

WHEN THE BROKER "FAILS UP"

How Excess or Insufficient Holdings Affect Claims of Customers to Amount of Their Securities

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"I BOUGHT 1,000 shares of 'steel' at 100 and sold 110," says the cheerful speculator.

"I reversed the process," admits another. "I bought at 110 and sold at 100."

"My luck was worse still," declares a third, "for I bought at 60 and when it was around 100 my broker who was carrying the stock went into bankruptcy."

The foregoing conversation may be duplicated any day in any financial experience exchange, and the last case presents a situation which is far too common.

Now, of course, it is common knowledge that if a business man enters into the populous and respectable state of bankruptcy his ordinary creditors are entitled to his assets in equal proportions, but where a bankrupt broker is carrying stock for a customer, steel, for instance, a different situation presents itself, and the customer will naturally ask himself the following questions:—

Did the broker have any steel stock in his possession at the time he went into bankruptcy?

If so, who is entitled to it, the receiver of the broker, or I?

Suppose, for instance, that the broker is carrying 100 shares of steel for a customer, and is not carrying any steel for any one else. When the broker goes into bankruptcy he has exactly 100 shares of steel in his possession.

In this case the customer would certainly be entitled to the stock, but things don't work out that way in real life. The broker is sure to have several customers interested in the same stock, and then the stock in his possession is sure to exceed or fall short of the number of shares he is carrying for his customers.

Where Holdings Exceed Requirements

Take the case where there is but one customer interested in a particular stock, but the stock in the broker's possession exceeds the number of shares he was carrying for the customer.

This point arose in a case where a broker was carrying 250 shares of a certain stock for a customer, and when the broker became bankrupt there were 350 shares of that particular stock in his possession. He was not carrying any of that stock for anybody else, and the question was whether the customer was entitled to claim his 250 shares out of the 350. The customer argued that if no other customer put in a claim, and there was more than enough to satisfy him, he would certainly be entitled to his 250 shares, while the receiver contended that there was not a sufficient identification or appropriation to the customer of his 250 shares.

The case went to the Supreme Court of the United States which held that the customer was entitled to his 250 shares of stock on the ground that, as the broker held the required quantity, the mere fact that he held more did not affect the matter, and that no more definite identification of the stock was essential.

"The certificates of stock were not the property itself," said the Supreme Court, "but merely evidence of it, and a certificate for the same number of shares represented precisely the same kind and value of property as another certificate for a like number of shares in the same corporation; and the return of a different certificate or the substitution of one certificate for another made no material change in the property right of the customer; and such shares are unlike distinct articles of personal property, differing in kind or value, as a horse, wagon, or harness, and stock has no earmark which distinguishes one share from another, but is like grain of a uniform quality in an elevator, one bushel being of the same kind and value as another.

"It is therefore unnecessary for a customer," the court went on to say, "where shares of stock of the same kind are in the hands of a broker, being held to satisfy his claims, to be able to put his finger upon the identical certificates

of stock purchased for him. It is enough that the broker has shares of a certain kind which are legally subject to the demand of the customer. And in this respect the trustee in bankruptcy is in the same position as the broker. It is said, however, that shares in this particular case are not so identified as to come within the rule. But it does appear that at the time of bankruptcy certificates were found in the bankrupt's possession in an amount greater than those which should have been on hand for this customer, and the significant fact is shown that no other customer claimed any right in those shares of stock. It was, as we have seen, the duty of the broker, if he sold the shares specifically purchased for the customer, to buy others of like kind, and to keep on hand, subject to the order of the customer, certificates sufficient for the legitimate demands upon him. If he did this, the identification of particular certificates is unimportant. Furthermore, it was the right and duty of broker, if he sold the certificates, to use his own funds to keep the amount good, and this he could do without depleting his estate to the detriment of other creditors who had no property rights in the certificates held for particular customers. No creditor could justly demand that the estate be augmented by a wrongful conversion of the property of another in this manner, or the application to the general estate of property which never rightfully belonged to the bankrupt."

The above case, it will be noted, applies to the case of a bankrupt broker who had in his possession shares of stock in excess of the stock which he was carrying for the customer and where that customer was apparently the only one for whom he was carrying any of that particular stock.

Where Holdings are Insufficient

In another case, also decided by the Supreme Court of the United States, the circumstances were just the reverse and the decision is an important one.

In this case the broker purchased 100 shares of "copper" stock for A, 30 shares for B, 50 shares for C and 100 shares for D, but the broker had disposed of nearly all of this stock, and at the time of his bankruptcy he had in his possession a certificate for 100 shares of "copper" stock and no more.

It appeared by the evidence that this certificate for 100 shares was never marked or otherwise identified by the broker as the property of any particular person or customer, or placed in any envelope bearing any indication that it was held for the special account of any particular customer, and no memorandum appeared upon the books of the broker showing that the stock was purchased or held for any particular account or customer, and that the same was received not for the account of any particular customer but from the stock exchange clearing house in the usual course of business.

Then A and C claimed that they were entitled to the 100 shares of copper stock pro rata—100/280 to A, and 50/280 to C.

It was claimed that as the stock in the bankrupt broker's possession was not equal to the amount which he should have had on hand to protect his customers, and that the broker having sold the shares specifically purchased for these customers, had not bought others of like kind nor kept on hand sufficient certificates to cover the claims of the customers, the customers were not entitled to a pro rata share of the stock, but the Supreme Court of the United States held otherwise and allowed the customers their proportion of the stock.

"If," said the court, "a certificate for 280 shares of 'copper' instead of 100 had been on hand, the four customers for whom that number were purchased might successfully claim them. And merely because the one actually in the box represented insufficient shares fully to satisfy all is not enough to prevent application of the rule so far as the circumstances will permit."

The Bank of England has notified British banks that they will no longer be required to maintain foreign balances there. Existing balances will receive interest to September 19th.