

STAMP Guarantees **Do They Really** **Guarantee Anything?**

An argument for enforcement procedures

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SECURITIES MEDALLION PROGRAMS PROVIDE A MECHANISM FOR THE EFFICIENT TRANSFER OF SECURITIES, BUT THE PROTECTIONS OFFERED BY THEM TO TRANSFER AGENTS ARE LIMITED AND JUSTIFY A FRESH LOOK AT THE NEED FOR ENFORCEMENT MECHANISMS

In the mid-1990s, with much ado and a broad base of industry and SEC support, The Securities Transfer Association, Inc. began the Securities Medallion Programs. Three such programs were evaluated and approved: Securities Transfer Agents Medallion Program ("STAMP"), Stock Exchanges Medallion Program ("SEMP"), and New York Stock Exchange, Inc., Medallion Signature Program ("MSP"). Oversight functions are performed by a not-for-profit corporation, its Board of Directors and its authorized Program Administrator. Each program was designed as a cooperative solution to the burdensome task of traditional signature card checks that tended to create drags on the security transfer process and increased costs to the securities industry.

The foundation of each program is the notion that signatories to the program would become holders (trustees, if you will) of guarantee medallions which, when employed by the securities broker, who usually knows or has some relationship with the signer (and thus can vouch for the signature), would provide Issuers of securities and their transfer agents with three contractual guarantees (in addition to the UCC-Article 8 guarantees attaching to every covered transaction).

The STAMP™ Guarantee Indemnity Agreement (from one of the more commonly used programs), in part, provides as follows:

“Guarantor does hereby, for itself and its successors and assigns, covenant and agree (a) to indemnify and hold harmless Agents and Issuers, and their officers, directors, agents and employees, in whatever capacity they may act, from and against any and all claims (whether groundless or otherwise), losses, liabilities, damages and expenses, including but not limited to disbursements and counsel fees (whether incurred in connection with such claims, losses, liabilities, damages and expenses or in connection with the enforcement of any rights hereunder), arising out of or in connection with the transfer, payment, exchange, purchase or delivery of securities in reliance upon the imprint, or, if Guarantor’s negligence shall have contributed substantially thereto, an impression or imprint resembling or purporting to be the Imprint, when used as aforesaid; and (b) to indemnify and hold harmless [the name of the Surety Company] as Surety, from and against any and all claims, losses, liabilities, damages and expenses, including, but not limited to, costs, disbursements and counsel fees, by reason of its having acted in accordance with the STAMP Surety Bond which it has executed in favor of Agents and Issuers.

Guarantor will not assert as a defense against any claim for indemnity hereunder any law, ordinance or regulation of any jurisdiction outlawing or prohibiting the

use of the Imprint as aforesaid, or assert any defense that the Imprint was *ultra vires*, which defenses are hereby expressly waived. Agents and issuers will have no responsibility to authenticate or otherwise verify the Imprint's manual or facsimile signature, but shall be required to conduct themselves, when relying upon the Imprint, in a commercially reasonable manner."

Based largely on these guarantees of genuineness of signature and promise of indemnification, the STAMP programs have been met with broad acceptance. Their goals of streamlining transactions and eliminating unnecessary and costly administrative checks are noble and in many ways they have served as an effective lubricant to grease the wheels of securities transactions.

This being said, all is not well in the practiced application of these STAMP programs' lofty goals. Consider if you will the following scenario from an actual case:

Example

"A" Trust Company, through its Main Transfer Agent (Joe's Investment Service) issues a stock certificate to registered owner John Smith of Buffalo, New York for 500 shares of Acme Corporation common stock at \$100 per share. Total value \$50,000. Stock certificate is stolen by one "John Smith of New York City, New York," alias "Bad Guy". Bad Guy opens a brokerage account in Chicago with Tech Beat Brokerage, a STAMP signatory, who guarantees Bad Guy's forged signature. Blind Trust Company, on behalf of Tech Beat Brokerage, presents the certificate to "The Bank," as transfer agent. The Bank registers the certificate as presented. The true John Smith of Buffalo, having never received his shares, makes a lost certificate claim, with appropriate affidavit, against the Main Transfer Agent, which, in compliance with UCC Article 8 guidelines, purchases shares of Acme Corporation to cover the claims of the real John Smith. The Bank then indemnifies the Main Transfer Agent pursuant to its operating agreement.

The Bank, having paid out based on the STAMP guarantee of Tech Beat makes demand on it based on its STAMP guarantee and UCC Article 8, Part 306 warranties, that provide:

- (a) A person who guarantees a signature of an endorser of a security certificate warrants that at the time of signing:
 - (1) the signature was genuine;
 - (2) the signer was the appropriate person to endorse, or if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person; and

(3) the warranties under this section are made to the person taking or dealing with the security in reliance on the guaranty and the guarantor is liable to the person for loss resulting from their breach.

Assume further that Tech Beat, in response to The Bank's demand for satisfaction (waits well more than the 10 day default period provided by the STAMP guidelines and then), raises spurious arguments as to whether The Bank is at fault in its registration of the certificate (because the real Mr. Smith had had a previous lost certificate) and denies the claim. When The Bank makes a claim directly to Tech Beat's surety (Almighty Indemnity Group) per the directives of the STAMP agreement, the Surety merely parrots Tech Beat's denial without any investigation of its own.

The Problem

Because there are no enforcement provisions built into the typical STAMP guarantee program, under this scenario, The Bank's only options are:

- (1) Initiate litigation to recover the \$50,000 lost; or
- (2) Execute an indemnification hold harmless release in favor of Tech Beat to obtain any of Bad Guy's account funds that may have been frozen by Tech Beat after notice of forgery.

As one can imagine, neither of these two options will make The Bank whole. Option (1) is drawn out and expensive. Legal fees and costs would quickly eat up the \$50,000 lost. Option (2) is viable only if a significant amount of assets have been frozen (which in most cases would require considerable fortuity) and has the effect of releasing Tech Beat and its surety from responsibility for their respective breaches of warranty and STAMP guarantees and places the onus for any future liability on The Bank as the issuer of the hold harmless release.

LESSON: As a practical matter, the STAMP guarantee only has value when the transaction amount subject to the guarantee is sufficiently large to justify protracted litigation to recover it since any unscrupulous broker STAMP signatory could raise sufficient denials and defenses to effectively defeat the transfer agent's ability to recover any significant amount of the loss.

Suggested Solutions

As with most any standardized cooperative market program, the practical success or failure of the program as well as its ability to function effectively and efficiently in a market environment, depends in large measure on the integrity of its participants or signatories. To the extent that any participant effectively undermines or emasculates the primary bases of the cooperative program, those participants must be weeded out and cut-off from participation. The only way to effectively accomplish this purpose is by the creation of a cooperative oversight review board made up of elected participant

representatives, imbued with power to review the actions of participants and revoke the signatory status of those who choose to violate the precepts of the organization. Perhaps in such a way, the sanctity of the programs' guiding principles can remain inviolate. The constituted Board could also function as an Alternative Dispute Resolution ("ADR") body that could adjudicate any monetary disputes as a mandatory and binding alternative to any formal legal action. In this way, the program would provide a built-in relief forum that would be time-efficient and cost-effective without regard to the size of the monetary dispute. Provision for the payment of costs and attorney's fees to the prevailing party could be part of the revised program. The cost of the ADR program would also be paid by the loser as a disincentive to making specious claims.

Another potentially effective adjunct to the ADR program would be to incorporate into the program a continuously updated publication of all STAMP related disputes. If the involved business community had ready access to information on those signatories that were allegedly defaulting on their obligations, informal pressures would likely result in less protracted litigation.

Conclusion

STAMP guarantees are an accepted and vital part of the investment securities transaction process, providing speed and efficiency to the transaction. The practical realities of unscrupulous brokers and their surety companies threaten the long-term operation of these programs. Oversight review committees and binding ADR systems should be considered to minimize the damage caused by signatory violators.

The author is a founding partner in the Chicago-based law firm of Cray Huber Horstman Heil & VanAusdal LLC. An element of his litigation, resolution and counseling practice deals with the representation of transfer agents, banks, brokers and sureties in securities disputes over guarantees and indemnity claims.