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THE TRANSFER OF SECURITIES IN ORGANIZED MARKETS:
A COMPARATIVE STUDY OF CLEARING AGENCIES IN THE UNITED STATES OF AMERICA, BRITAIN AND CANADA

By Egon Guttman* and Thomas P. Lemke**

The development of a negotiable security to enable free transferability of an interest in a commercial corporation was an essential by-product of organized securities markets. The requirement for liquidity in investments called for the concomitant negotiability of the interest in which the investment existed, that is, the free transferability of such interest without any claims against the rights so transferred. This paper will examine how the absence of negotiability affects the method of delivery and transfer (settlement) in an organized market. It will also note how negotiability has affected the settlement of market transactions. Though this paper concentrates on the rules governing share ownership, these rules also apply mutatis mutandis to debt issues.

To understand the problems of the organized market requires an analysis of the relationship established by share ownership. Share ownership, as a conglomerate of rights in a corporation, conceptualizes what once was looked upon as “membership,” formed by a contractual relationship as spelled out by the memorandum and articles of association, which had replaced the “Deed of Settlement,” in the formulation of a corporation.


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1 The over-the-counter market and exchanges.

2 “Colloquially expressed, even the thief who has no legal right or claim to the instrument or to the rights and interests which it represents can in many instances give the bona fide purchaser a perfect title!” Israels & Guttman, Modern Securities Transfers (2d ed. Boston: Warren, Gorham & Lamont, 1967, cumulative supplement 1980) at S. 1-9.

3 Cf. Companies Act, 1948, 11 & 12 Geo. 6, 38, s. 26 (U.K.). A similar effect arose under Canadian federal and provincial laws both under letters patent and the memorandum of association systems. See Wegenast, The Law of Canadian Companies (Toronto: Burroughs, 1931) at 244-47. In the United States this would also appear to be the underlying concept. See, e.g., Delaware Gen. Corp. Law (Title 8, Ch. 1, (1976)) §§101, 103, 108 and 164; Model Business Corporation Act, American Bar Association, §§17-20.

The concept of an independent legal personality of a corporation was clearly expressed in English law in the judgment of Lord MacNaghten in \textit{Salomon v. Salomon \& Co.},\textsuperscript{5} which finds its counterpart both in American\textsuperscript{6} and in Canadian jurisprudence.\textsuperscript{7} The articles of association are generally held to constitute a contract not merely between each individual shareholder but between the shareholders and the company.\textsuperscript{8} There are some limitations on the effect of such a contract. As Lord Herschell stated in \textit{Welton v. Saffery},\textsuperscript{9} "[i]t is quite true that the articles constitute a contract between each member and the company, and that there is no contract in terms between the individual members of the company; but the articles do not any the less, in my opinion, regulate their rights \textit{inter se}.”\textsuperscript{10} Thus, standing to sue for a breach of the articles granting a shareholder specific rights unconnected with his position \textit{qua} shareholder, such as appointment to an office, seems to be confined to the company and does not give rise to a cause of action in the shareholder.\textsuperscript{11} The rule in \textit{Foss v. Harbottle}\textsuperscript{12} carried this further by preventing a minority shareholder from basing an action for damage caused to him personally upon harm done to the corporation by the majority, if the act was one which could be ratified by a majority.\textsuperscript{13} The effect of this rule was to further contradict the concept of interlinking contractual relationship creating “membership.”

In the United States this approach was not strictly adhered to and the possibility of a derivative suit was recognized,\textsuperscript{14} in some instances even with-

\textsuperscript{8}See, \textit{Wood v. Odessa Waterworks Co.} (1889), 42 Ch. D. 636, 58 L.J. Ch. 628, 37 W.R. 733, \textit{per Stirling J.}
\textsuperscript{10}Id. at 315 (A.C.), 505 (L.T.), 512 (W.R.).
\textsuperscript{12}(1843), 2 Hare 461, 67 Eng. Rep. 189, 9 Digest 616 (Ch.).
\textsuperscript{14}\textit{Hawes v. Oakland}, 104 U.S. 450 (1882), while recognizing the right to sue, engrafted a “demand requirement” on such right. See also \textit{J.I. Case Co. v. Borak}, 377 U.S. 426 at 432, 84 S.Ct. 1555 at 1560 (1964). "The injury which a stockholder suffers ... ordinarily flows from the damage done the corporation, rather than from the damages inflicted directly upon the stockholder." But note \textit{Abbey v. Control Data Corp.}, 460 F. Supp. 1242 (D. Minn. 1978) \textit{aff’d} 603 F.2d 724 (8th Cir. 1979) applying "business judgment" rule to prevent derivative suit. And see \textit{Zapata Corp. v. Maldonado}, 430
out the prerequisite of a demand on directors or shareholders. In addition, liability of shareholders for some specified obligations of the corporation, such as wage claims of employees, has often been retained by various statutes in the Anglo-American legal systems.

Whether arising from “contract” or “membership,” the content of the concept of a share in Anglo-American jurisprudence has been analyzed by Farwell J., in Borland’s Trustee v. Steel Bros. & Co. Ltd.: 17

A share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se in accordance with §16 of the Companies Act 1862. The contract contained in the Articles of Association is one of the original incidents of the share. A share is not a sum of money settled in the way suggested, but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money or less amount. 21

Thus, the “share” is essentially a chose in action as well as a property right. It can be viewed as a “peculiar” bundle of rights in relation to the corporation. 22 Under this analysis, there is no legal reason why freedom of transferability could not be reasonably restricted either by contract or by requirement of law. 24 “Share ownership” is dependant upon recognition by the cor-

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A. 2d 779 (Del. Sup. Ct. 1981) indicating that the Court is to decide whether it would be in a corporation’s best interest not to have a derivative suit brought by a shareholder.

10 See Note: Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit (1960), 73 Harv. L. Rev. 746.


17 [1901] 1 Ch. 279, 49 W.R. 120.

18 Authors’ footnote: See now Companies Act, 1948, 11 & 12 Geo. 6, c. 38, s. 20 (U.K.).

19 Authors’ footnote: It is not a sum of money dealt with according to executory limitations.


21 Supra note 17, at 288 (Ch.), 121 (W.R.).

22 Colonial Bank v. Whinney (1886), 11 App. Cas. 426, 56 L.J. Ch. 43, 55 L.T. 362 (H.L.). As to the approach in the United States, this is a conclusion which is reached based on an analysis of the rights and powers of shareholders. See generally, Ballantine, Ballantine on Corporations (Chicago: Callaghan, 1946).

23 Cross-options, restrictions on alienation to prevent a violation of securities laws and restrictions on alienation to prevent loss of tax advantages under Sub-Chapter S of the Internal Revenue Code, are some examples. Note, the recommendations under S.E.C. Rules 146 and 147, 17 C.F.R. §§230.146 and 230.147 promulgated under the Securities Act of 1933, 15 U.S.C. §§77b and 77c to legend security certificates. See Israels & Gutman, op. cit., supra note 2, Ch. VIII.

24 See e.g., Companies Act, 1948, 11 & 12 Geo. 6, c. 38, s. 28(1)(a) (U.K.) (Private company). Alaska Native Claims Settlement Act, 43 U.S.C. §1606(h) (1976) (shares totally inalienable for 20 years). Note: all restrictions on transfers must be rea-
poration of the individual as a share owner through entry upon its register of “share owners.” This is the means by which the corporation acknowledges that an individual is entitled to the “bundle of rights” in the corporation, irrespective of what rights he may be able to assert through his transferee who, until replaced on this list, is the person recognized as share owner by the corporation. Before an English corporation can recognize the transferee, however, the transferee must apply to be placed on the shareowners’ list by signing the instrument of transfer. Presumably this indicates that he agrees to the terms of the memorandum or articles of association and to the by-laws of the corporation and, under English and Canadian law, that he accepts the obligation to pay any sum still due on the share to the corporation.

Long before other choses in action were recognized as assignable at law, shares were transferable at common law. The effect of transferability of a share does not follow the simple method of assignment of a common chose in action. Legal title will not be transferred by mere notations to the corporation. Only upon acceptance of the transfer, through entry on the shareowners’ list, will such legal title vest in the transferee. Thus, a struggle developed between share ownership as “property,” the alienation of which cannot be unreasonably restricted, and share ownership acquired as a “release of one person from membership and the admission of another in his place,” which should enable the obligor to raise claims against the transferee which he would have had

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against the transferor. Even claims of which the obligor has been given proper, legally binding notice would be enforceable against the transferee, absent specific legal rules; as such, transfers or assignments are subject to equities.

The effect of this approach to share ownership is that an unregistered transfer goes unrecognized by the corporation and may be defeated by a subsequent bona fide assignee or transferee, provided he gains registration first. In addition, vesting of an interest in the chose in action in a third person prior to registration of transfer could affect the rights of the transferee. Furthermore, there is the potential problem of notice of an “adverse claim” to the corporation prior to the transferee demanding to be placed on the register of shareholders.

This latter problem is somewhat obviated in English law by the early case of Hartga v. Bank of England, which was later embodied in the Companies Clauses Consolidation Act of 1845. This rule provides that the corporation need not be concerned with any claim to beneficial ownership of its shares. A corporation, therefore, can transfer share ownership to a fiduciary and can thereafter transfer on the instructions of such fiduciary without inquiring as to the rightfulness of the transfer. The only requirement is that the corporation satisfy itself that the request comes from a fiduciary duly constituted as such. Case law in the United States followed this approach until Chief Justice Taney, in Lowry v. Commercial & Farmers Trust Co., imposed on the cor-

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31 E.g., Stoddart v. Union Trust, [1912] 1 K.B. 181, 81 L.J. K.B. 140, 105 L.T. 806 (C.A.) and Re China S.S. Co., ex parte MacKenzie (1869), L.R. 7 Eq. 240, 38 L.J. Ch. 199, 19 L.T. 667. I.e., claims which arise under the contract creating the shares, such as calls.

32 This, of course, is subject to provisions, such as Companies Act, 1948, 11 & 12 Geo. 6, c. 38, s. 117 (U.K.), entitling the company to reject notice of a trust, expressed, implied or constructive. But see Bradford Banking Co. v. Briggs (1886), 12 App. Cas. 29, 56 L.J. Ch. 364, 56 L.T. 62 (H.L.).


37 1845, 8 & 9 Vict., c. 16, s. 20 (U.K.). See now, Companies Act, 1948, 11 & 12 Geo. 6, c. 38, s. 117 (U.K.).


39 15 Fed. Cas. 1040 (1848).
poration the duties of a trustee who "is bound to execute the trust with proper diligence and care, and is responsible for any injury sustained by its negligence or misconduct." Several United States' jurisdictions promulgated statutes to avoid the effect of this "Taney doctrine." These statutes crystallized in the *Uniform Act for Simplification of Fiduciary Security Transfers* and the more comprehensive *Uniform Commercial Code — Article 8, Investment Securities*. Although not completely clearing the trust from the records of the corporation, the UCC limits the proof that can be demanded by a corporation and protects the corporation, complying with the provisions of the UCC, from allegations of having violated the trust relationship. In this area, the Uniform Law Commissioners, while agreeing in principle with the English approach, still see it as being too broad and imprecise to be adopted by them.

With regard to other "adverse claims," English law takes the approach that "the company shall not be bound by or be compelled in any way to recognize (even when having notice thereof) any equitable, contingent, future or partial interest in any share... or... any other rights in respect of any share except an absolute right to the entirety thereof in the registered holder." The UCC, however, provides that an issuer who has received written notice of an adverse claim to an investment security must "discharge any duty of inquiry by any reasonable means, including notifying an adverse claimant by registered... mail [sent to] the address furnished by him...." The adverse claimant will then have thirty days to contest the registration of transfer.

Not only did transferability of "share ownership" change the legal concept of "membership" in a corporation, it also helped to change the economic concept. Corporations are no longer necessarily owner-managed. Management may well be in one or more persons who do not own shares, but who con-

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40 Id. at 1047.
42 Still in force in approx. 35 jurisdictions of the United States of America.
43 [Hereinafter U.C.C.]. The U.C.C.-Article 8 has been enacted in all states of the U.S.A., the District of Columbia, Guam and the Virgin Islands. An amended version to take account of "the uncertificated security" has been enacted in Minnesota (Ch. 695 L. 1978), West Virginia (S.B. 110, L. 1979), Connecticut (P.A. 79-435) and Colorado (H.B. 1487, L. 1981). In Canada also, Ontario's *Business Corporations Act*, R.S.O. 1980, c. 54 and the *Canada Business Corporations Act*, S.C. 1974-75, c. 33, Part IV incorporates a "derivative" of Article 8 of the U.C.C.
44 Compare *Companies Act*, 1948, 11 & 12 Geo. 6, c. 38, s. 117 (U.K.).
45 *Companies Act*, 1948, 11 & 12 Geo. 6, c. 38, sched. 1, Table A, Art. 7.
47 U.C.C. §§8-403; *Canada Business Corporations Act*, S.C. 1974-75, c. 33, ss. 72(7) and 73(1).
48 Id., §§8-403(2); *id.*, s. 73(2).
control the corporation, while share ownership may be in persons who neither have, nor wish to exercise, control. Their interest may be solely represented by an investment intent in which share ownership in a particular corporation reflects the optimization of a portfolio; in other words, the basis on which the investor is prepared to take a risk in return for profits.

Law and theory of the market place coalesce on this point. Both require free alienability of the property right, the *chose in action* represented by share ownership, in order to provide liquidity of investment. Since share ownership is not dependant upon the issuance of a share certificate, the share certificate is merely evidence of ownership of the *chose in action*. English law approaches this issue by denying the effectiveness of a notice of an adverse claim to the corporation. A further attempt to effectuate this liquidity has been to provide that "a certificate, under the common seal of the company, specifying any shares held by any member, shall be *prima facie* evidence of the title of the member to the shares." As such, the share certificate estops the corporation from denying the facts evidenced thereon that the person named, on the date of the certificate, was the registered owner of the number of shares represented by the certificate, and that to the extent indicated, the shares have been fully paid. In other words, the corporation does not assert any lien on the shares unless such claim is indicated on the certificate. This is not an ongoing representation. As Romer L.J. stated in *Rainford v. James Keith & Blackman Co., Ltd.*, "[t]he only representation is that at the date of the certificate the person named therein was owner of the shares." One result is that a failure to deliver the certificate to a transferee, followed by a subsequent sale and delivery of the certificate to a third party, will not give this subsequent purchaser a cause of action against the corporation should it refuse to recognize him as a share owner. This solution does not answer the demand for free negotiability of the interest in a corporation so as to facilitate trading in an organized market.

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52 Such notice is not totally ineffective, however. It will prevent the corporation from giving priority to a lien it may claim, which arose subsequent to such notice. *Bradford Banking Co. v. Briggs*, supra note 32.
53 *Companies Act, 1948*, 11 & 12 Geo. 6, c. 38, s. 81 (emphasis added).
54 [1905] 2 Ch. 147 at 154, 92 L.T. 786, 54 W.R. 189.
56 The basis of this approach is the rather weak one of "estoppel". The claimant must have relied on the representation and this is possible even though he was an original recipient, *Balkis Consol. Co. v. Tomkinson*, [1893] A.C. 396, 63 L.J. Q.B. 134, 69 L.T. 598 (H.L.). The issuer will also be bound by a statement that the share is fully paid up, *Bloomenthal v. Ford*, [1897] A.C. 156, 66 L.J. Ch. 253, 76 L.T. 205 (H.L.). The holder will be able to transfer these shares free from liability to make up any outstanding calls, even though a purchaser from him has notice of the true facts. *Barrow's Case* (1880), 14 Ch.D. 432, 49 L.J. Ch. 498, 42 L.T. 891 (C.A.). On the other hand, only share warrants, issued when shares are fully paid up and after exacting revenue requirements are satisfied, are negotiable bearer securities in England. *Companies Act, 1948*, 11 & 12 Geo. 6, c. 38, ss. 83, 112. Note: There is only one stock exchange in the United Kingdom, the London Stock Exchange. See The Stock Exchange of the United Kingdom and Ireland, Stock Transfer (Recognized Stock Exchanges) Order, S.I. 1973/536.
The various United States’ jurisdictions have adopted a different solution. The UCC\textsuperscript{57} provides for “a negotiable instrument law dealing with securities.”\textsuperscript{58} The effect of Article 8 is to fuse the intangible interest represented by share ownership with the certificate evidencing that share by providing that transfer of the certificate automatically carries with it the shares represented thereby. Negotiability of the certificate will enable a \textit{bona fide} purchaser, described 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,”\textsuperscript{59} to take the share “free of any adverse claim.”\textsuperscript{60}

The \textit{Canada Business Corporations Act}\textsuperscript{61} has adopted the approach of the UCC and it has rejected the approach followed in English law.\textsuperscript{62} The share certificate is treated as a negotiable instrument,\textsuperscript{63} negotiated by delivery if endorsed in blank or by endorsement and delivery if not so endorsed, as where the registered owner is the transferor.\textsuperscript{64} Until a change in the list of registered owners occurs, however, the corporation may “treat as absolute owner of the security the person in whose name the security is registered in a securities register.”\textsuperscript{65}

Organized securities markets have long recognized the dangers to good faith purchasers of securities who are subject to adverse claims. To eliminate such dangers they have sought, by rule, to limit the concept of “good” delivery. As between members of the market, “good” delivery is limited to cases where the form of the registration and the corresponding endorsement has no feature which could conceivably be interpreted to give “notice”\textsuperscript{66} of a potential adverse claim of any type. To comply with this requirement, a broker receiving a security from a customer, which is registered in the name of a fiduciary or which in any other way may cause the appearance of an adverse claim, will

\textsuperscript{57} \textit{Supra} note 43.
\textsuperscript{58} U.C.C. §8-105. The U.C.C. thereby continues the policy started by the \textit{Uniform Stock Transfer Act}, resultant upon the inapplicability of the \textit{Negotiable Instruments Act} to investment securities. \textit{C.f. Edelstein v. Schuler & Co.}, [1902] 2 K.B. 144 at 154-56 \textit{per} Bingham J. expressing the policy of the \textit{Imperial Bills of Exchange Act, 1882}, 45 & 46 Vict., c. 61, a policy which would not help with share ownership.
\textsuperscript{60} U.C.C. §§8-301(1) and (2); \textit{Canada Business Corporations Act}, S.C. 1974-75, c. 33, §844(2), 56(2).
\textsuperscript{61} S.C. 1974-75,c. 33, Part VI. An example at the provincial level is Ontario's \textit{Business Corporations Act}, R.S.O. 1980, c. 54, which followed the lead of the U.C.C.-Article 8. The multi-party contracts between the Canadian Depository for Securities Ltd. and each of the participants in the depository, attempts to incorporate U.C.C.-Article 8 into their relationship.
\textsuperscript{62} \textit{Id.} See also Guttman, \textit{The Transfer of Shares in a Commercial Corporation—A Comparative Study} (1964), 5 B.C. Indus. & Comm. L. Rev. 491.
\textsuperscript{63} \textit{Canada Business Corporations Act}, S.C. 1974-75, c. 33, s. 44(3).
\textsuperscript{64} \textit{Id.}, ss. 60, 61, 62, 63.
\textsuperscript{65} \textit{Id.}, s. 47(1).
\textsuperscript{66} In this context “notice” included not only “reason to know” but all the proliferate forms of “constructive notice.”
immediately present the security for registration into "street name." As a result, the existence of any adverse claim should become apparent before the buying broker (a fortiori a purchaser whether or not bona fide) enters the picture.

If the possibility of an adverse claim appears, typically from a "stop transfer notice" on file with the issuer, the selling broker who has sold the security prior to registration of transfer into "street name" must shoulder the risk that the appearance of an adverse claim will delay his delivery to the buying broker beyond the settlement date. In such a case, the selling broker will have to cover in the open market and look to his customer for reimbursement.

Delivery of a security subject to adverse claims is not good delivery in any organized securities market. As a result, these markets provide for reclamation procedures. "Reclamation" connotes the right of a buying broker to return a security, previously delivered to and accepted by him in a market transaction, because of a defect in the security such as an adverse claim. The practical effect is to enable the buying broker to "put back" the security to the selling broker, requiring the latter to cover his contract by open market purchase of a like "clean" security. The effect of these rules and practices is to lead to a large number of changes of registration prior to rather than subsequent to delivery under a contract of sale, and therefore to minimize the number of cases in which a purchaser seeking registration of transfer in his name must defend his bona fide status as against an adverse claimant.

The Report of the Committee on Transfer of Securities criticized the idea of putting securities into "street name." It stated:

[W]e consider that this system does not save labour but rather increases it. The duties of the company pass to the 'names' who are called upon to perform the tasks of recording the transfer of shares, the distribution of dividends and capitalisation issues, applications for rights issues or other offers and other tasks which normally fall on the company. We believe this system would raise difficulties as to the legal relationship of the 'name' to the owner of the shares. We also consider that there would be objections to this method from those who, for varied reasons, dislike increasing the anonymity of shareholders.

A short time later it became evident that the practices of the stock exchange

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67 I.e., the name of his nominee recognized in the industry. Such registration will permit endorsement without an accompanying corporate resolution or other authentication of the signature.


69 U.C.C. §§8-403.


72 Many of these transfers occur also to protect the identity of the customer of the selling broker.

73 Dec. 1960, ¶43; Lord Richie, Chairman.
would require changes, and that the idea of shareholding by a nominee so as to facilitate prompt delivery, had to be re-examined.74

In the over-the-counter market, the English Stock Transfer Act75 provides for the seller to sign a "Stock Transfer Form" and hand it to the selling broker, who sends it to the company after endorsing it.76 If more than one sale is involved, the selling broker will send a "Broker's Transfer Form" to the buying broker, who presents it to the corporation for transfer of the shares to his customer. Only fully paid up shares can be transferred on the endorsement by the transferor and without the signature of the transferee. The name and address of the transferee must be stated, however. This provision of the Act overrides any contrary requirements in the memorandum or articles of association of the corporate issuer; for example, a requirement calling upon the transferee to sign the transfer application.77

With regard to stock exchange transactions a different approach has been adopted in Britain, and it has received approval by the Stock Exchanges (Completion of Bargains) Act of 1976.78 This is a computerized settlement system which has been in operation since April of 1979. It covers transfer accounting, lodgments—for investors, and stock management for jobbers (TALISMAN). This system applies only to stock exchange listed securities. It has two key elements: a depository company, SEPON Ltd. (Stock Exchange Pool Nominee),79 and the Settlement Centre of the Stock Exchange which, by means of book entries, traces the acquisitions and sales of shares on the London Stock Exchange. Upon striking a bargain, the broker and the jobber (specialist) make a report to the Stock Exchange Settlement Centre.80 The Settlement Centre "compares" the trade and, if it matches, issues a "sale docket" to the selling broker (clearance). The selling broker then delivers to the Settlement Centre the seller's certificate together with a "Stock Transfer Form" signed by the seller. Where the certificate is in excess of the number of shares to be transferred, the selling broker will tender such certificate together with a "Broker's Transfer Form" requesting only a partial transfer to SEPON Ltd. The remaining shares will then be re-issued to the seller. The Settlement Centre will send the certificate and the applicable transfer form to the corporation which then registers SEPON Ltd. as the owner of the shares.

74 See The Stock Exchange (Completion of Bargains) Act, 1976, c. 47 (U.K.) introducing the concept of a "stock exchange nominee."

75 1963, 11 & 12 Eliz. 2, c. 18 (U.K.). The Act was passed in response to the critique of Companies Act, 1948, 11 & 12 Geo. 6, c. 38, s. 79, by the Jenkins Committee, Report of the Company Law Committee (Cmnd. 1749 ¶482, 1962), see also supra note 73, at ¶27(b).

76 Id. at s. 2(1).

77 The signature of the transferee is required to signify assumption of outstanding obligations with respect to the security.

78 Stock Exchanges (Completion of Bargains) Act, 1976, c. 47 (U.K.).

79 To further facilitate the use of TALISMAN, the Finance Act of 1976, c. 40, s. 127 (U.K.) relieves certain transfers to this Stock Exchange nominee following sale from stamp duty. Only the delivery out to the buyer will attract the stamp duty. The obligation to see the stamp duty is paid is on the Stock Exchange.

80 Stock Transfer (Addition of Forms) Order 1979.
but generally will not issue a share certificate to SEPON Ltd. Where the shares are already within the TALISMAN system, book-keeping entries effectuating delivery to the buying broker or buying jobber will occur by crediting his account with the Settlement Centre and debiting the account of the selling broker or jobber. The Settlement Centre nets these obligations and informs the parties of their obligation to pay, or right to receive payment. Periodic reports instructing the issuing corporation to issue share certificates to the buying broker and a concomitant debit to the share account of SEPON Ltd. are made by the Settlement Centre.

An advantage of TALISMAN is that it interposes the Settlement Centre between each trade. Brokers for the seller receive payment of the price due to them from the Settlement Centre, while buying brokers make payment to the Settlement Centre. Recording and accounting is done by the Settlement Centre, which can communicate with the participants so as to transfer dividends or distribute proxies. Repeated registration of transfer is avoided by having only one registration into SEPON Ltd., followed by one transfer, at the direction of a broker having a credit in his Settlement Centre account, to the ultimate transferee. The TALISMAN system, however, does not guarantee the trade.

The negotiability of the share certificate has created a series of problems in the United States. In order to prevent the certificate from coming into the hands of a bona fide purchaser, who can defeat prior rights, a purchaser would have to insist on physical delivery of the certificate, even if his claim was merely to a security interest in the share ownership. Legending the cer-

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81 Id., s. 1. In the case of active stock this may occur on a daily basis. The forms used are adaptations of those used under the Stock Transfer Act of 1963, 11 & 12 Eliz. 2, c. 18. See id., s. 6(1).

82 Account periods extend over a two week period. Bargains during that period are settled on Account Day, i.e., the Tuesday of the next week but one after the close of the account. TALISMAN allows this period to be accelerated to the Monday.

83 As a result delivery can be within 14 days of settlement.

84 Delivery can only be effected if the selling broker or selling jobber has an adequate supply of shares in his account with the Settlement Centre. A delay also may occur where there are insufficient shares registered in SEPON Ltd. The former lack of shares may be due to fraud, but the latter delay may be caused by a delay in transfer into the name of SEPON Ltd. A Stock Exchange Compensation Fund has been set up to protect investors from fraudulent brokers.

85 Direct delivery is still possible outside the TALISMAN system.

86 See supra note 84. For a further discussion of the TALISMAN system, see Abrams, TALISMAN: A Legal Analysis, (1980), 1 Co. L. 17.

87 U.C.C. §8-105(1).

88 Id., §§-302.

89 Id., §§-301(2).

90 Id., §§-317.

91 Id., §§ 9-105(1)(i) and 9-304. Note: “Purchaser” includes a person who takes “by sale, discount, negotiation, mortgage, pledge, issue or reissue, gift or any other voluntary transaction creating an interest in property.” Id. §§ 1-201(32), (33).
tificate to give notice of an adverse claim to a subsequent purchaser would also achieve this effect and would prevent the certificate from being used to effectuate good delivery in the organized securities market. Negotiability also poses a security problem since such a certificate could be negotiated by mere delivery, if endorsed in blank.

As a result, transfers of share certificates in the United States created a veritable "paper blizzard." The registered owner would transfer to his broker, who would usually register the security into his street name. Subsequently, he would deliver his street name security to a buying broker who would then have the security transferred into the name of his customer. Cost and accounting control problems were multiplied because of the necessity of participating in various markets having different processing systems for clearance, settlement and delivery. In its Study of Unsafe and Unsound Practices of Brokers and Dealers, the Securities and Exchange Commission (SEC) indicated that the greatest opportunity to prevent recurrence of a "paperwork crisis," and the resultant danger of financial loss to the investing public, existed in creating a modernized nation-wide system for clearance, settlement, delivery, and transfer of securities. Congress, therefore, concluded that it was essential to create a national system for clearance and settlement which would be integrated with the "National Market System" which it had already ordained. The National Market System requires putting into place a coordinating mechanism to ensure co-operation among various entities engaged in securities processing—the clearing corporation, the securities depositaries, the transfer agents, and the issuers.

In addition, Congress called upon the SEC to bring about an end to the physical movement of securities certificates in connection with the settlement of transactions among brokers and dealers. The system that is now evolving is applicable only to securities held by participants in the securities industry, such as brokers, dealers, large banks and insurance companies, and not

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92 See text at notes 65-72, supra.
93 See supra note 2.
94 Note: The "paperwork crunch" of the late 1960's created a crisis in that the sudden increase in trading volume resulted in an expansion of trading facilities, without a concomitant expansion in the support areas. The subsequent market decline added to these woes. Securities Industry Study Senate Comm. on Banking, Housing & Urban Affairs, 92d Cong., 2d Sess. (1972); Securities Industry Study Senate Subcomm. on Banking, Housing & Urban Affairs, 93d Cong., 1st Sess. (1973); Securities Industry Study Subcomm. on Commerce & Finance of the House Comm. on Interstate & Foreign Commerce, 92d Cong., 2d Sess. (Subcomm. Print 1972); Robbins, Werner, Johnson & Greenwald, Paper Crisis in the Securities Industry: Causes and Cures (1969).
96 Supra note 94.
97 Study of Unsafe and Unsound Practices, supra note 95.
100 I.e., members of the securities industry.
to the ordinary individual share owner. Deposit of the share certificate with a securities depository results in these securities being registered in nominee or street name, and it facilitates transfer through bookkeeping entries on the books kept by the clearing corporation serving the market on which the transaction in the shares occurred. Securities of participants are held in fungible bulk. Only securities hypothecated by participants are segregated by the clearing corporation. Compliance with SEC rules to segregate a customer's fully paid or excess margin securities is satisfied by entries on the books of the participant. In the case of customers' securities held by brokers, additional protection is provided under the Securities Investor Protection Act.

The obligation of the broker in a market transaction in the United States arises regardless of performance by his customer. The resolution of the broker's obligation entered into on an organized securities market requires comparison, clearance, and settlement.

Information regarding the buy and sell side of the transaction is sent to a clearing agency by the brokers involved for "comparison." Each buy must be matched with a corresponding sell slip.

"Clearance" involves sorting the various trades according to brokers and advising their brokers of their delivery or payment obligation arising from the "compared trade." The simplest form of clearance is the "trade by trade" system (TBT), where brokers deal directly with each other once comparison has established their respective obligations. Clearance by book entry is one of the most important features of any national clearance system. This involves debit and credit entries in the accounts of selling and buying brokers on the books of the clearing corporation and it can be done by the "daily balance

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101 See text at note 67, supra.
103 See SEC Rule 15c2-1 (g), 17 C.F.R. § 240.15c2-1 (g).
104 See SEC Rules 15c3-3(a) (3), (4), 15c3-3(a) (3), (5), 8a-1 and 15c3-3(c) (1), 17 C.F.R. §§ 240.15c3-3(a) (3), (4); 240.15c3-3(a) (3), (5), 240.8a-1 and 240.15c3-3(c) (1). See further, Guttmann, Toward the Uncertificated Security: A Congressional Lead For States to Follow (1980), 37 Wash. & Lee L. Rev. 717 at 721-23.
107 Supra note 102.
108 This brings into operation the concept of "good delivery," where the form of the registration and the corresponding endorsement must have no feature which could conceivably give notice of the existence of an adverse claim to the security, N.Y.S.E. Rule 195-25; A.S.E. (Div. of Sec.) Rules SR 34-44; N.A.S.D., Uniform Practice Code, §§ 29-38. See further, Israels & Guttmann, supra note 2, Ch. VI, §§ 6.06 and 6.07.
109 Supra note 99 at n. 51.
order system" (DBO)\textsuperscript{110} which, on a daily basis, will net "buy" or "sell" positions for each participant in the clearing corporation having a "compared trade" due that day. As a result, payment or delivery may have to be made to, or received from, someone with whom there has been no "compared trade."\textsuperscript{111} Further, where the securities are in a depository, no physical delivery occurs.

The most sophisticated system is the "continuous net settlement" system (CNS), which interposes the clearing agency between the market participants. Under this system the obligation to pay for or to deliver securities is owed to the clearing agency, which in turn must disburse the securities or the money it receives, according to the obligation incurred in the compared trade. The interposition of the clearing agency enables continuous netting, so as to carry over these obligations from day to day.\textsuperscript{112}

Comparison and clearance must be completed by the day when the market rules call for the "settlement" of a trade by delivery of securities and payment of the amount due. Settlement can be by physical delivery and payment by certified check or banker's draft, (envelope delivery)\textsuperscript{113} or by book entry on "the books of the clearing corporation,"\textsuperscript{114} with no physical handling of the share certificates.\textsuperscript{115} In the CNS, settlement of the compared trade is guaranteed by the clearing agency, and participants settle directly with the clearing agency.

The proposed national clearing and settlement system called for by Congress must be structured so as to enable participants to compare, clear and settle all their transactions through one entity regardless of the market in which the trade is executed or the location of the other party to the transaction. This is called "one account processing," a method that does not prevent comparison through the clearing agency affiliated with the particular market place on which the transaction occurred, but requires an "interface" so as to allow comparison instructions to be directed to another clearing agency, which can then perform the clearing functions and generate settlement instruction.\textsuperscript{116} In granting interim registration\textsuperscript{117} to the National Securities Clearing Corporation

\textsuperscript{110} The DBO does not require book entry but will be less efficient that way.
\textsuperscript{111} See \textit{In re Weis Securities, Inc.}, 542 F. 2d 840 at 841 (2d Cir. 1976).
\textsuperscript{112} To enable securities traded on more than one market to be cleared by brokers who trade on more than one market, interfaces between clearing agencies are required to allow one account processing. This problem does not arise under the English TALISMAN as there is only one Stock Exchange in England, see infra note 141.
\textsuperscript{113} \textit{Supra} note 111.
\textsuperscript{114} U.C.C. § 8-320(1) (c).
\textsuperscript{115} Memorandum to Members and Member Organizations of the N.Y.S.E. on "Method For Central Handling of Securities," (July 30, 1964).
\textsuperscript{116} \textit{Supra} note 99, at 3921.
\textsuperscript{117} So far no applicant has shown ability to comply fully with the requirements of the SEC. Interim or temporary registrations have been granted. Such temporary or interim registration is only effective for a period of eighteen months, unless the SEC, by order, provides for a longer period. Within nine months of a grant of interim registration, the SEC must determine whether to institute proceedings to grant or deny registration. See SEC Rule 17Ab2-1(c), 17 C.F.R. § 240.17Ab2-1(c).
(NSCC), the SEC indicated that such registration was "an essential step toward the establishment, at an early date, of a comprehensive network of linked clearance and settlement systems and branch facilities with the national scope, efficiencies and safeguards envisioned by Congress in enacting the 1975 amendments."118

A system taking into account the immobilization of the share certificate seems to be in place. Its extension to the individual share owner is possible through the regulation of brokers and clearing agencies, which must assure effective participation of beneficial owners in corporate governance,119 as well as the requirement for disclosure of such beneficial ownership to enable information to be made available to market participants.120 The next logical step is the one called for by Congress, which requires the SEC to make "its recommendations, if any, for legislation to eliminate the securities certificate."121 By providing for the immobilization of the share certificate, the SEC has gone as far as it can go without interfering with state law.122 In order to eliminate the share certificate, state laws will have to be amended so as not to require the issuance of a share certificate.123

The uncertificated security is no stranger to the American securities market. In recent years, short term debt incurred by the federal government or by some of the independent federal agencies, such as The Federal Home Loan Bank and The Federal Farm Credit Bank, has not been embodied in an instrument but has been recorded on books kept by the Federal Reserve Bank as fiscal agent for the United States.124 Mutual funds also, especially open-ended no-loan funds, have rarely issued certificated shares.125 A transaction in an uncertificated security is not a "paperless" transaction; written instructions to transfer are still necessary.126

At present the question of the uncertificated security is under debate in

118 Supra note 99, at 3917.
120 E.g., id., § 13(d), 15 U.S.C. § 78m(d); SEC Rules 13d-1 et. seq., 17 C.F.R. § 240.13d-1 et seq.
121 Id., § 23 (b) (4) (E), 15 U.S.C. § 78w(b) (4) (E).
123 State corporation laws regarding share certificates fall into four categories: (1) laws requiring that certificates be issued; (2) laws requiring the issuance of a certificate should the registered owner demand a certificate; (3) laws permitting the articles of incorporation to determine the rights of registered owners to demand a certificate and (4) laws permitting issuers subject to the registration provisions of the Securities Exchange Act of 1934, 15 U.S.C. § 78l or the Investment Company Act of 1940, 26 U.S.C. § 4975 to dispense with the issuance of a certificate.
125 Dividend reinvestment plans do not provide for the issuance of certificates for fractional shares.
126 See the non-negotiable "initial transaction statement" contemplated by the proposed revision of U.C.C. Article 8 § 8-408(4) (1977).
the United States. Four jurisdictions have adopted a proposed UCC revision which attempts to provide for the uncertificated security. The effect of recognizing the uncertificated security is to acknowledge the share as a chose in action no longer embodied in a certificate to "reify" it. By creating a bona fide purchaser who can take such uncertificated share "free of any adverse claims," the proposed UCC revisions attempt to create a "negotiable chose in action," a term difficult to conceptualize. As has been shown, English law solved this difficulty by providing that the issuing corporation need not take note of any interest other than that of the legal shareholder. The UCC does not follow this lead. The proposed UCC revision also contains a provision which attempts to deal with a "pledge" of such chose in action, a concept which is very difficult to comprehend. Recognition of adverse claims and reliance on the "initial transaction statement" is an inconsistency which is difficult to reconcile in relation to an incorporeal right when the initial transaction statement does not "reify" the incorporeal right and thus is not negotiable.

Part 10 of the proposed Securities Market Law for Canada (Draft Act) draws on both traditional English corporation law concepts as modified by the Canadian experience, and developments in the United States under federal securities laws. The purpose of Part 10 is clearly stated to be "to facilitate the development and implementation in Canada of one or more book entry systems for the transfer and pledge of securities whether or not they are evidenced by security certificates." In stating the general purpose, the pro-

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128 Minnesota, West Virginia, Connecticut and Colorado, see supra note 43.

129 The revision does not mandate uncertificated securities. It merely provides a framework for the transfer of such uncertificated securities. See U.C.C. § 8-108(1977) Official Comment.


131 See Companies Act, 1948, 11 & 12 Geo. 6, c. 38, s. 117 and Sched. 1, Table A, Art. 7 (U.K.).

132 See especially the provision that "there can be no more than one registered pledge of an uncertificated security at any time." U.C.C. § 8-108 (1977). Is this really a "pledge?" We are dealing here with an incorporeal right. How do you limit this to one encumbrance where subsequent notice of an adverse claim is given to the obligor/issuer?

133 See U.C.C. §§ 8-403(4), 8-408(4) and 8-204(b) (1977). See also §§ 8-408(6), (7) (1977).

134 See U.C.C. §§ 8-408(4) and 8-105(2) (1977). We are not able to accept the argument advanced by Aronstein, Haydock & Scott, supra note 127, at 900, that this was a necessary compromise to attain the co-operation of issuers.

135 Including the Stock Exchange (Completion of Bargains) Act, 1976, c. 47 (U.K.).


137 Anisman et al., 1 Proposals for a Securities Market Law for Canada (Ottawa: Minister of Supply and Services, 1979) [hereinafter Draft Act] s. 10.01; see also s. 1.02.
posed statute recognizes the diversity of provincial corporation laws and the

Presently, the Canadian Depository for Securities Ltd. (CDS) is incrementally expanding its services to ultimately permit the certificateless issue and transfer of securities. Incorporated in 1970, CDS immediately commenced development of a comprehensive system to immobilize security certificates, to permit transfers and pledge by book entry, and even to permit certificateless issues and transfers.\footnote{Anisman \textit{et al., 2 Proposals for a Securities Market Law for Canada} (Ottawa: Minister of Supply and Services, 1979) at 173-74.} Because of the diversity of statutes, both at the federal and provincial levels, that regulate the issue and transfer of securities as well as the activities of financial intermediaries, CDS adopted a strategy of gradual development. Obligations are imposed on each participant pursuant to contract upon entry into the system. This approach avoided any immediate need for a large number of statutory changes. The purpose of Part 10 is to legitimize the operation of this comprehensive system of book entry and certificateless securities transfers, and thereby abrogate the need to rely on increasingly complex multi-party contracts.\textsuperscript{\footnote{\textit{Id.}}} The definition of a "clearing agency" in Section 2.10\textsuperscript{\footnote{\textit{Supra} note 137, s. 2.10 states: 2.10 "Clearing Agency" means a person that (a) maintains records of trades of securities for the purpose of settling claims for money and securities, (b) maintains records of transfers and pledge of securities for the purpose of determining ownership of or security interests in securities, (c) holds security certificates deposited with it for the purpose of permitting securities to be transferred by record entry, or (d) performs any one or any combination of the functions referred to in paragraphs (a) to (c), but does not include a securities firm or financial institution acting exclusively in the ordinary course of its customary business unless the commission provides otherwise by regulation.}} of the \textit{Draft Act} includes a securities depository.\footnote{\textit{C.f. Securities Exchange Act of 1934, §3(23), 15 U.S.C. §78c(23) (1976).}} Clearing agencies in Canada, including
Transfer of Securities

CDS, are significant components of a proposed Canada-wide securities market system to carry on transprovincial business activities. Therefore, such entities must register, pursuant to section 9.01 of the Draft Act, as self-regulatory organizations.\textsuperscript{147} This registration provides the jurisdictional nexus for Parliament’s legislative authority.

The provisions covered by Part 10 of the Draft Act only apply to securities that are deposited with a registered clearing agency. Since some provincial corporation statutes permit shares to be issued subject to “calls,”\textsuperscript{148} and since a failure to answer a call may entitle the issuing corporation to forfeit the share,\textsuperscript{149} the clearing agency must refuse to accept such shares.\textsuperscript{150} This obviates the possibility of a transferee of a share from the original beneficial owner, the person formerly on the records of the clearing agency, finding his rights forfeited by the issuer. In addition, a clearing agency may refuse to accept a security that is subject to a lien in favour of the issuer or subject to a restriction on its transfer.\textsuperscript{151} A security in the possession of the clearing agency, however, may become subject to such restrictions and, therefore, the clearing agency must have procedures to deal with such a contingency.\textsuperscript{152}

Only a “participant” can have securities placed with a clearing agency. A participant is a person for whom clearing and settlement functions are performed directly and not through an intermediary.\textsuperscript{153} In this respect, the approach is similar to that of a clearing corporation in the United States\textsuperscript{154} and to TALISMAN in England.\textsuperscript{155} Once the share is held by the clearing agency in its depository,\textsuperscript{156} “a participant has no right to pledge, transfer or otherwise deal with a security held for him . . . except through the facilities of the clearing agency.”\textsuperscript{157}

An issuer will enter a clearing agency on the shareowner list on receipt

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\textsuperscript{147} Supra note 137, s. 9.01(1) states: “No person shall carry on business as a securities exchange or clearing agency unless it is registered under this Part.”

\textsuperscript{148} A share issued subject to “calls” is one issued for less than its stated value, \textit{i.e.} par, subject to the issuing corporation receiving payments up to that value in amounts and at times to be determined by the Board of Directors.

\textsuperscript{149} See, \textit{e.g.}, Quebec Companies Act, R.S.Q. 1977, c. C-38, s. 69.

\textsuperscript{150} Supra note 137, s. 10.04(1) states: “A clearing agency shall not make an entry in its records in respect of a security that is not fully paid.”

\textsuperscript{151} Id., s. 10.09.

\textsuperscript{152} Id., s. 10.06 (blocked accounts). There appears to be no similar provision for a blocked account under the English TALISMAN. In the United States this problem could arise under U.C.C. Article § 9-304(4) but note U.C.C. §§ 8-105, 8-317 and 9-304(1).

\textsuperscript{153} Supra note 137, ss. 2.28, 9.03(3) (\textit{i.e.}, financial intermediaries). See also s. 10.18.


\textsuperscript{155} See notes 75-87 and accompanying text, \textit{supra}.

\textsuperscript{156} Supra note 137, s. 10.18.

\textsuperscript{157} Id., s. 10.12. Withdrawal of a security from the system is possible, provided the security is not in a blocked account. See \textit{id.}, ss. 10.13, 10.17.
of instructions to this effect from the registered owner.\textsuperscript{158} The issuer may then either issue a share certificate to the clearing agency or, where the relevant corporation law permits\textsuperscript{160} and the beneficial owner so requests, it may enter the clearing agency on its register of share owners without issuing a share certificate.\textsuperscript{160} The clearing agency, however, subsequently may demand that a certificate be issued in accordance with its instructions.\textsuperscript{161} The clearing agency must promptly credit the account of the participant with the shares and so inform the beneficial owner.\textsuperscript{162} In this respect, the registration of the uncertified share in the name of the clearing agency is analogous to the procedure adopted in England under the TALISMAN system, but it finds no present analogy in the United States, other than in connection with some government debt securities.\textsuperscript{163} Upon registration of the “uncertificated security,” the clearing agency, although recognized not to be the beneficial owner of the security,\textsuperscript{164} receives an “unimpeachable legal title to the underlying securities referred to in the entry.”\textsuperscript{165}

The thrust of the \textit{Draft Act} is to allow the transfer of securities within the system established by the \textit{Act} without any adverse claims affecting the transferee. Section 10.12 attempts to prevent such adverse claims from arising by restricting a participant’s dealings in such securities outside the clearing agency, while the absence of any claims to a security when it is introduced into the clearing agency is assured by sections 10.04(1) and 10.09(1).\textsuperscript{166} It is submitted, however, that none of these sections would prevent adverse claims being asserted against a security in the system.\textsuperscript{167} Absent a provision analo-

\textsuperscript{158} In the case of a new issue, these instructions will come from the clearing agency and the beneficial owner, \textit{i.e.}, the participant and the person claiming through the participant. See, \textit{id.}, ss. 2.06, 10.03. In the case of a transfer, the instructions will be received from a participant through the clearing agency. See, \textit{id.}, s. 10.04(2).

\textsuperscript{160} See, \textit{e.g.}, Ontario \textit{Business Corporations Act}, R.S.O. 1980, c. 54, s. 89.

\textsuperscript{161} \textit{Id.}, s. 10.13(2).

\textsuperscript{162} See note 160, supra.


\textsuperscript{164} \textit{Supra} note 137, s. 10.11(2).

\textsuperscript{165} \textit{Supra} note 143, at 180. This is based on the \textit{Draft Act}, \textit{supra} note 137, ss. 10.03(3) and 10.04(5).

\textsuperscript{166} Note the \textit{Draft Act}, \textit{id.}, s. 10.09(2) allows the clearing agency to accept a security subject to a restriction on transfer or a lien in the issuer and place such security into a blocked account. Securities so accepted would include securities acquired by a participant in an exempt distribution pursuant to s. 6.02 until the requirements of Part 5 of the \textit{Draft Act} are complied with, or securities governed by the \textit{Canada Business Corporations Act}, S.C. 1974-75, c. 33, s. 168 and \textit{Canada Business Corporations Regulations}, C.R.C. 1978, c. 426, ss. 51-57.

\textsuperscript{167} \textit{C.f.} Draft Act, \textit{id.}, s. 10.06 which provides that an “interested person” \textit{[see s. 10.02(b)]} can block the account of a participant to “perfect” such adverse claim.
gous to that contained in section 117 of the English Companies Act, 1948,\textsuperscript{168} however, and in the light of the Canada Business Corporations Act,\textsuperscript{169} the question arises whether the attempt to confer negotiability on such bookkeeping entry can be achieved. Specifically, it is not clear whether it is possible to prevent a person taking a transfer on the books and records of the clearing agency\textsuperscript{170} from being affected by any “adverse claims,” even though he is a bona fide purchaser without notice of the existence of such “adverse claim.”\textsuperscript{171}

The Draft Act assumes that an adverse claim can only be related to a transfer or pledge of a security. Sections 10.16 and 10.17 deal solely with an adverse claim arising from an incorrect entry on the books of the clearing agency “by reason of its error.”\textsuperscript{172} These sections do not deal with the effect of a notice of an adverse claim to the issuer.\textsuperscript{173} The difficulty here is to deduce from the wording of sections 10.03(3) and 10.04(5) that the issuance of a security in “bearer form” will in and of itself result in an “unimpeachable legal title” enabling the transfer of such rights not to be subject to adverse claims. Especially does this difficulty arise in connection with the transfer of an uncertificated security, which is a chose in action, not “reified” in a certificate.

An “adverse claim” could arise as follows: The clearing agency can demand that participants furnish it or the issuer with a list of beneficial owners for whom the participant holds the securities.\textsuperscript{174} This list\textsuperscript{175} can be relied upon by the issuer.\textsuperscript{176} A person alleging an incorrect entry has rights against the clearing agency.\textsuperscript{177} There would appear to be no reason why such claims cannot be protected by notice of an adverse claim to the issuer.\textsuperscript{178} Should the security be transferred out of the clearing agency to a bona fide purchaser for value and without notice, however, such adverse claim would be defeated.\textsuperscript{179} It is difficult to understand how the transfer of an incorporeal right can achieve this.

Sections 10.03(3) and 10.04(5) of the Draft Act provide that the issue or transfer to the clearing agency without certification shall have “the

\textsuperscript{168} 11 & 12 Geo. 6, c. 38 (U.K.). See also Companies Act, 1948, Sched. 1, Table A, Art. 7.
\textsuperscript{169} S.C. 1974-75, c. 33. See ss. 73(1), 72(7).
\textsuperscript{170} Supra note 137, s. 10.05.
\textsuperscript{171} Canada Business Corporations Act, S.C. 1974-75, c. 33, s. 56(2).
\textsuperscript{172} Supra note 137, s. 10.16(1) [Emphasis added.]
\textsuperscript{173} Canada Business Corporations Act, S.C. 1974-75, c. 33, ss. 73(1), 72(7).
\textsuperscript{174} Supra note 137, ss. 10.14(4). Such list, in itself, may amount to notice of claims to the security adverse to that of the registered owner if it describes the “beneficial interest,” for it would give the information required by s. 73(1) of the Canada Business Corporations Act, S.C. 1974-75, c. 33.
\textsuperscript{175} The clearing agency must first consolidate the list and comply with the requirement of confidentiality which will prevent associating any beneficial owner with a particular participant. Supra note 137, ss. 10.14(6)(7).
\textsuperscript{176} Id., s. 10.14(10).
\textsuperscript{177} Id., s. 10.16.
\textsuperscript{178} C.f. Israels & Guttman, supra note 2, Ch. XII, Section 12.04.
\textsuperscript{179} Canada Business Corporations Act, S.C. 1974-75, c. 33, s. 56(2).
same effect as an issue or transfer to the clearing agency of a security certificate in bearer form.” If this is an attempt to confer negotiability on such an incorporeal right, then how is this incorporeal right negotiated? Is it negotiated by delivery and if so, by delivery of what? The right itself is incorporeal. Clearly, as far as the issuer is concerned, the registered owner is the “clearing agency” until the item is transferred out of the agency’s name. Even though the “clearing agency is not the beneficial owner of a security held by it,” and though the issuer need not treat the clearing agency “as a registered owner of a security issued by it” for the purpose of, for example, voting or dividend distribution, it is the clearing agency that must instruct the issuer to transfer the security to another as registered owner. These provisions, though they establish the agency status of the clearing agency, cannot affect the rights of participants and beneficial owners to protection prior to seeking remedies under section 10.17 against the clearing agency. If these provisions merely seek to establish the rights of participants inter se in the “uncertificated security” held by the clearing agency, then these subsections need rewording, for they seem to grant negotiability of the right in the security itself. In addition, this approach would then appear to contradict the provisions of section 10.05 regarding “blocked accounts.”

If it is intended to create a “negotiable chose in action,” this will require direct changes in Canadian and provincial corporate statutes and laws, and not just such as would authorize the registration of share ownership without the issuance of a share certificate. It seems clear that sections 10.03(3) and 10.04(5) are in direct conflict with sections 73(1) and 72(7) of the Canada Business Corporations Act. Although a reconciliation of Part 10 could be achieved by a repeal of these sections, the benefit contained in these sections far outweighs that which such a repeal would attain. Not every transfer of securities takes place through a clearing agency. Not every transfer of securities involves participants in a clearing agency. The protection of adverse claimants thus may outweigh the gains to be attained. Although section 117 of the English Companies Act, 1948 enables most adverse claims to be kept off the register of shares of an English company, notice in lieu of distingias provides some protection to an adverse claimant. In the United States, also, the UCC section 8-403 (1977) continues to protect adverse claimants whether the security is certificated or uncertificated.

A possible solution would be to amend Part 10 to confine free alienability to transfers within the system. In part this is shown by the provision of section 10.06 requiring that a clearing agency establish a procedure whereby an in-
interested person may block the account of a participant, thereby "perfecting" an adverse claim. The effect of this would be to prevent securities subject to such adverse claim being presented to the issuer for transfer, with the issuer having to inquire whether this security is one subject to an adverse claim of which it has notice. To achieve this result sections 73(1) and 72(7) of the Canada Business Corporations Act would not need to be amended, but a further section could be added indicating that where securities are held by a participant in a clearing corporation, adverse claims will be effective only if notice is given to the clearing corporation in accordance with the procedures to be established under section 10.06.

The heart of Part 10 is section 10.05, which provides for settlement through bookkeeping entries rather than through physical delivery of securities certificates. In this respect, the Canadian approach is analogous to that adopted in England under TALISMAN, where securities are deposited with SEPON Ltd., and to the system adopted in the United States.

Part 10 goes further than either of these systems in providing for the establishment of "blocked accounts." A blocked account is defined as "an account of a participant over which a person other than the participant exercises control pursuant to procedures established under section 10.06." In order to allow broker-dealers in the United States to comply with the various federal securities law rules governing segregation of customers' fully paid and excess margin securities so that they do not become co-mingled with such broker-dealer's "free account" which he can use to collateralize personal loans, securities depositories provide for special "pledge-loan programs" into which they will transfer securities pledged by the broker-dealer to his own use or to cover margin extended to customers. This is the only account similar to the proposed "blocked account." There does not appear to be any similar provision under TALISMAN.

Only specified interested persons, such as "(i) a beneficial owner of a security, (ii) a pledgee of a security, or (iii) a judgment creditor of a beneficial owner of a security in the participant's account," or (iv) the issuer, can request that the account be blocked. Once the account of a

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187 Note Canada Business Corporations Act, S.C. 1974-75, c. 33, ss. 66(1)(d) and (3) as to constructive delivery by book entry. It would have been clearer had this section included a provision similar to that in U.C.C. § 8-313 (1)(e). It is more difficult to spell out this result by combining § 66(1)(d) with § 66(3) since § 66(1)(d) refers to an "identified security" raising the question whether identification of a "fungible bulk" would suffice. As to a pledge see supra note 137, s. 10.07 and compare U.C.C. § 8-108 (1977).

188 See Guttman, supra note 104.

189 See Gutman, supra note 104.

190 Id., s. 10.02(b) defines "interested person" as "a person who has an interest in a security in an account of a participant in a clearing agency."

191 Authors' footnote: id., s. 2.06 defines "beneficial ownership" to include "ownership through a trustee, legal representative, agent or other intermediary."

192 Authors' footnote: see, id., ss. 10.02(c), 10.07.

193 Id., s. 10.06(1).

194 Id., s. 10.05.
participant relative to a particular issue is blocked, these securities cannot be transferred without the instruction of the person who exercises control over the account by virtue of having blocked it.\textsuperscript{105} It is possible, therefore, to restrict the transfer of shares in a participant's account after such shares have been received by the clearing agency,\textsuperscript{106} without the "interested person" becoming the owner of the security or that person taking the account out of the name of the participant.

Two types of blocked accounts are envisioned. First, an account may be blocked in favour of a person, not the beneficial owner, who has a legally recognized interest in the security. Secondly, an account may be blocked in favour of a customer,\textsuperscript{107} so as to segregate such securities from those of other customers of the participant. The first type of blocked account is mandatory in order to protect third party interests, such as a pledgee\textsuperscript{108} or a judgment creditor.\textsuperscript{109} Creation of the second type of blocked account is left to the discretion of the clearing agency, subject to approval by the Canadian Securities Commission.\textsuperscript{200} By reserving to the Commission the power to supervise clearing agencies, the Commission will be able to act as a unifying influence. Although it is not intended to have the Commission approve all transfer procedures, matters relating to the by-laws of the clearing agency will require approval.\textsuperscript{201} In this respect the Canadian Securities Commission will be exercising supervisory powers similar to those exercised in the United States by the SEC.\textsuperscript{202}

To conclude, the development of securities markets requires the unrestricted transferability of securities. This paper has dealt mainly with the approach to achieving this goal in the context of the transfer of shares in a corporation as opposed to debt securities. The steps taken by the Securities Market Study to bring this project to fruition are to be commended. The issues raised will continue to occupy centre stage in debates in this area. In particular, the concept of a negotiable chose in action will require further analysis. Whether the solution is to repeal sections 73(1) and 72(7) of the \textit{Canada Business Corporations Act} or whether doing so results in "throwing the baby out with the bathwater," is a question requiring analysis of the benefits to be achieved by forcing all securities transfers into the mold of Part 10. Many transfers of securities are not tied to a stock exchange transaction, nor need they be entered into through participants in a clearing agency.

\textsuperscript{105} \textit{Id.}, s. 10.06(2).
\textsuperscript{106} \textit{Id.}, ss. 10.04(1), 10.09(2).
\textsuperscript{107} The use of the term "beneficial owner" in the \textit{Draft Act}, id., s. 10.08 enables the account to be blocked in favour not only of a customer of a participant, but also of a person claiming through such customer. \textit{Id.}, s. 2.06.
\textsuperscript{108} \textit{Id.}, s. 10.07.
\textsuperscript{109} \textit{Id.}, s. 10.10(1). This would include a judgment creditor of a beneficial owner, s. 2.06, who may not be a customer of the participant. See \textit{supra} note 196.
\textsuperscript{200} \textit{Id.}, ss. 15.01, 10.18(3).
\textsuperscript{201} \textit{Id.}, Part 9.
The fact that the Securities Task Force studied the approaches in the United States shows that it recognized the close affinity of securities transactions between the United States and Canada. The fact that the Securities Market Study looked beyond the shores of the American continent, shows that it was not prepared to give up its heritage from France and Great Britain. Transnational investments may ultimately require a unified system assuring investors their rights and protecting the securities industry from over-regulation. In taking this step to provide for the transferability of securities free from adverse claims, the Draft Act is participating in providing the means for a free flow of capital unimpeded by regulations unrelated to national security. The inter-relationship of the economics of the free world demand this and the subsequent melding of the three systems analyzed here may give a lead to the European Community as well as to the markets in the Americas.

203 Prof. Guttman wishes to indicate his appreciation to the authors of the Proposals for a Securities Market Law for Canada for the reference to his paper, The Transfer of Shares in a Commercial Corporation—A Comparative Study (1964), 5 B.C. Indus. & Comm. L. Rev. 491, supra note 143, at 172.