Volume 51 | Issue 3 Article 6

March 1949

Corporations--Stock Transfer by Trustee in Fraud of Cestui--Corporate Liability Under Uniform Fiduciaries Act

R. B. P.
West Virginia University College of Law

CASE COMMENTS

CORPORATIONS—STOCK TRANSFER BY TRUSTEE IN FRAUD OF CESTUI—CORPORATE LIABILITY UNDER UNIFORM FIDUCIARIES ACT.—Plaintiffs were infant beneficiaries of stock held in a North Carolina corporation. The trustee transferred the stock and diverted the proceeds to his own use and the corporation with knowledge of the trust relationship registered such transfer. Before doing so, the corporation had requested a court order authorizing the transfer and trustee in compliance therewith obtained a decree of a district court of Texas, the state of residence of the trustee and of plaintiffs, directing either partition of the stock or its sale and a division of the proceeds. The trustee partitioned part and sold the remainder and this deviation from the terms of the decree was evident in his directions to the corporation for registering the transfer. Later the trustee died insolvent. Plaintiffs sued the corporation for negligently registering the transfer in fraud of their title. Under Texas law, the district court, although a court of general jurisdiction was without jurisdiction to issue an order in the premises, such being within the exclusive jurisdiction of the county court. The trial court found that defendant's conduct was negligent and entered judgment for plaintiffs. Held, on appeal, that on the substantially undisputed facts the corporation as a matter of law was not negligent and not liable. It exercised reasonable diligence, by requiring a decree authorizing the transfer and in relying thereon despite the fact that the decree was void and the purported performance not in pursuance to its terms. Furthermore, the court intimated that even if the corporation were negligent recovery would be prevented by Uniform Fiduciaries Act, § 3. *Caroline Telephone & Telegraph Co. v. Johnson*, 168 F. 2d 489 (C. C. A. 4th 1948).

The majority common law view, prior to enactment of the Uniform Fiduciaries Act, compelled the corporation to determine the extent of the trustee's power. Not only was the corporation required to use diligence and care in registering a transfer of its corporate stock but also to inquire as to the purpose of the transfer by a fiduciary to ascertain whether he was committing a breach of trust. See, *e.g.*, *Baker v. Atlantic Coast Line R. R.*, 173 N. C. 365, 92 S. E. 170 (1917); *Wooten v. Wilmington & W. R. R.*, 128 N. C. 119, 38 S. E. 298 (1901); *Cox v. Bank*, 119 N. C. 302, 26 S. E. 22 (1896); CHRISTY, TRANSFER OF STOCK §§2-3 (2d ed. 1940); 3 SCOTT, TRUSTS 325 (1st ed. 1939); Scott, *Participation in a Breach of Trust*, 34 HARV. L. REV. 454 (1931). Even under this view, the corporation fulfilled its common law obligation in the instant case, if it acted with reasonable prudence in honoring a decree of a court of general jurisdiction in a suit embracing all persons concerned.

The Uniform Fiduciaries Act has been adopted by fourteen states including North Carolina in 1923. 9 U. L. A. 297. N. C. *Gen. States.* § 32-4, applicable only where stock is registered in the fiduciary's name, provides that the corporation is liable for registering a transfer of stock, "only when registration of the transfer is made with actual knowledge that the fiduciary is committing a breach of his obligation as fiduciary in making the transfer, or with knowledge of such facts that the action in registering the transfer amounts of bad faith." Thus liability now depends upon the actual knowledge or bad faith of the corporation or its transfer agent, so that the possibility of recovery against corporations because of wrongful stock transfers has been greatly reduced.

While there are no West Virginia cases directly in point, the same considerations seem to underline the adoption by West Virginia of the Uniform Stock Transfer Act, making stock certificates negotiable. W. VA. REV. CODE (1931) c. 31, art. 1. In 1947, the legislature enacted another relevant statute. W. VA. CODE, c. 31, art. 4 C, §§ 1-5 (Michie, Supp. (1947). Section 1 provides that any bank or trust company may register, in its own name or in the name of a nominee, any personal property held by it in a fiduciary capacity without disclosing the fiduciary relationship. Section 4 states that no liability shall attach to any corporation which "in compliance with the directions of any such bank or trust company acting under provisions of this article, transfers or changes the registration of any such property." Thus, if a bank or trust company follows this procedure, the corporation is relieved of the duty to inquire as to the purpose of the transfer. This statute achieves the same result in the case of corporate trustees as would be obtained under the Uniform Fiduciaries Act.

Adoption by the West Virginia legislature or courts of the view embodied in the instant construction of the Uniform Act, relieving the corporation from the common law duty to investigate, absent actual knowledge or knowledge of such facts as would put an ordinarily prudent man on inquiry that transfer is wrongful, would facilitate the transfer of securities.

R. B. P.