestion that the corporation could have protected itself merely by making payment of the dividends to the original record owner or his estate. If Y's representations to the corporation had been true, the corporation would have been placed on notice of an assignment and would not have been protected in subsequently paying dividends to the original record owner or his estate.[15] Since the corporation could not ascertain the truth of Y's representations until plaintiff's claim was made—the original record owner being dead and his administratrix having relinquished any claim to the shares—it seems clearly inaccurate to characterize the corporation's conduct as negligent.

The most adequate solution of the problem posed by the unique factual situation in the instant case can be found by examining the procedure governing replacement of lost or stolen certificates. Under Section 17 of the Act, which is basically a codification of the common law,[16] and under the provisions of most corporate by-laws,[17] the cor-

11. It would seem that the action of X's administratrix was merely a relinquishment of interest, rather than an "assignment." Actually, Y claimed that the original record owner, X, had assigned the shares to the brokerage firm through which Y claimed ownership of the shares. See Brief for Appellant, p. 4, Lindner v. Utah Southern Oil Co., 3 Utah 2d 302, 283 P.2d 605 (1955).

12. Lindner v. Utah Southern Oil Co., 3 Utah 2d 302, 283 P.2d 605 (1955).

13. *Ibid.* The court reached this conclusion by strictly construing the statute as protecting the corporation *only* if payment was made to the record owner or his estate. Thus, the court reasoned that payment of dividends to anyone other than the record owner or his estate was negligent.

14. See the text of § 3 quoted in note 7 *supra.*

15. See text supported by note 9 *supra.*

16. UNIFORM STOCK TRANSFER ACT § 17 (Commissioners' Note).

17. CHRISTY & MCLEAN, THE TRANSFER OF STOCK § 275 (2d ed. 1940). The corporation in the instant case issued the certificates voluntarily in accordance with its by-laws, cited in note 2 *supra;* thus § 17, dealing only with court-ordered issuance of certificates, was not applicable. The by-law provision of the defendant corporation, however, contained basically the same procedure in regard to the furnishing of an affidavit and an indemnity bond as § 17 of the Act. No

poration is not required to replace lost certificates unless the applicant furnishes an indemnity bond sufficient to protect the corporation from any liability incurred by reason of the fact that the original certificate remains outstanding. The courts which have considered the effect of an indemnity bond provision have readily concluded that the presence or absence of such bond does not in any way alter the corporation's liability.[18] Such a conclusion, however, is open to criticism. Admittedly, a court's decision should not be based on the existence or non-existence of an indemnity bond *in an individual case.* However, the availability of such a protective measure for the corporation *in every situation* involving a claim of a lost certificate should be determinative of liability when, as in the instant case, neither party, realistically, is at fault.[19] Ultimately, of course, the risk of loss will be, not on the corporation, but on the surety.[20] Since the surety can condition its issuance of the indemnity bond on satisfactory proof by the claimant of the actual loss of the certificates, the ultimate responsibility for the surety's mistaken judgment should be its own.

Certainly the actual owner of shares is entitled to benefit from the procedure established for the replacement of lost or stolen certificates.[21] Only in such a way will the desired objective, negotiability of share certificates, be achieved without undue interference with the interests of shareholders and the corporation. The quarrel, then, is not with the result reached in the principal case, but with the reasoning used to reach that result.

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cases were found in which a court distinguished the corporation's liability for a wrongful dividend payment in situations involving a voluntary replacement of the lost certificates from the liability imposed when the replacement was court-ordered.

18. Cleveland & Mahoning R.R. v. Robbins, 35 Ohio St. 483 (1880); First Nat'l Bank v. Stribling, 16 Okla. 41, 86 Pac. 512 (1905).

19. As to the corporation's standard of care, see text supported by note 15 *supra.* Plaintiff's failure to notify defendant of the assignment of the shares from the original record owner to herself for nearly twenty years was not negligent conduct. Cleveland & Mahoning R.R. v. Robbins, 35 Ohio St. 483 (1880). The corporation did not raise this issue in the instant case.

20. In the instant case the indemnity bond was in the amount of $25,000. The market value of the shares was $11,000 and the suit was for $4,000 in dividends. Thus the indemnity bond clearly covered the entire liability of the corporation. Brief for Appellant, pp. 1, 3, 4, Lindner v. Utah Southern Oil Co., 3 Utah 2d 302, 283 P.2d 605 (1955). In at least one case it has been held that the bond should be of the open penalty type. Chemical Bank & Trust Co. v. Anheuser-Busch, Inc., 360 Mo 877, 231 S.W.2d 165 (1950).

21. Two early cases relied on by defendant are not precisely in point. In Cleveland & Mahoning R.R. v. Robbins, 35 Ohio St. 483 (1880), the corporation issued new certificates and paid dividends to the *original* record owner. In Brisbane v. Delaware, Lackawanna & Western R.R., 94 N.Y. 204 (1884), the corporation issued the certificates and paid dividends to the *administrator* of the *original* record owner on his representation that the original certificates were lost. In spite of the factual distinction, however, the result in the instant case appears to be basically in conflict with the earlier decisions.