Providing an Effective Remedy in Shareholder Suits Against Officers, Directors, and Controlling Persons

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PROVIDING AN EFFECTIVE REMEDY IN SHAREHOLDER SUITS AGAINST OFFICERS, DIRECTORS, AND CONTROLLING PERSONS

Corporate officers, directors, and controlling persons occupy a fiduciary relationship toward the corporation and its shareholders in the exercise of control over corporate affairs. This fiduciary obligation requires that officers, directors, and controlling persons act in good faith and perform their offices in the best interests of the corporation and its shareholders and not to their own advantage. When this duty is breached, a shareholder may bring an action against these fiduciaries, either in his own name or derivatively for the benefit of the corporation. Under present law, however, it may be impossible for an American court to secure jurisdiction over a foreign person occupying such a fiduciary relationship. Furthermore, even if a foreign fiduciary is subject to the jurisdiction of a domestic court, present law allows judgments against such persons to remain unsatisfied, unless the foreign defendant has assets in the United States apart from his interest in a domestic corporation.

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1 For purposes of this article the term “controlling person” shall be synonymous with “principal shareholder” as that term is defined in section 16(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(a) (1970), i.e., “every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security....”

2 See, e.g., Southern Pacific Co. v. Bogart, 250 U.S. 483 (1919), in which a majority shareholder was held to act as trustee of the minority interests in a corporate reorganization; Mansfield Hardwood Lumber Co. v. Johnson, 263 F.2d 748 (5th Cir. 1959), in which the officers and directors of a liquidated corporation were found to have a duty to shareholders whose stock was purchased by the corporation prior to the liquidation; Higgins v. Shenango Pottery Co., 256 F.2d 504 (3d Cir. 1958), in which the officers of a corporation were held liable to the shareholders for the diversion of corporate business; and Zahn v. Transamerica Corp., 162 F.2d 36 (3d Cir. 1947), in which a controlling shareholder was held accountable to the minority for directing the corporation to exercise redemption rights over the minority’s stock at a price lower than the eventual liquidation value. See generally Pepper v. Litton, 308 U.S. 295 (1939).


5 If the duty breached is owed directly to the shareholder, the action may be brought by the shareholder in his own name. Where the duty breached is one owed to the corporation and the corporation fails to enforce its rights, a shareholder may bring the action for the benefit of the corporation. See generally N. Lattin, The Law of Corporations 410-62 (2d ed. 1971).

6 Recent revelations concerning the relationship of Hermann Mayer, an Austrian national, to General Refractories Company, Inc. illustrate the problem. Mayer, the beneficial owner of 17 percent of General Refractories Company’s outstanding common stock, was accused by the Securities and Exchange Commission (SEC) of having used his position as a major shareholder to influence corporate decisions to
One means of securing jurisdiction over or enforcing a judgment against a corporate officer, director, or controlling person is to attach her stock interest in the corporation. Statutes in forty-nine states, however, provide that a person's interest in a corporation may be levied against only by seizing the stock certificates which represent the interest. Thus, a foreign shareholder whose only property interests within the United States consist of corporate stock may avoid effective judicial action merely by keeping the stock certificates outside the United States.\(^7\)

The most obvious means of providing shareholders with an effective remedy in such situations would be to provide for the initiation of suits for breach of fiduciary duty against officers, directors, and controlling persons by the attachment of their share interests in the state of incorporation.\(^8\) This article will examine the compatibility of such a provision with the policies underlying the present law and with Supreme Court pronouncements questioning the constitutionality of prejudgment seizure of property. Specific amendments to both the ABA-ALI Model Business Corporation Act and Article Eight of the Uniform Commercial Code\(^9\) are proposed in an appendix to this article.

I. The Evolution of the Law of Attachment of Corporate Shares

The law of attachment of corporate shares has evolved primarily in response to the changing role of the corporation in our economic syste
Remedy in Shareholder Suits

tem and the evolution of the role played by the stock certificate in share transfers. An understanding of the nexus between law and commercial practice, therefore, is necessary before one attempts to evaluate the desirability of providing for the attachment of corporate shares without actual seizure of stock certificates.

Prior to the nineteenth century, jurists treated an ownership interest in a corporation as a chose in action which, like other intangible interests, was not subject to levy. Then, as now, a shareholder did not have any right to specific corporate assets and the shareholder's interest in the corporation was considered incorporeal and incapable of being physically seized or attached.

During the nineteenth century the concept of levy against intangible interests was gradually accepted, and courts and legislatures recognized that a shareholder's rights to receive profits and to participate in the distribution of corporate assets upon liquidation were valuable property interests which should be subject to the demands of creditors and other adverse claimants. Many states adopted statutes under which the shareholder's interest was considered as having a situs in the state in which the corporation was domiciled, and which gave the courts of the domiciliary state exclusive jurisdiction over matters concerning the interest.

Under these statutes the shareholder's interest existed only on the books of the corporation, which were the sole evidence of ownership. Consequently, the shareholder's interest was subject to attachment only where the corporate books were kept, that is, at the domicile of the corporation. Levy was made on the shareholder's interest by service of notice on the corporation. If the attached interest was represented by stock certificates, new certificates were issued to a purchaser at the execution sale, and the outstanding certificates were made void and cancelled on the corporation's books. Since the property interest involved was merely the intangible right to receive profits and to participate in the assets of the corporation upon liquidation, the stock certificate was treated as having no intrinsic

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11 Id.
15 See Wood, supra note 10, at 219.
16 See Ashley v. Quintard, 90 F. 84 (N.D. Ohio 1898); Winslow v. Fletcher, 53 Conn. 390, 4 A. 250 (1885); Cantor v. Sachs, 18 Del. Ch. 359, 162 A. 73 (Ch. 1932); United States Express Co. v. Hurlock, 120 Md. 107, 87 A. 834 (1913); Plimpton v. Bigelow, 93 N.Y. 592, 29 Hun 362 (1883).
17 See Wood, supra note 10, at 220.
18 See Beale, The Exercise of Jurisdiction In Rem to Compel Payment of a Debt, 27 HARV. L. REV. 107, 111 (1913); Loiseaux, Liability of Corporate Shares to Legal Process, 1972 DUKE L.J. 947, 949; Wood, supra note 10, at 220.
19 Beale, supra note 18, at 111.
20 Loiseaux, supra note 18.
21 Id.
value or legal significance.\textsuperscript{22}

This treatment of stock certificates developed at a time when corporations were basically local enterprises and corporate assets formed a relatively unimportant part of the national wealth.\textsuperscript{23} During the latter part of the nineteenth century this situation changed. Corporations became more important vehicles for holding assets and corporate ownership became more widespread.\textsuperscript{24} Trading in shares of corporate stock increased. Stock certificates themselves became accepted as documents of value and purchasers came to rely on the certificate as "representing for all practical purposes the share itself."\textsuperscript{25}

The increased significance accorded stock certificates in commercial markets brought to light the fundamental weakness of the traditional legal approach to the transfer of a shareholder's interest in a corporation. While stock certificates were traded as if an interest in the corporation was thereby transferred, under the law no change of ownership was accomplished until the transfer was recorded on the corporation's books.\textsuperscript{26} Upon hearing that his shares had been attached, the holder of the certificates, therefore, could sell or borrow against the stock interest by endorsement and delivery of the certificate.\textsuperscript{27} Since existing law did not recognize the negotiability of the certificates, a good faith transferee in such instances was left with documents which the market had recognized, but which the law, and therefore the corporation, treated as worthless.\textsuperscript{28} Moreover, existing communications technology made it impossible for lenders and purchasers to make an effective investigation prior to lending or purchasing.\textsuperscript{29}

The New York courts were the first to respond to the plight of subsequent transferees which this divergence of law and commercial practice created by recognizing as valid attachments made by seizure of stock certificates.\textsuperscript{30} This procedure was gradually recognized in other jurisdictions\textsuperscript{31} and in 1907 was adopted as the basic means of attachment of shareholder interests under the Uniform Stock Transfer Act (USTA).\textsuperscript{32}

\textsuperscript{23} Id., supra note 10, at 222.
\textsuperscript{24} Id.
\textsuperscript{25} Id.
\textsuperscript{26} Beale, supra note 18, at 111.
\textsuperscript{27} Cf. Pomerance, supra note 13, at 64.
\textsuperscript{28} See, e.g., People's Nat'l Bank v. Cleveland, 117 Ga. 908, 44 S.E. 20 (1903); Young v. South Tredegar Iron Co., 85 Tenn. 189, 2 S.W. 202 (1886).
\textsuperscript{29} See Loiseaux, supra note 18, at 950.
\textsuperscript{31} See, e.g., Mitchell v. Leland Co., 246 F. 103 (9th Cir. 1917); Griswold v. Kelly-Springfield Tire Co., 94 N.J. Eq. 308, 120 A. 324 (1916); Pomerance, supra note 13, at 63-64.
The USTA attempted to give to stock certificates a legal significance commensurate with their commercial importance and, thereby, to eliminate the possibility of certificates being transferred to a bona fide purchaser after the shareholder's interest had been attached. The Act gave the stock certificate legal importance by providing that a transfer of the certificate would operate to transfer the shareholder's interest, and that such transfer would operate as an effective conveyance of title. So that a prior attachment could not be defeated by negotiation of the certificate to a bona fide purchaser, the Act provided for effective attachment only where the certificate had been actually seized or surrendered to the issuer, or where the holder was enjoined from transferring the certificates.

II. ATTACHMENT OF CORPORATE SHARES UNDER CURRENT LAW

The USTA has been superseded by Article Eight of the Uniform Commercial Code (UCC) in every jurisdiction except Louisiana. Article Eight endorses the basic policies underlying the USTA and expands its coverage to include non-equity securities. As explained by Professor Carlos Israels, Chairman of the National Commissioners on Uniform State Laws Subcommittee on Article Eight,

...the article is an attempt to modernize and simplify the law applicable to 'investment securities', first by endowing them with negotiability in its full sense, and then by delineating the rights of holder and issuer economically and logically flowing from and connected with negotiability.

33 Wood, supra note 10, at 225.
34 Crane v. Crane, 373 Pa. 1, 5, 95 A.2d 199, 201 (1953). See also 6 Uniform Laws Annotated § 13, Commissioner's Note:

[It] is clearly improper ever to allow an attachment of stock unless some method is adopted to prevent a subsequent transfer of the certificate. Otherwise it is impossible to realize on the attached property since there would always be a possibility of a subsequent transfer of the original certificate.

35 6 Uniform Laws Annotated § 1.
36 6 Uniform Laws Annotated § 5.
37 6 Uniform Laws Annotated § 13. This provision met with substantial opposition and was not enacted in a number of jurisdictions which adopted the Uniform Act. See generally Austin & Nelson, Attaching and Levying on Corporate Shares, 16 Bus. Law. 336, 337 (1961); Note, Attachment of Corporate Stock: The Conflicting Approaches of Delaware and the Uniform Stock Transfer Act, 73 Harv. L. Rev. 1579 (1960). 6 Uniform Laws Annotated § 13 provided:

No attachment or levy upon shares of stock for which a certificate is outstanding shall be valid until such certificate be actually seized by the officer making the attachment or levy, or be surrendered to the corporation which issued it, or its transfer by the holder be enjoined.

39 Uniform Commercial Code §§ 8-102(1)(a), 8-105(1), 8-301(1), (2).
Article Eight provides that "securities," defined in the Code to include any instrument, debt or equity, commonly traded on a security exchange, are negotiable instruments, and that a bona fide purchaser may take a security free from any adverse claim, including a claim that "a particular adverse person is the owner of or has an interest in the security." Thus, Article Eight makes it clear that the intangible rights of a creditor or shareholder do not exist apart from the certificate.

This primacy of the stock certificate is carried over in the Article Eight provision on attachment and levy. Section 8-317 of the UCC parallels section 13 of the USTA, except that the former provides for a valid levy or attachment only if the security is actually seized by an officer of the court or surrendered to the issuer. The provision in section 13 of the USTA, recognizing as valid attachments where the holder of the certificate was enjoined from transferring the certificate, is not included in section 8-317 of the UCC. The comments to section 8-317 make it clear that the drafters were of the opinion that recognition of attachment by enjoining transfer would be inconsistent with the basic notion that no levy should be valid unless "all possibility of the security finding its way into a transferee's hands" has been removed.

One important corporate jurisdiction, Delaware, has not accepted the Article Eight treatment of attachment and levy. While Delaware has

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41 Uniform Commercial Code § 8-102(1)(a) provides:
(a) A "security" is an instrument which
(i) is issued in bearer or registered form; and
(ii) is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and
(iii) is either one of a class or series or by its terms is divisible into a class or series of instruments; and
(iv) evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.

42 Uniform Commercial Code § 8-105(1).
43 A bona fide purchaser is defined in Uniform Commercial Code § 8-302 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 one in registered form issued to him or endorsed to him or in blank.

44 Uniform Commercial Code § 8-301(2).
45 Uniform Commercial Code § 8-301(1).
46 See Folk, Article Eight—Investment Securities, The Uniform Commercial Code in North Carolina, 44 N.C.L. Rev. 654 (1966) [hereinafter cited as Folk, Investment Securities]. A minor exception to this general rule exists where a registered owner has notified the issuer that the owner's securities have been lost or stolen. Uniform Commercial Code § 8-405(2).
48 See note 37 supra.
49 Uniform Commercial Code § 8-317(1) provides:
(1) No attachment or levy upon a security or any share or other interest evidenced thereby which is outstanding shall be valid until the security is actually seized by the officer making the attachment or levy but a security which has been surrendered to the issuer may be attached or levied upon at the source.
50 Uniform Commercial Code §§ 8-317(1).
51 Uniform Commercial Code § 8-317, Comment 1.
adopted most of the provisions of Article Eight, including provisions recognizing the negotiability of investment securities\textsuperscript{52} and the priority of the bona fide purchaser,\textsuperscript{53} the Delaware version of section 8-317 leaves existing statutory attachment and sequestration provisions unaffected by declaring that they are controlling in the event of conflict with any provisions of the Delaware version of Article Eight.\textsuperscript{54}

The principal method of attaching shares of a Delaware corporation owned by a nonresident officer, director, or shareholder is to invoke the Delaware sequestration statute,\textsuperscript{55} which provides for the public sale of sequestered property to induce the defendant to make a general appearance and to satisfy the plaintiff's claim should the defendant fail to appear.\textsuperscript{56} The statute avoids conflict with the bona fide purchaser provisions of Article Eight by providing that any assignment or transfer of the seized property after sequestration shall be void.\textsuperscript{57} This treatment of the transfer denies a transferee the status of "purchaser,"\textsuperscript{58} and a fortiori, qualification as a bona fide purchaser.\textsuperscript{59} The statute further provides that, after seizure, the public sale

shall transfer to the purchaser all the right, title and interest of the defendant . . . as fully as if the defendant . . . [had] transferred the same to the purchaser in accordance with law.\textsuperscript{60}

Thus, where the seized property consists of securities, the purchaser at a public sale assumes the status of a bona fide purchaser.\textsuperscript{61}

This provision would not be effective with regard to the attachment of corporate shares, however, if shareholders were allowed to avoid its application by holding securities in a street name\textsuperscript{62} or by using some other device which separates legal and beneficial ownership.\textsuperscript{63} To prevent this result the


\textsuperscript{54} Del. Code Ann. tit. 6, § 8-317(1) (1974) provides:

(1) Nothing contained in this subtitle shall repeal, amend or in any way affect sections 169 and 324, title 8, or sections 365 and 366, and chapter 35, title 10; and to the extent that any provision of this subtitle [Article Eight] is inconsistent with such sections, sections 169 and 324, title 8, and 365 and 366 and chapter 35, title 10, shall be controlling.


\textsuperscript{56} Del. Code Ann. tit. 10, § 366(a) (1974) provides in part:

The Court may compel the appearance of the defendant by the seizure of all or any part of his property, which property may be sold under order of the Court to pay the demand of the plaintiff, if the defendant does not appear, or otherwise defaults.


\textsuperscript{58} See Del. Code Ann. tit. 6, § 1-201(32), (33) (1974).


\textsuperscript{60} Del. Code Ann. tit. 10, § 366(c) (1974).

\textsuperscript{61} See Del. Code Ann. tit. 6, § 8-301(1), (2) (1974).

\textsuperscript{62} Securities registered in the name of a broker, securities dealer, or bank as a nominee of the beneficial owner are said to stand in a "street name." C. Israels & E. Guttmam, Modern Securities Transfers § 3.09 (rev. ed. 1971).

\textsuperscript{63} Another device which a shareholder could use would be to transfer his securities to a trust of which the shareholder was the beneficiary.
Delaware courts have looked to beneficial ownership as the interest which the equitable sequestration remedy seeks to reach. Thus, beneficial ownership has been dispositive in attempts to reach the interests of nonresident corporate directors who were not shareholders of record, as well as the equitable interest retained by a transferor where the property was transferred with the intent of defrauding the transferor's creditors. If the nonresident defendant holds merely legal title, the sequestered shares are released upon application of the beneficial owners. The relevance of beneficial ownership under the sequestration statute is limited only by the availability of discovery by which a nonresident defendant's beneficial interest can be identified with reasonable certainty. Thus, Delaware is the only state which provides shareholders with a fully effective remedy against dishonest or incompetent officers, directors, and controlling persons; and even in Delaware the effectiveness of the remedy is dependent on a judicially created doctrine and not on any express statutory language.

III. The Compatibility of the Proposed Amendments with Current Law

If amendments to the ABA-ALI Model Business Corporation Act and Article Eight of the UCC are to provide shareholders with an effective remedy against breaches of fiduciary duty by nonresident officers, directors, and controlling persons, the attachment of shares beneficially owned by such individuals must be possible by means of some procedure short of actual seizure of the certificates. The balance of this article will examine the compatibility of such an attachment provision with the stated goal of Article Eight of the UCC to make certificates fully negotiable and with the due process clause of the fourteenth amendment.

65 Id.
68 Compare Green v. Johnston, 34 Del. Ch. 115, 99 A.2d 627 (Sup. Ct. 1953), in which two nonresident directors, appearing specially to seek dissolution of a sequestration order on the ground that they were not shareholders of record were required to answer interrogatories with respect to their beneficial ownership of corporate shares, and in which on appeal a subsequent writ of sequestration based on the information obtained from the interrogatories was upheld, with Cannon v. Union Chemicals and Materials Corp., 37 Del. Ch. 399, 144 A.2d 145 (Ch. 1958), in which a shareholder was denied use of discovery procedures where the issuer corporation's answer to the sequestration notice showed no shares of stock held in the name of the defendant and a subsequent merger of the issuer corporation into a New Jersey corporation deprived the Delaware courts of jurisdiction over the shares.
69 See notes 6-7 and accompanying text supra.
A. The Proposed Amendments and Article Eight of the Uniform Commercial Code

1. The Stock Certificate in Modern Securities Transfers—The fundamental policy of full negotiability of investment securities under the UCC has never been seriously questioned. The negotiability of stock certificates under Article Eight is thought to facilitate the liquidity which securities trading markets provide to investors in that negotiability establishes the priority of a bona fide purchaser and, thus, gives a necessary degree of certainty to all share transactions. In turn, the liquidity of stock certificates is viewed as a key factor in the ability of corporations to raise capital and to retain earnings for economic expansion. In recognition of this relationship between negotiability and liquidity, the priority of subsequent bona fide transferees has been accorded ever greater importance since the USTA was drafted. The protection of a bona fide transferee is now viewed in terms of its impact on the national economic well-being, not simply in terms of fairness to the transferee, and one commentator has gone so far as to state that modern securities markets could not function without the "indispensable right of a bona fide purchaser for value to extinguish issuer defenses and adverse claims to securities." However, this view not only overstates the case; it does not comport with modern commercial practice. As the following discussion will illustrate, although providing for the attachment of corporate shares without the actual seizure of the stock certificates would impair the full negotiability of the certificates, such a provision would be entirely consistent with, and reflective of, present commercial practice. Such a provision, therefore, should have only a minimum impact on share liquidity and the certainty of transfer which the bona fide purchaser provision of Article Eight was supposed to provide.

The changes wrought by the USTA and its successor, Article Eight of the UCC, were thought necessary to protect the bona fide purchaser who relied upon the delivery of a stock certificate only to find that his interest in the corporation was subordinated to that of an unknown judgment creditor. These changes, however, were developed in an era when elec

71 The liquidity of a stock certificate is measured in terms of the ease of converting the certificate into cash.
73 Cf. Folk, Investment Securities, supra note 46, at 654.
74 Smith, supra note 72, contends that if stock certificates were not so highly liquid, the ability of corporations to raise funds by selling new issues would be reduced because investors would move to other investment media and equity investors would be less willing to allow management to retain earnings if the option of easily disposing of their holdings was not available.
75 Id. at 924.
76 Folk, Investment Securities, supra note 46, at 654.
77 See part I supra.
tronic communication was unknown and buyers and sellers traded their corporate interests in face-to-face transactions. Under such conditions, the physical transfer of tangible certificates was the quickest, safest, and most practical means of meeting the demands of the market.

In most share transactions today, however, the role played by the stock certificate is quite different. Most stock purchases are made through brokers, and it is the legal relationship between the buyer and his broker, not the priority of a bona fide purchaser under Article Eight, which protects the buyer's rights. This relationship between the buyer and his broker is grounded on a contractual, as well as agency, theory, and exists independently of the legal relationships which develop in the stock transaction between the buyer broker and the seller broker and between the seller broker and the seller.

Upon effectuation of the trade by the buyer and seller brokers a contract arises between the buyer and his broker which obligates the latter to deliver a stock certificate representing a specified number of corporate shares in exchange for the selling price plus the broker's commission. The buyer normally will then have five days after receiving a confirmation of the trade to fulfill his obligation to remit payment. This contract will remain executory on the part of the buyer broker, however, until delivery of the certificate registered in the buyer's name some weeks or months after his remittance of payment. Throughout this process the identity of the seller is unknown to the buyer and the certificate which the buyer eventually receives is almost never the seller's certificate. The buyer, therefore, looks solely to his broker and not to the seller for performance.

Although it may be weeks or months before the purchaser receives the certificates representing his purchase, enforceable legal relationships arise from the time the seller and purchaser first contact their respective brokers, and it is the seller broker who, pursuant to these relationships, assumes the ultimate risk that the seller's delivery of the certificate will be timely and proper. In making a trade the seller broker assumes an obligation under both the UCC and, where the transaction occurs on an exchange, under

78 See Report of the American Bar Association Committee on Stock Certificates, Section on Corporation, Banking, and Business Law 2-3 (Sept. 15, 1975) [hereinafter cited as ABA Report].
79 Id.
81 See generally ABA Report, supra note 78, at 4.
82 Werner, supra note 80, at 606.
83 See ABA Report, supra note 78, at 4-5; Werner, supra note 80, at 606.
84 ABA Report, supra note 78, at 4.
85 Id.
86 Id.
87 Id. at 5.
88 Id.
89 Id. at 4.
90 Id. at 5.
91 See Uniform Commercial Code §§ 8-306, 8-313, 8-314.
exchange rules\textsuperscript{92} to deliver a certificate to the buyer broker free of adverse claims and defenses. The buyer broker in turn relies on the seller broker's obligation in sending the confirmation of purchase to the buyer. Since the certificate follows legal relationships established in the market and does not create those relationships,\textsuperscript{93} it must be concluded that the impairment of the full negotiability of stock certificates which would result from a provision recognizing attachments by means of service of notice on the corporation would have little or no impact on the functioning of the securities markets from the point of view of a purchaser.

Such a provision would, however, affect the position of seller brokers, who would shoulder the ultimate risk should an attempt be made to transfer certificates representing the attached shares. For example, a seller broker will often effectuate a trade without having the seller's certificate in its possession. In such cases, the seller broker transfers either certificates from inventory or certificates bought or borrowed specifically for the purpose of settling that obligation to the buyer broker.\textsuperscript{94} The seller usually has five days after receipt of confirmation of the trade to deliver her certificates, which the seller broker will then attempt to have registered in its own name to replace those transferred in the settlement process.\textsuperscript{95} If the share interest represented by the certificate has been attached by service of notice on the corporation, the certificates would be cancelled upon receipt by the corporation or its transfer agent. The seller broker, assuming payment had been remitted,\textsuperscript{96} would then be left with an action against the seller. The result would generally be the same where the seller broker had possession of the certificates when the trade was made since a seller broker will generally register certificates out of the seller's name prior to their transfer to another broker.\textsuperscript{97} In those rare transactions in which the seller's certificates are transferred between brokers directly by endorsement, the ultimate risk would still fall on the seller broker because of its obligation to deliver certificates free of adverse claims or defenses.\textsuperscript{98}

Without modification, the present legal structure of the market would, therefore, place the burden on the seller broker to be aware of the fact that its customer is an officer, director, or controlling person of the corporation.

\textsuperscript{92} See, e.g., N.Y. Stock Exch. Const. art. XII, §§ 1, 2, reprinted in 2 CCH N.Y. STOCK EXCH. GUIDE, para. 1551-52.
\textsuperscript{93} Werner, supra note 80, at 606.
\textsuperscript{94} See ABA REPORT, supra note 78, at 5. Even if the seller's certificates were endorsed directly to the buyer broker, the selling broker would bear the ultimate risk as he would have violated his obligation to deliver a clean certificate. See notes 91, 92 supra.
\textsuperscript{95} See ABA REPORT, supra note 78, at 4-5.
\textsuperscript{96} In most transactions a seller will receive a credit to her account with the seller broker rather than immediate payment upon delivery of her certificates. See ABA REPORT, supra note 78, at 4.
\textsuperscript{97} See, e.g., New York Stock Exchange Rules 195-225, reprinted in 2 CCH N.Y. STOCK EXCH. GUIDE, para. 2195-2225 which limit the concept of "good" delivery with the result that most shares are registered out of the seller's name, prior to their transfer between brokers. Cf. C. ISRAELS & E. GUTTMAN, MODERN SECURITIES TRANSFERS § 6.06 (rev. ed. 1971).
\textsuperscript{98} See notes 91-92 and accompanying text supra.
whose stock is to be sold, and that such shares are subject to levy without seizure of the certificates. While this burden may require a seller broker to conduct investigations of customers prior to trading in the securities markets on their behalf, it should be noted that existing rules of the New York Stock Exchange, the American Stock Exchange, the National Association of Securities Dealers, and the Securities and Exchange Commission already impose just such an obligation of investigation on all brokers. As a practical matter, a provision recognizing valid attachments by means of service of notice on the issuer corporation would merely place on a seller broker the burden of verifying the rightfulness of the seller's transfer by contacting the issuer prior to remitting payment.

Ironically, the present market system with its legal emphasis on the delivery of stock certificates is now considered a serious impediment to the free transfer of share interests which it was designed to promote. Increased volume in the late 1960's forced securities markets to shorten trading hours and to restrict trading activities of firms unable to keep cur-


The obligation created by these rules is generally described as the "know your customer" doctrine. The rules generally require the exercise of "due diligence" to learn the essential facts relative to every customer, order, and account.

It should be noted that the liability of a broker for consummating a customer's fraudulent transfer may be recognized under the "know your customer" doctrine even though the true owner may have been negligent with regard to lost or stolen certificates. This result is justified on four policy grounds:

(1) As a practical matter the only way to control customer fraud is to place an enforceable duty of policing transactions on the brokers;
(2) Brokers are generally in the best economic position to distribute the loss among individual investors and to insure against the risks created;
(3) Brokers, as professionals, are held to a higher standard of care and professional responsibility than individual investors;

See Comment, The "Know Your Customer" Rule of the NYSE: Liability of Broker-Dealers Under the UCC and Federal Securities Laws, 1973 Duke L.J. 489, 494-99. Thus, there should be no difficulty in imposing a similar burden on the broker in situations where the attaching party was not negligent with regard to attachment of the certificates.

100 Such verification would usually only require the broker to telephone the issuer or transfer agent to determine whether an attachment of the shares had been made. If no attachment had been made the broker could cut off subsequent transfers by notifying the issuer or transfer agent that the shares were being transferred.

It is equally reasonable to place the burden of ascertaining a borrower's power to pledge securities as collateral on the lender because such transactions are usually preceded by a period of negotiation and credit investigation. ABA REPORT, supra note 78, at 11. A lender would thus be able to follow the same procedure of contacting the issuer and securing its priority prior to disbursement of the loan.

101 ABA REPORT, supra note 78, at 3.
rent with the task of physically transferring the stock certificates. The realization that it is no longer practicable to rely on the physical transfer of stock certificates to establish legal rights has resulted in the proposal of numerous alternative systems, each of which is based on the concept of the reduced legal significance of the stock certificate. As final evidence of the limited importance of fully negotiable stock certificates to the functioning of modern securities markets one need only take note of the numerous recommendations by legal commentators that a certificateless market system be instituted or that the present legal system be revised to facilitate the use of "uncertificated shares."

2. Notice to Subsequent Transferees—Although it would be consistent with existing "know your customer" standards to simply deny a seller broker protection as a bona fide purchaser against attachments of share interests accomplished without seizure of the certificates representing those interests, it is possible to reconcile such an attachment provision with the manner in which the present law protects the rights of a subsequent transferee of the stock certificates. Such a reconciliation would not only further reduce the burden on seller brokers, it would also protect the transferee in brokerless transactions involving a simultaneous exchange of certificates for cash.

Article Eight emphasizes the protection of the interests of a bona fide purchaser by recognizing the absolute priority of a bona fide purchaser's interest over all adverse claims, including the claim of the true owner. However, as it has been concluded that limiting the protection afforded a bona fide purchaser under Article Eight would have at most a minor impact

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102 See Werner, supra note 80, at 605. Cf. Smith, supra note 72, at 924.
105 See ABA REPORT, supra note 78.
106 See note 99 supra.
108 UNIFORM COMMERCIAL CODE §§ 8-301(1), (2).
on the functioning of the securities markets and the liquidity of stock certificates, a viable alternative to recognizing the absolute priority of a bona fide purchaser would be to eliminate the possibility that a transferee would need to claim bona fide purchaser status.

One method of eliminating the need for a transferee to claim bona fide purchaser status would be to ensure that all subsequent transferees take the certificate with full notice of any potential adverse claims. This could be done by requiring that certificates representing share interests attachable by service of notice on the corporation bear a transfer legend stating that the shares are subject to attachment without seizure of the certificates, and informing a potential transferee of the procedure for establishing the priority of his claim. A transferee would not need the protection of Article Eight as he would not go through with the transaction if he could not establish the priority of his claim to the share interests with the issuer.

The possible use of notice as an alternative to the protection afforded by bona fide purchaser status was recognized in *Progressive Forwarding, Inc. v. Cander Realty Corp.*, in which the Supreme Court of New York County granted an order directing an issuer corporation to cancel unsurrendered certificates registered in the name of a judgment debtor who had fled the country. The court further directed that new certificates be issued and sold at public auction to satisfy the claim of the judgment creditor. This result was justified, notwithstanding the language of section 8-317 of the UCC to the contrary, on the grounds that the transfer of the certificates in question was subject to an agreement between the shareholder and the

109 See notes 70-100 and accompanying text supra.

110 It should be noted that the unhampered and undelayed circulation of securities is less essential than the instant transferability of commercial paper. Folk, *A Premise*, supra note 70, at 1380-81; cf. Israels, *supra* note 40, at 677. Thus, this proposal is easier to justify than a limitation on the protection afforded a holder in due course under Article Three.

111 A bona fide purchaser is defined in *Uniform Commercial Code* § 8-302 as a purchaser "for value in good faith and without notice of any adverse claim. . . ." However, Comment 1 to *Uniform Commercial Code* § 8-317 (which defines valid levy) indicates that the giving of notice to a transferee may not fulfill the requirement of that provision and that there must be no possibility that a purchaser in good faith and without notice may take the security. Section 8-317, Comment 1 states in part that

[a] valid levy cannot be made unless all possibility of the security finding its way into a transferee's hands has been removed. This can be accomplished only when the security has been reduced to possession by a public officer or by the issuer.

It should be noted that the quoted language makes express reference to the *Uniform Stock Transfer Act* provision (§ 13) which permitted attachment where the holder was enjoined from transferring the certificate and it is quite possible that the drafters did not consider the alternative of a levy which is valid against a transferee having notice of the adverse claim.

112 For a discussion of how a transferee could establish the priority of his claim see note 100 supra.

issuer corporation, and that this restriction was evidenced on the face of the certificates.\textsuperscript{114}

Commentators have attacked \textit{Progressive Forwarding} primarily on the ground that it is questionable from the limited facts presented whether the legend on the certificates was sufficient to protect a subsequent transferee.\textsuperscript{115} There is no reason, however, why a suitable legend, drafted specifically for that purpose and conspicuously located on the certificate, could not eliminate the need for a subsequent transferee to claim bona fide purchaser status.\textsuperscript{116}

A requirement that all shares beneficially owned by an officer, director, or controlling person bear such a legend would not create any undue restraint on the alienability of such shares.\textsuperscript{117} Upon receiving the certificates, a potential transferee or the seller broker would be informed by the legend that the transferee's position may be subordinate to that of a prior adverse claim\textsuperscript{118} recorded with the issuer or transfer agent.\textsuperscript{119} The transferee could then guarantee his position of priority and that of all subsequent transferees by contacting the issuer or transfer agent pursuant to instructions contained in the legend and informing him of the transfer.\textsuperscript{120}

Furthermore, such a transfer restriction would only supplement the restraints which already apply to most shares beneficially owned by an officer, director, or controlling person of a corporation. For example, if the shares are registered pursuant to section 12 of the Securities Exchange Act of 1934,\textsuperscript{121} their transfer is subject to restrictive federal regulation under section 16 of the same act,\textsuperscript{122} while unregistered shares are generally subject to a transfer restriction imposed by the issuer to preserve the exempt status of the shares.\textsuperscript{123}

The UCC recognizes the validity of transfer restrictions on negotiable securities as long as the restrictions are noted conspicuously on the cer-

\textsuperscript{114} N.Y.L.J., May 6, 1969, at 2, 6 UCC REP. SERV. 390 (Sup. Ct. N.Y. Co. 1969). Although not expressly discussed, it would appear that the court felt that section 8-317 was inapposite as the transfer legend provided the transferee with notice that he should confirm the validity of the transfer with the issuer. The court also placed special emphasis on the fact that the judgment debtor had fled the country, making seizure of the certificates impossible.


\textsuperscript{116} For an example of such a legend see Appendix infra. See note 100 supra.

\textsuperscript{117} See notes 105-07 supra.

\textsuperscript{118} An adverse claim is defined to include "a claim that a transfer was or would be wrongful. . . ." \textsc{Uniform Commercial Code} § 8-301(1). A transfer restriction is treated as an adverse claim. \textsc{Uniform Commercial Code} § 8-204, Comment 1.

\textsuperscript{119} A corporation may delegate its powers and functions in respect to the maintenance of transfer records relating to its securities to a professional transfer agent. \textsc{Cf.} C. ISRAELS & E. GUTTMAN, MODERN SECURITIES TRANSFERS §§ 7.02-.06 (rev. ed. 1971).

\textsuperscript{120} The transferee would be protected as a purchaser under \textsc{Uniform Commercial Code} § 8-301(1).


\textsuperscript{123} Folk, \textit{A Premise}, supra note 70, at 1399.
A transforee who accepts certificates with notice of the transfer restriction takes the certificates subject to any adverse claim stemming from the restriction, but has a warranty action against the transferor should the transfer be upset by an adverse claimant.\textsuperscript{125}

B. The Proposed Amendments and the Constitution

In many cases an officer, director, or controlling person cannot be brought under the jurisdiction of a court and effective action lies only against property of such person found within the jurisdiction of the court. In other cases, where an officer, director, or controlling person is subject to, or submits to, personal jurisdiction, it is possible for such person to remove property from the jurisdiction before a judgment is rendered. Such removal may well make it impossible for a victorious plaintiff to enforce a judgment. It is especially important, therefore, that the attachment of shares be allowed prior to a final determination of the merits of the case. The Supreme Court of the United States, however, has traditionally taken the position that due process considerations demand that any significant deprivation of property by means of state action be preceded by reasonable notice and opportunity for a hearing unless there is a countervailing compelling public interest.\textsuperscript{126} The present application of this traditional standard has been clouded by recent Court decisions\textsuperscript{127} which raise two questions with respect to the constitutionality of the attachment of corporate shares to secure jurisdiction over a defendant or to insure the enforceability of a judgment: (1) whether there is a sufficient state interest underlying

\textsuperscript{124} \textit{Uniform Commercial Code} § 8-204.

\textsuperscript{125} The rights of a transferee with notice of a valid transfer restriction are protected by \textit{Uniform Commercial Code} § 8-306(2)(a) under which the transferor warrants that his "transfer is effective and rightful." This concept of rightful transfer includes freedom from any contractual restriction and thus includes transfer restrictions. By warranting that the transfer is "effective", the transferor guarantees that all necessary endorsements are present and that no adverse claims exist which would prevent registration of transfer into the name of the transferee. C. Israels & E. Guttman, \textit{Modern Securities Transfers} §§ 4.05-.06 (rev. ed. 1971).

An issuer may, pursuant to \textit{Uniform Commercial Code} §§ 8-401(c),(e), 8-403, refuse to register any transfer which does not comply with a valid transfer restriction, and this refusal gives rise to the transferee's right to rescind or reject the transfer under §§ 8-306(2), 8-316. The vast majority of securities transfers involve brokers who make similar warranties under section 8-306(5) and the transaction would be thwarted long before the transferee ever saw the certificate. In most such transactions, the first step would involve the seller broker's attempt to register the security out of the seller's name. If the shares had been previously attached, the transaction would not proceed beyond this initial step, for the issuer corporation would not register the transfer. See Folk, \textit{A Premise, supra} note 70, at 1401.


For the purposes of this article it is assumed that a temporary, nonfinal deprivation, such as occurs in a prejudgment attachment or garnishment, would be inconsistent with due process requirements. See Gordon v. Michel, — Del. Ch. —, 297 A.2d 420 (Ch. 1972).
the legislation to justify postponement of the defendant’s right to a hearing before possession of property is interfered with; and (2) whether quasi in rem jurisdiction, upon which actions under the proposed amendments might be based, should be subject to a “minimum contacts” test as required in the case of in personam actions.

1. Sufficient State Interest—The state interest which the proposed amendments would serve would be to confer upon state courts jurisdiction over all controversies involving a breach by an officer, director, or controlling person of his fiduciary duty under state corporation law and guarantee that injured shareholders are not without redress. The Supreme Court in *Fuentes v. Shevin*, 128 in finding replevin statutes in Florida and Pennsylvania unconstitutional, recognized, in a footnote, that attachment used to secure jurisdiction in a state court is “clearly a most basic and important public interest.”129 The Court set out a three-part test for determining whether a public interest is of sufficient importance to justify postponing the defendant’s right to notice and a prior hearing. Under this test the seizure must be “directly necessary” to secure the important public interest; there must be a special need for prompt action; and the procedure must be subject to the strict control of the state.130

In subsequent decisions the Court has further clarified the meaning of the latter two factors. In *Mitchell v. W. T. Grant Co.* 131 the Court upheld the constitutionality of the Louisiana sequestration procedure which provided for the issuance of writs by a judge132 upon the filing of an affidavit clearly setting out the nature and amount of the claim and grounds for relief,133 as well as a post-seizure hearing at which the writ would be dissolved unless the attaching party proved the ground on which the writ was issued.134 *Mitchell* was followed by *North Georgia Finishing, Inc. v. Di-Chem, Inc.* 135 in which the Court held a Georgia garnishment procedure unconstitutional as failing to have the “saving characteristics” of the Louisiana procedure.136 It seems clear, despite the arguably inconsistent nature of the latest pronouncements, that there is sufficient state control over attachment or garnishment proceedings if the authorizing writ is issuable only by a judge. Furthermore, it seems clear that an attachment procedure would not conflict with due process requirements if it requires the plaintiff to plead more than conclusory allegations and provides for an immediate post-seizure hearing at which the plaintiff must present proof of the grounds on which the writ was issued or face dissolution of the writ.

The Supreme Court has not, however, elaborated further on the *Fuentes* requirement that the seizure be “directly necessary” to secure an important

129 407 U.S. at 91 n.23.
130 407 U.S. at 91-93.
132 See 416 U.S. at 606 n.5.
133 LA. CODE CIV. PRO. art. 3501 (1960).
134 LA. CODE CIV. PRO. art. 3506 (1960).
136 419 U.S. at 607.
While it is unquestionable that a state has an important interest in "providing a forum to resolve controversies properly subject to its jurisdiction," some commentators have read the "directly necessary" language as implying that prejudgment seizure provisions used to secure jurisdiction would be constitutionally acceptable only where seizure is the sole means by which a court can secure jurisdiction over the controversy.

In the absence of a definitive Supreme Court pronouncement the issue cannot be fully resolved. However, those courts which have reached the issue have not given a literal reading to the "directly necessary" language. The leading decision on this question is *Lebowitz v. Forbes Leasing & Finance Corp.*, which dealt with the constitutionality of the Pennsylvania foreign attachment rules. In *Lebowitz* a Pennsylvania resident commenced an action for invalid discharge against a Delaware corporation by writ of foreign attachment executed by sheriff's service on two banks holding funds deposited by the defendant corporation, which was also subject to personal service under the Pennsylvania long-arm statute. The court found that the availability of a long-arm statute did not obviate the necessity for attachment in that

in contrast [to jurisdiction under the long-arm statute] foreign attachment provides an immediate and certain basis on which to exercise jurisdiction over a nonresident defendant. It thereby constitutes a greater inducement for such a defendant to appear and consequently, accomplishes one of the principal objectives underlying the enactment of foreign legislation.

Since the primary function of a provision allowing attachment of shareholder interests in corporations without seizure of certificates would be to permit the attachment of stock of foreign nonresident shareholders, it may be argued that the provision should be limited in application to situations in which the defendant shareholder is not otherwise subject to service. However, where the defendant is properly served and ignores the service because he and his assets are outside the physical jurisdiction of United States courts, such a limitation would totally emasculate application of the proposed amendments. In such cases the ability to seize all available assets is especially important, both to compel the defendant's appearance and to provide some basis for satisfying the plaintiff's claim should the defendant refuse to appear. Requiring pre-seizure notice would only increase the

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137 407 U.S. at 91.
138 See Folk & Moyer, supra note 126, at 764.
143 456 F.2d at 982.
144 Id.
possibility that a defendant would attempt to thwart the amendments by means of an intervening transfer.\textsuperscript{146} The reasoning of the court in \textit{Lebowitz} appears, therefore, especially applicable to the proposed amendments and the state interest upon which they are founded.

2. Establishing Jurisdiction by Means of Prejudgment Attachment—It has long been recognized that the foundation of a court’s jurisdiction is the physical power which it may exert over persons or property found within the geographic boundaries of its jurisdiction.\textsuperscript{146} The exercise of quasi in rem jurisdiction, therefore, is predicated on the ability of a court to seize or otherwise proceed against the res.\textsuperscript{147} Where the res consists of intangible property, it is generally recognized that, for purposes of jurisdiction, attachment, or garnishment, the situs of the intangible property is wherever the debtor or garnishee is subject to in personam jurisdiction.\textsuperscript{148}

In Delaware, where the tangible stock certificate is accorded lesser legal significance, it is provided by statute that the situs of the stock in a Delaware corporation is always considered to be Delaware.\textsuperscript{149} This statute provides a basis for the sequestration of stock owned by nonresident shareholders in Delaware corporations,\textsuperscript{150} and a similar provision would be necessary to give effect to the proposed amendments.

Two leading commentators on Delaware corporation law, however, have questioned whether the use of such prejudgment seizure provisions to establish jurisdiction over a nonresident defendant may result in a denial of due process.\textsuperscript{151} The basis of their analysis is the isolation of two distinct types of quasi in rem actions: (1) those in which the res is the direct focus of the controversy; and (2) those in which the res is merely a jurisdictional tool for bringing a claim unrelated to the subject property.\textsuperscript{152} These commentators argue that where quasi in rem jurisdiction is used to bring a claim unrelated to the subject property, as would be the case where jurisdiction over corporate shares was used to enforce a claim for breach of fiduciary duty, that in substance the action has more in common with an in personam action.\textsuperscript{153} They conclude that the jurisdictional test in such cases should be a measure of the state’s interest in the controversy, and that the statutory situs of the shareholder’s interest should not control.\textsuperscript{154}

To this end it is suggested that quasi in rem jurisdiction under the Delaware sequestration statute should be recognized only where the “minimum

\textsuperscript{146} See, \textit{e.g.}, \textit{McDonald v. Mabee}, 243 U.S. 90, 91 (1917).
\textsuperscript{149} \textit{Del. Code Ann.} tit. 8, § 169 (1953).
\textsuperscript{150} See \textit{Folk \& Moyer, supra note} 126, at 777-89.
\textsuperscript{151} \textit{Id.}
\textsuperscript{152} \textit{Id.} at 780-82.
\textsuperscript{153} \textit{See id.} at 782.
\textsuperscript{154} \textit{Id.} at 784.
contacts' test\textsuperscript{155} used to determine the availability of in personam jurisdiction can be met, especially where the plaintiff is a nonresident as well.\textsuperscript{156}

While ultimate resolution of this issue must await Supreme Court determination, it should be noted that present case law is contrary to this position. It has been held by at least one federal district court that the "minimum contacts" test is inapplicable where the plaintiff invokes quasi in rem jurisdiction.\textsuperscript{157} This result has been justified not only on the ground that the state has an interest in aiding its citizens in prosecuting claims against nonresident defendants, but also on the ground that there is an important state interest in having the courts of the state in which a corporation is organized decide corporate law questions involving that corporation. One court has summarized this position by stating that

a director or officer should be obliged to respond in [the jurisdiction in which the corporation is organized] which is in a unique position to make an authoritative determination of 'housekeeping' issues and to grant complete relief.\textsuperscript{158}

This analysis should apply equally to a controlling person and would appear to justify recognition of a suit by a nonresident shareholder against an officer, director, or controlling person whose breach of fiduciary duty should be adjudicated under the law of the state in which the corporation was organized.

IV. Conclusion

As illustrated in the foregoing discussion, a provision which allows the shares of officers, directors, and controlling persons to be attached without the actual seizure of the stock certificates representing the shares, notwithstanding the impact of such a provision on the negotiability of stock certificates, would not disrupt the functioning of the securities markets. Furthermore, such a provision could be drafted to minimize its impact on the manner in which existing law protects the rights of a bona fide transferee of the stock certificate by requiring a restrictive legend to be carried on each certificate owned by such a person, and to comply with recent Supreme Court standards for prejudgment seizures by requiring judicial supervision over the issuing of writs of attachment and by providing for a post-seizure hearing at which the officer, director, or controlling person could challenge the propriety of the attachment.

In order to provide shareholders with a more effective remedy in actions

\textsuperscript{155} The principle that due process considerations require some minimum contact between the forum state and an individual or corporate defendant being subjected to in personam jurisdiction was first recognized by Chief Justice Stone in International Shoe Co. v. Washington, 326 U.S. 310, 319 (1945) and has undergone further development in subsequent Supreme Court decisions. See Hanson v. Denckla, 357 U.S. 235 (1958); McGee v. International Life Insurance Co., 355 U.S. 220 (1957); Perkins v. Benguet Consolidated Mining Co., 342 U.S. 437 (1952); Traveler's Health Association v. Virginia, 339 U.S. 643 (1950).

\textsuperscript{156} See Folk & Moyer, supra note 126, at 767, 784.


\textsuperscript{158} Gordon v. Michel, — Del. Ch. —, 297 A.2d 420, 422-23 (Ch. 1972).
based on a breach of fiduciary duty it is proposed that a section be added to
the ABA-ALI Model Business Corporation Act which would provide for
the initiation of suits against officers, directors, and controlling persons for
a breach of their fiduciary duty to the corporation or to its shareholders by
attachment of their share interests in the state in which the corporation is
organized. Such a provision should provide for direct judicial supervision
over the attachment process and an immediate post-seizure hearing, and
should contain language which clearly establishes the jurisdiction of the
courts of the state over such share interests, without regard to the location
of the stock certificates.

To minimize potential conflict with the basic negotiability premise of the
UCC, it is recommended that ABA-ALI Model Business Corporation Act
section 23 be amended to require that all shares which are beneficially
owned by an officer, director, or controlling person bear a transfer legend
sufficient to give notice to any subsequent transferee that the shares may
be subject to a prior levy and specifying the procedure for establishing a
senior right.

Finally, it is proposed that section 8-317 of the UCC be amended so as
to recognize as valid an attachment of shares of a corporation beneficially
owned by an officer, director, or controlling person of that corporation by
means of service of notice of such attachment on the corporation.

APPENDIX

PROPOSED AMENDMENT TO THE ABA-ALI MODEL
BUSINESS CORPORATION ACT ADDING SECTION 49A

Subject to the provisions of section 49, any person who is a holder of
record of shares or voting trust certificates in a domestic corporation may
institute an action against any nonresident officer or director of the
domestic corporation, or against any other person who directly or indirectly
is the beneficial owner of 10 percent or more of any class of security, for
breach of his fiduciary duty to the corporation or to its shareholders. Such
action may be commenced by the filing of a complaint, containing specific
facts verified by separate affidavit setting out in detail the nature of the
violation and the grounds for recovery, and requesting an order of the
Court directing such nonresident defendant to appear before the Court
on a designated day not less than thirty days from the date of the filing.
Such an order shall be issuable only by a judge [insert state court designa-
tion], who shall make all inquiries necessary to verify the validity of the
complaint and to verify the necessity for prejudgment relief.

Notice of the order shall be served upon a nonresident defendant by
registered air mail letter sent to the defendant's last known address, and
shall be published pursuant to court rules in the state or country of resi-
dence of the defendant. Such notice shall contain a statement of the
defendant's rights and liabilities under this Act.

A copy of the order, when served on the issuing corporation, at its
corporate headquarters or at the place where the transfer records for its
securities are maintained, shall effectively attach all shares of the issuing corporation of which the defendant is, directly or indirectly, the beneficial owner. Such shares may be sold under order of the Court, and the proceeds applied to meet the claim of the plaintiff, if the defendant fails to appear or otherwise defaults.

The nonresident defendant may, at any time on or before the day on which he is ordered to appear, make a special appearance before the Court granting the order solely to contest the validity of the order.

Any transfer or assignment of certificates representing the attached shares which occurs subsequent to service of the order upon the issuing corporation shall be void. Upon sale of the shares under order of the Court, the certificates representing the shares, if still in the possession of the defendant, shall be voided and cancelled on the books of the corporation. The purchaser of the shares under order of the Court shall be entitled to and have all the right, title, and interest of the defendant in the seized shares, and such sale shall transfer to the purchaser all the right, title, and interest in the shares as fully as if the defendant had transferred the same to the purchaser in accordance with law.

For the purposes of this Act, the situs of the shares of stock in a domestic corporation shall be this State.159

PROPOSED AMENDMENT TO ABA-ALI MODEL
BUSINESS CORPORATION ACT SECTION 23

All certificates which represent share interests directly or indirectly beneficially owned by an officer, director, or any other person owning beneficially 10 percent or more of any class of equity security shall carry the following legend.

NOTICE: The share interests represented by this certificate are subject to ATTACHMENT and LEVY by means of judicial order served on [insert appropriate corporate officer or transfer agent]. Such ATTACHMENT and LEVY will have priority over any right, title, or interest created by a subsequent transfer of this certificate. Any party may obtain information regarding prior ATTACHMENT or LEVY and secure priority over subsequent ATTACHMENT or LEVY by contacting [insert address, phone number, and cable address of appropriate corporate officer or transfer agent].

159 Besides providing a basis for a court's jurisdiction over share interests, this provision should also control should a court in another jurisdiction be asked to issue a writ for the seizure of stock certificates. See Mills v. Jacobs, 333 Pa. 231, 4 A.2d 152 (1939), in which a Pennsylvania court held that the state of incorporation has exclusive jurisdiction over situs and, therefore, a Pennsylvania statute providing for attachment of corporate shares by means of seizure of the certificates could not be used to attach the shares of a Delaware corporation, notwithstanding the fact that the certificates were located in Pennsylvania.
PROPOSED AMENDMENT TO UNIFORM COMMERCIAL
CODE SECTION 8-317

Section 8-317. Attachment or Levy Upon Security

(1) Subject to the exceptions in subsections (2), (3), and (4), no attachment or levy upon a security or other interest represented thereby which is outstanding shall be valid until the security is actually seized by the officer making the attachment or levy.

(2) A security which has been surrendered to the issuer may be attached or levied upon by service of notice of garnishment either at the registered office of the issuer in the jurisdiction in which it was organized or at the place where the transfer records for such security are maintained.

(3) A security which is beneficially owned by an officer or director of the issuer or by any other person who is directly or indirectly the beneficial owner of 10 percent or more of any class of security of the issuer may be attached or levied upon by service of a writ of attachment, issuable only by a judge, at the registered office of the issuer in the jurisdiction in which it was organized or at the place where the transfer records for such security are maintained.

(4) A creditor whose debtor is the owner of a security shall be entitled to such aid from courts of appropriate jurisdiction, by injunction or otherwise, in reaching such security or in satisfying the claim by means thereof as is allowed at law or in equity in regard to property which cannot readily be attached or levied upon by ordinary legal process.

—Michael H. Woolever

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160 The basic format of this amendment is taken from an amendment proposed by the Committee on Stock Certificates of the American Bar Association, Section on Corporation, Banking, and Business Law. ABA REPORT, supra note 78, at B-23.