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CORPORATIONS-SHARES OF STOCK-REASONABLENESS OF RESTRICTION ON TRANSFER OF SHARES

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CORPORATIONS—SHARES OF STOCK—REASONABLENESS OF RESTRICTION ON TRANSFER OF SHARES—Defendant corporation's by-laws provided, inter alia, that shareholders wishing to dispose of their shares must, in absence of contrary agreement with the remaining shareholders, give latter an option to buy at a price equal to book value, regardless of market value of these shares. This restriction was not set forth in the share certificates as required by statute.[1] On refusal of defendant corporation to permit transfer of its shares except in compliance with the terms of the by-law, complainants brought suit for declaratory judgment, and obtained a finding that these terms were void. *Held,* affirmed.

[1] Ala. Code (1940) tit. 10, §62.

The by-law restriction violated the statute and also constituted an unreasonable restriction on transfer, since, although it gave the other shareholders the right to purchase at book value, it did not give the vendors a corresponding power to compel purchase at this price. *Security Life and Accident Ins. Co. v. Carlovitz*, (Ala. 1949) 38 S. (2d) 274.

In absence of restraints of their alienation, shares of stock are as freely transferable as other personalty.[2] Valid restraints on transfer may arise either from statute, charter, by-law, or express agreement among the shareholders. Transfer of shares can properly be prevented by statute,[3] although some jurisdictions may find unduly severe statutory restrictions void as unreasonable and therefore contrary to public policy.[4] Charter restrictions on transfer are upheld, unless palpably unreasonable, on the ground that shareholders buy shares subject to such restrictions, and in effect agree to them.[5] By-laws may properly impose restrictions of a formal nature on transfer of shares, for example, by requiring that transfers be made in a particular way to enable the corporation to ascertain the identity of its shareholders.[6] Though a corporation may not, through a by-law and in absence of statutory authority, completely preclude the transfer of shares,[7] and though courts look with disfavor on substantive restraints on stock transfers and construe them strictly,[8] most courts hold that a corporation may, through a by-law, impose reasonable substantive (as distinguished from formal) restrictions on transfer, when convenient to attainment of corporate purposes and not violative of statute.[9] Though many courts hold that without specific legislative permission no restrictions can be imposed by means of a by-law, most courts manage to find at least implied permission from the corporation statutes.[10] The Uniform Stock Transfer Act, now in effect in most states, by requiring that all restrictions be set forth in the certificates themselves, implicitly authorizes reasonable restrictions.[11] Although there is a conflict as to whether or not the corporation may, in absence of statute, require the selling shareholder to give the corporation or its remaining shareholders a purchase option at market value,[12] the majority

[2] 12 FLETCHER, CYC. CORP., perm. ed., §5452 (1932).

[3] Howe v. Roberts, 209 Ala. 80, 95 S. 344 (1923).

[4] Morgan v. Struthers, 131 U.S. 246, 9 S.Ct. 726 (1889); Ireland v. Globe Milling Co., 19 R.I. 180, 32 A. 921 (1895).

[5] Lawson v. Household Finance Corp., 17 Del. Ch. 1, 147 A. 312 (1929). Cf. Green v. E. H. Rollins & Sons, Inc., 22 Del. Ch. 394, 2 A. (2d) 249 (1938), noted in 37 MICH. L. REV. 1140 (1939).

[6] Bloede Co. v. Bloede, 84 Md. 129, 34 A. 1127 (1896).

[7] Howe v. Roberts, supra, note 3.

[8] In re Starbuck's Estate, 129 Misc. 460, 221 N.Y.S. 540 (1927).

[9] Lawson v. Household Finance Corporation, supra, note 5.

[10] Nicholson v. Franklin Brewing Co., 82 Ohio St. 94, 91 N.E. 991 (1910). See 65 A.L.R. 1159-63 (1930).

[11] 6 Uniform Laws Annotated §15 (1922).

[12] See Bloede v. Bloede, supra, note 6, which holds that this option may not be required.

view is that such an option may be insisted upon.[13] However, the corporation may not make the right to transfer dependent on the approval of a particular corporate official.[14] It is true that a corporation can, through agreement among its shareholders duly supported by consideration, obtain broader restrictive powers than it can create through a by-law. It clearly can contract for a purchase option—even in jurisdictions not otherwise permitting such options except by statute[15]—and for other restrictions on transfer not properly the subject of by-law.[16] In fact, any agreement not void, as in restraint of trade or otherwise against public policy, can be enforced. The tendency is to validate such agreements if they do not contravene public policy, on the ground that they are within proper contract powers.[17] However, in the instant case, lack of mutuality of the option provision was said to preclude reliance upon it as an express agreement, as well as to render it unreasonable and violative of statute. In view of the limitations imposed by most courts on the right to restrict transfer of shares through by-laws, it would seem that the court's conclusion in the principal case is sound and amply supported by precedent.[18]

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[13] See 8 FLETCHER, CYC. CORP., perm. ed., §4205 (1932), and Nicholson v. Franklin Brewing Co., supra, note 10.

[14] Sargent v. Franklin Ins. Co., 25 Mass. 90, 19 Am. Dec. 306 (1829).

[15] Hoberg v. McNevins, 169 Wis. 486, 173 N.W. 221 (1919).

[16] Nat. Bank of the Pacific v. Western Pac. R. Co., 157 Cal. 573, 108 P. 676 (1910); New England Trust Co. v. Abbott, 162 Mass. 148, 38 N.E. 432 (1894).

[17] Searles v. Bar Harbor Banking & Trust Co., 128 Me. 34, 145 A. 391 (1929).

[18] See BALLANTINE, CORPORATIONS, §336 (1946).