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Corporations - Stock Transfer - Enforceability of Restrictions on Right of Transfer When Not Stated on Certificate

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CORPORATIONS—STOCK TRANSFER—ENFORCEABILITY OF RESTRICTIONS ON RIGHT OF TRANSFER WHEN NOT STATED ON CERTIFICATE—A by-law[1] of defendant corporation provided that no stockholder could sell his shares unless he first offered them for sale to the corporation or its directors. The by-law also stated that this restriction should be printed on the stock certificates and would thereupon bind all present or future owners or holders. The corporation never complied with this latter provision. Plaintiff, having knowledge of the by-law restriction, purchased two shares of the corporation's stock, but these shares were not first offered for sale to the corporation or its directors. When the corporation refused to transfer the shares, plaintiff sued to compel a transfer and the issuance of new certificates to him. The equity court granted the requested relief. On appeal, *held,* affirmed. Under the terms of the by-law and the requirements of section 15 of the Uniform Stock Transfer Act,[2] such a restriction is not enforceable, even against one who has actual knowledge, unless stated on the stock certificate. *Hopwood v. Topsham Telephone Co.,* (Vt. 1957) 132 A. (2d) 170.

Section 15 of the Uniform Stock Transfer Act has been adopted in all but three states.[3] Under its provisions, a number of cases have arisen in which an attempt was made to enforce restrictions on sale against persons who had actual knowledge of the restrictions, even though not printed on the certificate.[4] In two early cases,[5] where the offending parties

1 Principal case at 171.

2 "There shall be no lien in favor of a corporation upon the shares represented by a certificate issued by such corporation and there shall be no restriction upon the transfer of shares so represented by virtue of any by-laws of such corporation, or otherwise, unless the right of the corporation to such lien or the restriction is stated upon the certificate." Vt. Stat. (1947) §5880.

3 The section has not been adopted in North Dakota or Kansas. California has adopted a substitute, omitting any reference to restrictions. Cal. Corp. Code Ann. (Deering, 1953) §2479.

4 For a general review of cases prior to 1951, see 29 A.L.R. (2d) 901 (1951).

5 Baumohl v. Goldstein, 95 N.J. Eq. 597, 124 A. 118 (1924); Doss v. Yingling, 95 Ind. App. 494, 172 N.E. 801 (1930).

were corporate officers, restrictions were held valid on the theory that the officers owed a semi-fiduciary duty to the corporation and should not be allowed to take advantage of the statute since they were in a position to see that the restriction was stated on the certificate. Some of the more recent decisions,[6] however, though perhaps distinguishable from the early cases, have taken a strict view of the statute and held that actual knowledge of the restriction makes no difference if the statement is not printed on the certificate. The principal case follows this trend, and, as the statute is worded, proper principles of statutory construction suggest no other result.[7]

Despite the fact that section 15 fulfills the commissioners' purpose of making certificates of stock "so far as possible the sole representatives of the shares which they represent,"[8] it perhaps fails to take account of certain practical considerations. Restrictions on sale of stock are found most often in small closely held corporations where stockholders are more than likely to be aware of the restrictions. Thus, the statute, as interpreted by the majority of courts, often applies where it serves no purpose of giving notice, but only contravenes the considerations which have supported restraints on alienation of stock, such as preserving the personal element and resulting close control of the corporation. Reasonable restraints seem therefore justified to help maintain this relationship.[9] Where the restraint stems from an agreement solely between the stockholders, the likelihood is great that, as a practical matter, the statutory requirements will be overlooked, and yet, the statute would still seem to apply to invalidate the restraint.[10] While the problem is alleviated to a degree by the "semi-fiduciary" exception when corporate officers are involved in the transfer, at least one case has not seen fit to make this exception.[11] It is admitted that a less strict requirement would introduce problems of proof of actual knowledge, but the difficulties would seem to be justified since the inequities which may result from application of the strict view would be avoided.

In addition, the wisdom of applying the same strict rule to restric-

[6] See, e.g., Costello v. Farrell, 234 Minn. 453, 48 N.W. (2d) 557 (1951); Security Life and Accident Ins. Co. v. Carlovitz, 251 Ala. 508, 38 S. (2d) 274 (1949); Age Publishing Co. v. Becker, 110 Colo. 319, 134 P. (2d) 205 (1943).

[7] For an excellent interpretative analysis of §15, see Costello v. Farrell, note 6 supra, noted in 36 MINN. L. REV. 269 (1952).

[8] Commissioners' Note to §15, 6 UNIFORM LAWS ANNOTATED 20 (1922).

[9] For analysis of validity of such restrictions and reasons for enforcing them, see Cataldo, "Stock Transfer Restrictions and the Closed Corporation," 37 VA. L. REV. 229 (1951); 25 IND. L. J. 56 (1949); and 10 UNIV. FLA. L. REV. 54 (1957).

[10] This conclusion is based on the "or otherwise" phrase of the statute, note 2 supra. However, in Tomoser v. Kamphausen, 307 N.Y. 797, 121 N.E. (2d) 622 (1954), the court distinguished the case on this ground and enforced the restriction.

[11] Sorrick v. Consolidated Telephone Co., 340 Mich. 463, 65 N.W. (2d) 713 (1954), noted in 8 VAND. L. REV. 640 (1955).

tions as is applied to liens[12] is questionable for several reasons. First, the practical necessity of calling the impediment to the holder's attention is less in the case of a restriction. This results from the fact that a lien usually affects only certain shares while restrictions generally apply to all shares. In addition, a lien is just as likely to attach to a share of a large corporation where the stock will probably be transferred without personal knowledge of the affairs of the corporation, while, as seen above, a restriction is more likely to be found in a small corporation where the probability of actual knowledge is much greater. Second, the combination of the two provisions in one section has made it unclear whether the restriction must be printed on the certificate in its entirety. While the phrase, "the right of the corporation," may refer only to the lien provision of the section and the original intent may have been to have the restriction on transfer completely spelled out on the certificate, at least two courts have held the contrary.[13] Moreover, at least one legislature has changed section 15 to require only a notice of the restriction,[14] and this is recommended in the interest of simplicity.

In the light of the foregoing, it is suggested that consideration be given to the following changes in section 15. First, provisions respecting restrictions should be placed in a separate section. Second, stating the restrictions on the certificate should be required to hold only persons without actual knowledge of the restriction. Third, only a reference to the restriction should be required, with some provision made for easy access to a copy of the restriction. These changes in section 15 would reconcile the practical need for restrictions on stock sales in small closely held corporations with the policy of the statute to protect innocent purchasers, and, at the same time, make the statute clearer and facilitate compliance with its provisions.

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[12] Note 2 supra.

[13] Weissman v. Lincoln Corp., (Fla. 1954) 76 S. (2d) 478 at 483, held the statute should read, "the right of the corporation to . . . the restriction." In Allen v. Biltmore Tissue Corp., 2 N.Y. (2d) 534 at 540, 141 N.E. (2d) 812 (1957), the court reached the same result as in Weissman v. Lincoln Corp., while disapproving of its reasoning, by interpreting the word "stated," to permit "incorporation by adequate reference." See note 2 supra.

[14] Minn. Stat. Ann. (1953; Supp. 1956) §302.16.