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CORPORATIONS--TRANSFER OF SHARES--RESTRICTION BY SHAREHOLDERS' AGREEMENT

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CORPORATIONS—TRANSFER OF SHARES—RESTRICTION BY SHAREHOLDERS' AGREEMENT—The original shareholders of a family corporation had entered into a private agreement, noted on the stock certificates, which provided that before sale by any of the parties of any stock to a non-member, such stock must first be offered to the remaining stockholders. Defendant *B*, the widow of one of the founders, contracted to sell her stock to plaintiff, a non-member, without first offering it to defendants *L* and *M*, who own the balance of the stock. Plaintiff now seeks specific performance of his contract with defendant *B*. Defendants *L* and *M* seek to exercise their option to purchase according to the stockholders' agreement. *Held*, defendants *L* and *M* are entitled to specific performance of their agreement, and their right is superior to that of plaintiff. *Oppenheim Collins & Co., Inc. v. Beir*, 187 Misc. 428, 64 N.Y.S. (2d) 19 (1946).

The extent to which the transfer of corporate shares by stockholders can be restricted has been the subject of much litigation, arising mainly with respect to by-law restrictions. By-laws which unreasonably restrict the transfer of stock are invariably held invalid, unless authorized by specific legislation,[1] while reasonable restrictions in the by-laws are generally upheld.[2] A by-law which prohibits the sale of the corporation's stock to outsiders without first offering it to the other stockholders, or to the corporation, is recognized by the weight of authority as a reasonable restriction.[3] Some courts have indicated that even if such a by-law itself is an invalid exercise of corporate power, still it may be binding as a contract on the stockholders who unanimously adopt it.[4] In the principal case, the restriction was imposed by a private agreement between the stockholders, and apparently no by-law was involved. It seems clear that such a contract is valid unless in restraint of trade.[5] Courts have generally upheld private agreements between stockholders which impose reasonable restrictions on their right to trans-

[1] 18 C.J.S., Corporations, § 391c, d (1939), and cases cited; 8 FLETCHER, CYC. CORP., § 4205 (1931), and cases cited.

[2] Supra, note 1.

[3] "Stock in a corporation is not merely property. It also creates a personal relation analogous otherwise than technically to a partnership . . . . there seems no greater objection to restraining the right of choosing one's associates in a corporation than in a firm." Barrett v. King, 181 Mass. 476 at 479, 63 N.E. 934 (1902); Chafee v. Farmers' Co-op. Elevator Co., 39 N.D. 585, 168 N.E. 616 (1918). Baumohl v. Goldstein, 95 N.J. Eq. 597, 124 A. 118 (1924), involved a by-law which gave the corporation an option to purchase within twenty days after notice by the stockholder of his desire to transfer his stock. The court conceded that the right of a stockholder to sell his stock could not be defeated by any provision in the by-laws, but went on to say, at 599: "The questioned provision . . . does not amount to a restriction on the power of sale. It is, in its very essence and purpose, the first step or agreement in such a sale."

[4] New England Trust Co. v. Abbott, 162 Mass. 148, 38 N.E. 432 (1894), 27 L.R.A. 271 (1895); Model Clothing House v. Dickinson, 146 Minn. 367, 178 N.W. 957 (1920); Sterling Loan & Investment Co. v. Litel, 75 Colo. 34, 223 P. 753 (1924); Searles v. Bar Harbor Banking & Trust Co., 128 Me. 34, 145 A. 391 (1929), 65 A.L.R. 1154 at 1159 (1930).

[5] 3 COOK, CORPORATIONS, § 622c (1923), and cases cited; 13 AM. JUR., Corporations, § 336, and cases cited.

fer their stock.[6] Such a restriction as in the principal case is normally considered reasonable for contract purposes.[7] The court apparently took this for granted without discussing the matter, and passed on the problem of whether specific performance should be decreed. On this point it is generally agreed that the legal remedy is inadequate.[8] The result of this case seems to be supported in all respects by the weight of authority.

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[6] Whittingham v. Darrin, 45 Misc. 478, 92 N.Y.S. 752 (1904), involved an agreement by the two majority stockholders of a small corporation, providing that the stock of either could be sold to an outsider only by the mutual consent of the two stockholders, and further that in the event of desired sale by either party the other should have a prior right of purchase; Kassel v. Empire Tinware Co., 178 App. Div. 176, 164 N.Y.S. 1033 (1917), where three sole shareholders agreed that upon the death of any one of them within five years, the survivors should become the owners of his stock and should pay a specified price to the decedent's legal representative; Rigg v. Reading & S.W. St. Ry. Co., 191 Pa. St. 298, 43 A. 212 (1899), where the stockholders agreed that one should give the others the first opportunity to buy his shares when he desired to sell. See also Jones v. Brown, 171 Mass. 318, 50 N.E. 648 (1898); Lane v. Barnard, 185 App. Div. 754, 173 N.Y.S. 714 (1917).

[7] Brown v. Britton, 41 App. Div. 57, 58 N.Y.S. 353 (1899); Rigg v. Reading & S. W. St. Ry. Co., 191 Pa. St. 298, 43 A. 212 (1899); Model Clothing House v. Dickinson, 146 Minn. 367, 178 N.W. 957 (1920).

[8] Scruggs v. Cotterill, 67 App. Div. 583, 73 N.Y.S. 882 (1902); Boswell v. Buhl, 213 Pa. 450, 63 A. 56 (1906); Wilson v. Bowers, (D.C.N.Y. 1931) 51 F. (2d) 261.