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Corporations - Provisions in Articles Authorizing Call of Common Stock at Option of Corporation

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CORPORATIONS—PROVISION IN ARTICLES AUTHORIZING CALL OF COMMON STOCK AT OPTION OF CORPORATION—Amendments to the articles of organization of the defendant corporation provided that the board of directors might at any time purchase its common stock in whole or in part from any holder thereof. After the directors initiated proceedings to purchase a portion of the shares held by plaintiff, plaintiff brought a bill in equity asking that an injunction be issued to restrain the corporation from proceeding further. The superior court entered a decree for the defendant. On appeal, *held*, affirmed. The provision authorizing the call of common stock is neither forbidden by statute nor contrary to public policy. *Lewis v. H.P. Hood & Sons, Inc.*, (Mass. 1954) 121 N.E. (2d) 850.

Statutes in a number of states, including Massachusetts, contain no provisions with regard to the issue of redeemable shares.¹ The statutes which do permit the issue of redeemable shares often limit the authorization to the creation of redeemable preferred or special shares, remaining silent on the power to issue redeemable common shares.² A Delaware decision construing a statute of this type assumed that silence as to the common shares impliedly negated the power to provide for their redemption.³ The Maryland statute, on the other hand, provides that any class of shares may be made redeemable, either at the option of the corporation or the holder.⁴

Only one other American case has been found which considered the power of a corporation to provide in its articles for the call of common

¹ The only applicable Massachusetts statute authorizes the issue of "two or more classes of stock with such preferences, voting powers, restrictions and qualifications thereof" as shall be fixed in the agreement of association or articles of incorporation or in an amendment thereto. Mass. Laws Ann. (1948) c. 156, §14.

² Del. Code Ann. (1953) tit. 8, §243; 14 N.J. Stat. Ann. (1939) §8-3; Ore. Rev. Stat. (1953) c. 57, §57.080; Va. Code (1950) tit. 13, §87.

³ *Starring v. American Hair & Felt Co.*, 21 Del. Ch. 380, 191 A. 887 (1937), *affd.* 21 Del. Ch. 431, 2 A. (2d) 249 (1937).

⁴ "Every corporation of this state by its charter may provide: . . . (5) That one or more classes of stock, as specified, may be redeemed at the option of the corporation or of the holders of such stock and the terms and conditions of redemption." Md. Code Ann. (Flack, 1951) art. 23, §14.

stock at its own option.⁵ In that case the power was denied as an unreasonable restraint on alienation. The court in the principal case felt that the power to call the common stock affected the quality of the stock rather than its alienability. As a practical matter, however, the purpose of such a provision in the articles of a closely held corporation is to limit the field of possible holders of the stock to those who are associated with the corporation. Of course the owner is free to dispose of his stock if this provision is the only limitation on transferability. Restrictions have been held valid which prohibited transfer unless the stock was first offered to the corporation,⁶ or which retained in the corporation an option to purchase the shares of retiring employees.⁷ In general, restraints upon alienation of corporate stock have been held valid unless "unreasonable"⁸ with reasonableness depending on the peculiar circumstances of each case.⁹ Provisions in articles of incorporation which permit the call of preferred stock at the option of the corporation are not unusual,¹⁰ and there is no compelling reason why common stock should be treated differently. It is true that an option in the hands of directors to call the stock of any shareholder at any time might be subject to abuse, but this possibility is not a sufficient ground for denying the existence of the power. Furthermore, since directors act in a fiduciary capacity,¹¹ the powers of a court of equity are available to guard against discriminatory or unfair use of the call provision. The importance of giving managers an ownership interest in the business is well recognized,¹² and the provision in question is one good method of achieving this result.

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⁵ *Greene v. E. H. Rollins & Sons, Inc.*, 22 Del. Ch. 394, 2 A. (2d) 249 (1938). This case was not decided on the same statutory basis as *Starring v. American Hair & Felt Co.*, note 3 *supra*. Rather paradoxically the court assumed that the statutory authority of a corporation to purchase and acquire its own stock was also authority for a provision for the call of stock at the option of the corporation.

⁶ *Monotype Composition Co. v. Kiernan*, 319 Mass. 456, 66 N.E. (2d) 565 (1946); *Lawson v. Household Finance Corp.*, 17 Del. Ch. 343, 152 A. 723 (1930).

⁷ *New England Trust Co. v. Abbott*, 162 Mass. 148, 38 N.E. 432 (1894).

⁸ *Longyear v. Hardman*, 219 Mass. 405, 106 N.E. 1012 (1914).

⁹ See 37 MICH. L. REV. 1140 (1939).

¹⁰ 11 FLETCHER, CYC. CORP., perm. ed. §5309 (1932); Dodd, "Purchase and Redemption by a Corporation of Its Own Shares: The Substantive Law," 89 UNIV. PA. L. REV. 697 (1941).

¹¹ *Stratis v. Andreson*, 254 Mass. 536, 150 N.E. 832 (1926); *Bosworth v. Allen*, 168 N.Y. 157, 61 N.E. 163 (1901).

¹² Dean, "Employee Stock Options," 66 HARV. L. REV. 1403 (1953).