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## CORPORATIONS - RESTRAINTS ON ALIENATION OF STOCK STIPULATED IN THE CHARTER

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CORPORATIONS — RESTRAINTS ON ALIENATION OF STOCK STIPULATED IN THE CHARTER — The charter of the defendant corporation provided that the board of directors had authority to purchase its common stock at any time when the holder thereof was not an employee, or the holder had not received his common stock by conversion of the preferred. In accordance with the authority granted by this provision, the directors of the defendant corporation adopted a resolution to purchase the common stock owned by the plaintiff, who was not an employee and had not received his common stock by conversion of preferred shares. Plaintiff asked that an injunction be issued restraining defendant from proceeding further. Defendant demurred. *Held*, demurrer overruled on the ground that the restraint was unreasonable and void, unless the defendant could show, on further proceedings, that the restraint was necessary for the successful operation of its business. *Greene v. E. H. Rollins & Sons, Inc.*, (Del. Ch. 1938) 2 A. (2d) 249.

Although the law, in general, views with disfavor restraints upon alienation,<sup>1</sup> nevertheless reasonable restrictions upon the power to transfer stock, where such restrictions are contained in the articles of incorporation and the stockholder has notice of the restraint, are recognized in every jurisdiction.<sup>2</sup> What is a reasonable restraint seems to depend largely on the facts of each particular case. Certain restrictions have, however, become typed, and in such situations the restriction is deemed reasonable or unreasonable regardless of the facts of the particular case under consideration.<sup>3</sup> In looking at the specific fact situation to determine whether the restraint is reasonable, the courts take into consideration various factors. Factors that have been considered are the size of the corporation,<sup>4</sup> the degree of restraint on the power to alienate,<sup>5</sup> and the right of the present stockholders to determine who shall invest in their business.<sup>6</sup> Emphasis is also placed on whether the provision is for the best interest of the

<sup>1</sup> *Lawson v. Household Fin. Corp.*, 17 Del. Ch. 343, 152 A. 723 (1930); 2 SIMES, *FUTURE INTERESTS*, §§ 439, 440 (1936).

<sup>2</sup> 12 FLETCHER, *CYCLOPEDIA CORPORATIONS*, rev. ed., § 5454 (1932); *Bloomingtondale v. Bloomingtondale*, 107 Misc. 646, 177 N.Y.S. 873 (1919). Under the Uniform Stock Transfer Act, § 15, the restriction must be stated in the stock certificate.

<sup>3</sup> 29 YALE L. J. 352 (1920); 78 UNIV. PA. L. REV. 422 (1930).

<sup>4</sup> *People ex rel. Rudaitis v. Galskis*, 233 Ill. App. 414 (1924).

<sup>5</sup> *People ex rel. Malcolm v. Lake Sand Corp.*, 251 Ill. App. 499 (1929).

<sup>6</sup> *Baumohl v. Goldstein*, 95 N. J. Eq. 597, 124 A. 118 (1924).

whole enterprise,<sup>7</sup> whether control of the corporation is still in the majority of the stockholders,<sup>8</sup> whether the business is of the type that requires honest and skilled personnel<sup>9</sup> or in which an unfriendly stockholder might injure the corporation,<sup>10</sup> and whether the limitation upon alienation is necessary or convenient to attain the objects set forth in the charter of the corporation.<sup>11</sup> Another factor which probably exists, although not mentioned specifically in any of the cases on the subject, is whether the restraint allows the corporation an unfair advantage in respect to its stockholders. The test applied in the instant case<sup>12</sup> includes most of these factors and seems to be as good a test to determine reasonableness as can be obtained with such an elastic concept. The court found that the motives for the restriction were to insure the harmonious conduct of the business and to prevent the introduction of any common stockholder for any reason deemed unsuitable. It would seem that the motives do not justify the degree of restraint imposed, provided the court rightly concluded that the practical effect of the restraint is to deny to the stockholder the ability to sell to anyone but the corporation. From an academic viewpoint this determination is sound, but it might be questionable whether actual business experience would substantiate it.

<sup>7</sup> *People ex rel. Rudaitis v. Galskis*, 233 Ill. App. 414 (1924).

<sup>8</sup> *Mason v. Mallard Telephone Co.*, 213 Iowa 1076, 240 N. W. 671 (1932).

<sup>9</sup> *Casper v. Kalt-Zimmers Manufacturing Co.*, 159 Wis. 517, 149 N. W. 754, 150 N. W. 1101 (1914).

<sup>10</sup> *68 Beacon St. Inc. v. Sohler*, 289 Mass. 354, 194 N. E. 303 (1935).

<sup>11</sup> *Lawson v. Household Fin. Corp.*, 17 Del. Ch. 343, 152 A. 723 (1930).

<sup>12</sup> The test the court adopted here was "whether the restraint was necessary for the successful operation of its business."