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Corporations - Right of Shareholder Under Uniform Stock Transfer to Have Shares Transferred Contrary to Corporation By-Laws

Lawrence N. Ravick S.Ed.
University of Michigan Law School

CORPORATIONS—RIGHT OF SHAREHOLDER UNDER UNIFORM STOCK TRANSFER ACT TO HAVE SHARES TRANSFERRED CONTRARY TO CORPORATION BY-LAWS —The defendant, a Michigan corporation, adopted a "constitution" (by-laws) which contained the following provisions: ". . . no member shall be allowed to own more than five shares of stock at any one time." This restriction was not written into the articles of incorporation or printed upon the stock certificates. Plaintiff was at one time the president and director of the defendant corporation.

While an officer, he acquired twenty-five shares of stock, having at the time full knowledge of the by-law provisions. When he was no longer an officer, plaintiff purchased an additional share of defendant's capital stock and requested the secretary of the defendant to transfer this share on the corporation's books. The request was refused. Plaintiff sought specific performance of an implied agreement to transfer such stock. On appeal from a judgment for defendant, *held,* reversed. The plaintiff was entitled to relief even though he had notice of the restrictive provisions; the defendant had not complied with provisions of Michigan law, which required any limitations on the right to transfer or acquire stock to be stated in the articles of incorporation and on the stock certificates.[1] *Sorrick v. Consolidated Telephone Co.,* 340 Mich. 463, 65 N.W. (2d) 713 (1954).

The legislative policy of requiring restrictions to be placed in the articles and on the certificates is declaratory of the common law, which regarded corporate stock as personal property, transferable at the will of the holder.[2] The cases generally declared that corporate by-laws which attempted to restrict alienability were void in the absence of limitations imposed by statute or charter.[3] However, since restricting the transferability of shares was one method of giving to the original shareholders the power to choose future associates, reasonable restrictions have been upheld when they were recited in the articles.[4] On the other hand, absolute prohibitions against the transfer of stock have not been sustained by the courts.[5] While a legislature may no doubt grant to a corporation the right to restrict the transferability of its shares by means of the by-laws,[6] the Michigan legislature has permitted such restrictions only when they are recited in the corporate charter and on the stock certificates.[7] A practical reason for requiring that any qualification on shareholders' rights be placed in the articles and on the certificates is found in the fact that by-laws are exclusively within the control of the corporation and are available only to existing shareholders, whereas the articles are a matter of public record and the certificates may be

[1] ". . . there shall be no restriction upon the transfer of shares so represented by virtue of any by-law of such corporation, or otherwise, unless . . . the restriction is stated upon the certificate." Mich. Comp. Laws (1948) §441.15. This provision is the same as §15 of the Uniform Stock Transfer Act. 6 ULA (1922). Cf. Mich. Comp. Laws (1948) §450.25. Mich. Comp. Laws (1948) §450.4, as amended by Mich. Pub. Acts (1951) No. 239, relates to the contents of the articles of incorporation and provides that they shall contain in respect to the stock "a statement of all or any of the . . . qualifications, limitations or restrictions thereof." "The shares of the capital stock . . . may be divided into classes with such . . . restrictions as may be provided for in the articles." Mich. Comp. Laws (1948) §450.17.

[2] 10 ROCKY MT. L. REV. 117 (1938).

[3] For an almost identical factual situation as that occurring in the principal case, decided at common law, see Miller v. Farmers Milling & Elevator Co., 78 Neb. 441, 110 N.W. 995 (1907). See 13 AM. JUR., Corporations §337 (1938).

[4] 42 HARV. L. REV. 555 at 557 (1929); Lufkin Rule Co. v. Secretary of State, 163 Mich. 30, 127 N.W. 784 (1910).

[5] 65 A.L.R. 1159 at 1165 (1930); 18 IOWA L. REV. 88 (1932).

[6] Security Life & Accident Ins. Co. v. Carlovitz, 251 Ala. 508, 38 S. (2d) 274 (1949).

[7] See note 1 supra.

examined by any prospective purchaser. The notice on the certificate should be drawn with care and precision because of the courts' practice of strictly construing restrictions on alienation.[8] A restrictive provision which has not been printed on the stock certificate as required by the Uniform Stock Transfer Act[9] has been held unenforceable in the great majority of cases even where the purchaser had prior knowledge of the restriction.[10] In two cases, however, a person with knowledge of such restriction was held bound by the limitation even though there had not been compliance with the act.[11] In both cases the person seeking to avoid the restriction was an incorporator and officer of the corporation. To escape an inequitable result, the courts construed the by-laws as contracts to which the purchasers were parties.[12] Emphasis was given to the fact that the purchasers, as officers of the corporation, stood in a fiduciary relation to the shareholders. The principal case falls somewhere between these two groups of cases. Here the court admitted that the equities of the case were strongly in favor of the defendant, but reasoned that they "should not write into the law a limitation on stock transfers contrary to the well accepted understanding of the method of creating such limitations, as is expressed by the [Michigan] legislature. . . ."[13] The decision made no mention of a contract between the plaintiff and the corporation or shareholders, and no fiduciary duty could be found since the plaintiff was not an officer at the time he acquired the share of stock. The drafters of the USTA recognized that a recitation of the restriction on the certificate is the only effective means of giving such notice.[14] The decision in the principal case is consistent with the policy of the USTA in increasing the negotiability of the stock by making "certificates of stock so far as possible the sole representatives of the shares which they represent."[15]

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[8] See O'Neal, "Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting," 65 HARV. L. REV. 773 (1952).

[9] The USTA has been enacted in all 48 states, but in Kansas and North Dakota §15 has been omitted. See note 1 supra.

[10] Security Life and Accident Ins. Co. v. Carlovitz, note 6 supra; Age Publishing Co. v. Becker, 110 Colo. 319, 134 P. (2d) 205 (1943); Costello v. Farrell, 234 Minn. 453, 48 N.W. (2d) 557, 29 A.L.R. (2d) 890 (1951); Farrell v. Pepsi Cola Bottling Co., 234 Minn. 466, 48 N.W. (2d) 564 (1951); Peets v. Manhasset Civil Eng. Inc., 68 N.Y.S. (2d) 338 (1946); Re Magnetic Mfg. Co., 201 Wis. 154, 229 N.W. 544 (1930).

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

[12] This argument was presented but rejected by the court in Security Life and Accident Ins. Co. v. Carlovitz, note 6 supra, at 513.

[13] Principal case at 469.

[14] Where the drafters of the USTA intended to limit the application of its provisions to purchasers without notice, they specifically so provided. Costello v. Farrell, note 10 supra, at 460.

[15] 6 ULA §15, Commissioners' Note (1922).