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STOCK TRANSFER RESTRICTIONS: CONTINUING UNCERTAINTIES AND A LEGISLATIVE PROPOSAL

WILLIAM H. PAINTER†

RESTRICTIONS ON THE TRANSFER of corporate stock have become almost an indispensable feature of the so-called "close" corporation in modern times, but the problem of their validity has by no means been wholly resolved. Generally speaking, a restriction on transfer is any condition or limitation which qualifies the right of a stockholder to alienate his interest in a corporation. It may take the form of an absolute prohibition of transfer, a prohibition of transfer to designated individuals or members of a class, or a condition that no transfer will be effective unless the stockholder first offers the stock to the corporation or its stockholders. The latter type restriction is frequently referred to as a right of "first refusal" or "first option". It may be perpetual or limited in time, and purport to bind only stockholders assenting to it or made applicable to transferees. The number of possible variations and combinations of restrictions is virtually without limit, and the validity of particular restrictions depends, at least in part, upon their form as well as upon the circumstances under which they are sought to be enforced.¹

The reasons why corporations or stockholders may seek to impose restrictions upon the transfer of shares are nearly as diverse as the forms the restrictions themselves may take. Most frequent, perhaps, is the wish to confine ownership of the corporation, and the management which results from ownership, to a relatively few persons who may be closely related to one another and familiar with and friendly to the policies and purposes of the corporation. Some types of restrictions may reflect a desire to perpetuate various advantages of operating a business as a partnership and yet benefit from the protections afforded by doing business in the corporate form. Other restrictions may be designed primarily to prevent shares from falling into the hands of competitors, or descending to next-of-kin or legatees

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1. For a useful summary and classification of the most frequently used types of restrictions, see O'Neal, Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting, 65 Harv. L. Rev. 773, 776 (1952).
of former stockholders who may be unsympathetic to present management.

The law with respect to the validity and effect of restrictions on transfer of stock has developed, at least in this country, in a confused and piecemeal fashion. For the most part, it is case law. The decisions are largely based upon supposed requirements of "public policy," but the "policy" itself has rarely been fully enunciated, and the reasons behind it and requiring its application to corporate stock are seldom analyzed in a very satisfactory way, from either an historical or a strictly technical standpoint. On the other hand, the results reached by the courts have usually been defensible on the basis of common sense, at least if the fundamental assumptions behind the decisions are accepted without criticism. Generally speaking, these assumptions are: first, that stock in a corporation is "personal property" and, second, that restrictions on alienation of "personal property," and hence on corporate stock, should be regarded with disfavor.

The first of the above assumptions is less subject to doubt than the second due to the fact that many corporation statutes expressly provide that stock in a corporation is "personal property" and transferable in the same manner as "personal property." This has caused

2. Among the useful discussions of problems in this area are the following: Ballantine, Corporations §§ 336-38 (rev. ed. 1946); 12 Fletcher, Private Corporations §§ 5452-58 (rev. vol. 1957); 2 O'Neal, Close Corporations: Law and Practice §§ 7.01-29 (1958); Stevens, Corporations § 129 (2d ed. 1949); Cataldo, Stock Transfer Restrictions and the Closed Corporation, 57 Vt. L. Rev. 229 (1951); Hayes, Corporation Cake With Partnership Frosting, 40 Iowa L. Rev. 157 (1954); Hornstein, Judicial Tolerance of the Incorporated Partnership, 18 Law & Control of Prof. 435 (1953); Ballantinf, Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting, 65 Harv. L. Rev. 773 (1952). The following student notes are particularly helpful: 44 Cornell L.Q. 133 (1958); 42 Harv. L. Rev. 555 (1929); 45 Mich. L. Rev. 779 (1947); 30 Mich. L. Rev. 766 (1932); 16 U. Chi. L. Rev. 742 (1949); 26 Va. L. Rev. 354 (1940); 68 Yale L.J. 773 (1959). Additional references to valuable secondary sources are contained in O'Neal, Close Corporations: Law and Practice op. cit. supra § 7.01 n.1 and Hayes, supra at 157 n.3. Numerous cases are collected in the following annotations: 61 A.L.R.2d 1318 (1958); 2 A.L.R.2d 745 (1948); 138 A.L.R. 647 (1942); 65 A.L.R. 1159 (1930).

3. "Public policy is a very unruly horse and when once you get astride it you never know where it will carry you." Tracey v. Franklin, 31 Del. Ch. 477, 481, 67 A.2d 56, 58 (Sup. Ct. 1949), quoting from Burrough, J., in Richardson v. Melish, 2 Bing. 229, 252, 130 Eng. Rep. 294, 303 (C.P. 1824). The Tracey case involved a restraint on transfer of voting trust certificates, rather than stock, but the court's reasoning is characteristic: "Insofar as concerns restraints upon the alienation of personal property, and in particular of corporate stock, while an owner, in exercising legally permissible freedom to deal with his property, may enter into many transactions which have the effect of restraining its transferability for temporary periods in the future, nevertheless, arbitrary restraints on alienation are forbidden and unless restraints are imposed for purposes recognized as sufficient, they will be held invalid." (Id. at 484, 67 A.2d at 59). The restraint, which was to extend for a period of ten years, was held invalid. Compare Tracey, supra, with Lawson v. Household Finance Corp., 17 Del. Ch. 343, 152 Atl. 723 (Sup. Ct. 1930).

4. E.g., Del. Code Ann. tit. 8, § 159 (1953); "The shares of stock in every corporation shall be deemed personal property and transferable as provided in subchapter VI of this chapter . . . .}
many courts to make the further inference that, since historically restraints on alienation of at least some forms of "personal property" have for reasons of public policy been discouraged or prohibited by law, and since stock is declared by statute to be "personal property," it must be freely alienable.

But not all courts have thought this way. Holmes, when Chief Justice of the Supreme Judicial Court of Massachusetts, observed, in a classic and frequently quoted opinion:6

"Stock in a corporation is not merely property. It also creates a personal relation analogous otherwise than technically to a partnership. Notwithstanding decisions under statutes . . . there seems to be no greater objection to retaining the right of choosing one's associates in a corporation than in a firm."

Reasoning such as the above is perhaps more in sympathy with the tendency of English courts to enforce restrictions on transfer if they may be upheld under fundamental principles of contract law, despite the analogy between stock and personal property.6 However, in this country, and in the face of statutes which expressly declare stock to be personal property, courts may be less free to emphasize the contractual, at the expense of the property-like characteristics of stock. Yet it need not necessarily follow that a policy against restraints on alienation which historically may have had its original applicability with regard to chattels and certain other forms of personal property must ipso facto apply to corporate stock because of a legislative determination that it is personal property.7

6. See Gower, Some Contrasts Between British and American Corporation Law, 69 Harv. L. Rev. 1369, 1377-78 (1956). The author observes that the English have never been burdened with the American notion that stock is "property" the alienation of which cannot be unreasonably restrained. John Chipman Gray was apparently in agreement with the English view and with that of Holmes in the Barrett case, supra note 5. Gray, Restraints on the Alienation of Property 24 (2d ed. 1895).
7. See Note, 45 Mich. L. Rev. 779, 780 (1947), arguing that the validity of restraints should not be determined by criteria applicable to other forms of personal property: "Given the premise that a share of stock is a property interest, the analogy that unreasonable restrictions on transferability are unreasonable restraints on the alienation of property in the estate sense may be too easily and irrationally drawn." The writer suggests as an alternative criterion a determination of whether the restraint constitutes "such a severe burden on the stockholder's freedom of disposition that he has no reasonable way out of the business unit." Another writer has suggested that the test should be based upon the intentions of the parties: "Theoretically, the employee could contract away all his rights as a shareholder. The relevant inquiry is not whether an agreement is a restriction on alienation but whether the situation before the court was the intended result of the agreement actually made." Note, 68 Yale L.J. 773, 777 n.26 (1959). See also Note, 16 U. Chi. L. Rev. 742 (1949) and Note, 44 Cornell L.Q. 133, 134 (1958). The latter adopts an intermediate position and suggests that permissible restrictions on stock transfers might be more severe than those allowed with respect to other forms of personal property and yet should not be as broad as permissible restrictions on assignment of contract rights.
Most of the early cases in this area give relatively little indication of how the public policy relating to restraints generally became applicable to corporate stock, and they are even less helpful for their reasoning. Many of them concern the question of whether a bank or other financial institution may prohibit transfer of its stock by one who has become indebted to it, either directly by way of a loan, or indirectly due to a guarantee or endorsement of commercial paper which the bank has taken at a discount. As to the validity of such restrictions, the authorities are in apparent conflict from the earliest times, the tendency having been, if anything, to enforce the restriction if it were contained in the charter. Provisions in the charter and in the by-laws restraining transfer by a debtor-stockholder were expressly permitted, with respect to national banks, by the Currency Act of 1863, but the relevant passage of the statute was repealed in the following year. The Supreme Court of the United States interpreted the repeal as a legislative determination of the inherently evil nature of restrictions of this type, at least when applied to banking institutions, regarding them as promoting “secret liens” and depriving depositors and other creditors of the safety of their investment to the extent that capital may be reduced by retirement of the stock belonging to the debtor upon cancellation of his indebtedness.

The extent to which the cases relating to national banks influenced courts called upon to determine the validity of similar restrictions with respect to state banks is not entirely clear, but from

11. First Nat'l Bank v. Lanier, 78 U.S. (11 Wall.) 369 (1871). The Currency Act of 1864 provided merely that banks were to have the power to prescribe the manner in which stock was transferable on their books. This was held insufficient to authorize the imposition of a restriction on transfer of stock held by a debtor-stockholder. In addition, the Currency Act of 1864 contained a provision prohibiting a bank from making a loan or discount on shares of its capital stock and from purchasing its own shares except to prevent loss in connection with a debt previously contracted in good faith, with a further direction that any shares so purchased be sold within six months. These provisions were relied upon by the Court in establishing a congressional intent to prohibit banks from lending to stockholders on the collateral of their own stock and from purchasing the same except under the conditions set forth in the Act. The same result was subsequently reached by the Court in Bullard v. Bank, 85 U.S. (18 Wall.) 589 (1873). Accord, Evansville Nat'l Bank v. Metropolitan Nat'l Bank, 8 Fed. Cas. 891 (No. 4573) (C.C.D. Ind. 1871); Conklin v. Second Nat'l Bank, 45 N.Y. 655 (1871); Feckheimer v. Nat'l Exchange Bank, 79 Va. 80 (1884). Cf., Rosenbach v. Salt Springs Nat'l Bank, 53 Barb. 495 (N.Y. Sup. Ct. 1868) (relying primarily on an absence of authorization in the charter and not on the Currency Act of 1864). Contra, In re Dunkerson, 8 Fed. Cas. 48 (No. 4156) (D. Ind. 1868). The Dunkerson holding may be erroneous in view of the later decision in Lanier, supra, unless the fact that the plaintiff in Dunkerson was the stockholder's assignee in bankruptcy,
the manner in which the various opinions cite and rely upon one another as authorities, it is likely that the decisions based upon federal law reinforced to a considerable degree any existing disfavor with which restraints of at least this particular variety were regarded.12 Similar reasoning was then applied not only to state banks but to the numerous industrial enterprises which were growing up throughout the nation. It was perhaps characteristic of the mood of the expanding economy that the interests of the market-place, favoring the free transfer of securities and other property interests, should prevail over rights based on ownership which confer on the owner the power to keep his property out of the flow of commerce as long as he may wish.13

While the decisions almost invariably justify the results reached by an appeal to a supposed "public policy" against restraints, recourse is often had to various statutes as well, although courts have hardly been consistent as to the manner in which the statutes should be construed. If any tendency is discernible it has been to assume the appli-
cability of a policy against restraints on alienation and to conclude that such restraints should be permissible only to the extent that they have been expressly authorized by statute. A few courts, on the other hand, although acknowledging the existence of the policy, have taken the position that reasonable restraints are permissible in the absence of some statutory provision expressly prohibiting them. Other cases have stressed the significance of a limited statutory permission to adopt by-laws with respect to particular subjects, including a narrow power to “regulate” transfers of stock (the term “regulate” being frequently interpreted as relating merely to the mechanical aspects of stock transfers), and have held that by-laws with respect to matters not enumerated in the statute are prohibited, particularly where they have the effect of restraining, rather than merely “regulating” transfers.

14. See, e.g., Farmers’ & Merchants’ Bank v. Wasson, 48 Iowa 336, 340 (1878), where the court said, with regard to a restriction making transfers subject to the approval of the board of directors, “As the restriction is not imposed by express authority of the statute of the State, it cannot . . . be enforced.” In Driscoll v. West Bradley & Cary Mfg. Co., 59 N.Y. 96, 105 (1874), the court, in holding invalid a by-law restriction against transfer of stock by a debtor and construing a statutory provision authorizing by-laws for “the regulation of . . . [the company’s] affairs, and for the transfer of its stock,” observed that, if it had been intended to authorize by-laws restricting, rather than merely regulating, transfers, “from the nature of the right to be affected, and the favor which that right has met with from the law, [this] would be plainly expressed when intended to be given.” See also Kretzer v. Cole Bros. Lightning Rod Co., 193 Mo. App. 99, 181 S.W. 1066 (1916) (The opinion indicates that, although previous decisions had taken the view that restrictions may be valid if expressly authorized by the charter, express authorization must be found in the statute as well; a statutory provision similar to that in Driscoll, supra, was held to relate exclusively to the formality of transfer and not to authorize the imposition of restrictions.); O’Brien v. Cummings, 13 Mo. App. 197 (1883). A more recent case in Ohio has taken somewhat the same position, although holding a restriction valid as a contract between the stockholders. First Nat’l Bank v. Shanks, 34 Ohio Op. 359, 73 N.E.2d 93 (C.P. 1945).

15. In Mason v. Mallard Telephone Co., 213 Iowa 1076, 1079, 240 N.W. 671, 672 (1932), where a statute gave the corporation power to “render the interests of the shareholders transferable,” the court argued that, “If the Legislature had intended to provide that no restriction should be placed upon the transferability of stock, it might well have found unmistakable English with which to announce such intention.” The case is noted in 18 Iowa L. Rev. 88 (1932). See also Jennings v. Bank of California, 79 Cal. 323, 21 Pac. 852 (1889); Dempster Mfg. Co. v. Downes, 126 Iowa 80, 101 N.W. 735 (1904). In Massachusetts, the presence of a provision in the statute requiring the articles of incorporation to set forth the “restrictions, if any, imposed upon . . . transfer [of the shares]” has been construed as an implied grant of authority to place restrictions on alienation. See, e.g., Longyear v. Hardman, 219 Mass. 405, 106 N.E. 1012 (1914). The language in the statute appears to be tenous justification for the results reached in some of the cases. See note 20 infra, and Lewis v. H. P. Hood & Sons, 331 Mass. 670, 121 N.E.2d 850 (1954), discussed in text accompanying note 46 infra. The Massachusetts courts have traditionally inclined toward a contractual view of the problem of restraints on alienation, such as that adopted in England. See Gower, supra note 6, and the opinion of Holmes, C.J., in Barrett v. King, 181 Mass. 476, 63 N.E. 434 (1902). See also Brown v. Little, Brown & Co., 269 Mass. 102, 110, 168 N.E. 521, 525 (1929): “The absence of definite statutory limitations upon the power to impose such restrictions must be taken as a legislative determination that considerable latitude in this particular is permissible.”

Reasoning of this sort seems as tenuous as that of decisions which conclude, from an absence of any express statutory reference to restrictions, that they must therefore be permissible.\textsuperscript{17}

The result reached by the cases first mentioned appears to be the more sensible one, at least if it be assumed that the traditional reluctance of the law to enforce restraints on alienation should extend to shares of stock, yet it would be preferable to place little, if any, reliance either upon the absence of an express statutory provision relating to restrictions, or upon provisions which may refer to restrictions but do so merely in an incidental or ambiguous fashion.

As stated previously, the basic question is whether a doctrine which relates primarily to real and tangible personal property should be applied to stock, which, although expressly declared by many statutes to be personal property, also has some of the characteristics of a contract.\textsuperscript{18} Some of the early cases recognize this,\textsuperscript{19} but for the most part courts have been content to equate stock and personal property and apply a supposed public policy against restraints, with little or no analysis of any competing considerations which may arise from an equally significant policy of promoting the freedom of persons to enter into contractual relationships.

Generally speaking, absolute restrictions of various sorts are held invalid. Thus restrictions requiring the consent of the corporation,

\textsuperscript{17} For an interesting non-sequitur, see the reasoning in Steele v. Farmers' & Merchants' Mutual Telephone Ass'n, \textit{supra} note 16, at 590, 148 Pac. at 665, to the effect that the "rule" has been that corporate power must be "clearly granted, either by express terms [of the statute] or by necessary implication. When the corporation, as a factor in the economic life of the state, was the subject of much popular criticism, the rule was adhered to. Now that the corporate form of organization is freely resorted to by all classes of people, the rule will not be departed from."

\textsuperscript{18} Barrett v. King, 181 Mass. 476, 63 N.E. 934 (1902).

\textsuperscript{19} Nicholson v. Franklin Brewing Co., 82 Ohio St. 94, 91 N.E. 991 (1910); Fitzsimmons v. Lindsay, 205 Pa. 79, 54 Atl. 488 (1903). In the Nicholson case, the court, in enforcing a "first refusal" option, remarked with apparent sarcasm, "It does not appear to have been deemed necessary in these cases to demonstrate that the right to alienate property should be more highly regarded than the right to make contracts respecting it. By the assumption that it should be, a task of much obvious difficulty has been avoided." \textit{Supra} at 118-11, 91 N.E. at 994, In Fitzsimmons the reasoning is reminiscent of Barrett v. King, \textit{supra} note 18, decided one year earlier, the court observing, with respect to a first option among shareholders exercisable in case of death or retirement, "Such agreements are quite common among partners as to their shares in the firm assets, and are enforced by courts without hesitation. No reason of overruling public policy is apparent why they should not also be sustained in relation to shares of stock in what is really only a private trading corporation." \textit{Supra} at 203, 54 Atl. at 489. The argument that small, privately held corporations should be treated differently was made in \textit{In re Klaus}, 67 Wis. 401, 29 N.W. 582 (1886) and was rejected. See also Miller v. Farmers' Milling & Elevator Co., 78 Neb. 441, 110 N.W. 995 (1907), following the reasoning of the \textit{Klaus} case. Similarly, in Johnson v. Laffin, 13 Fed. Cas. 758, 761 (No. 7393) (C.C.E.D. Mo. 1878), \textit{aff'd}, 103 U.S. 800 (1880), the court, in speaking of the freely alienable character of corporate stock, as distinct from partnership interests, which require a dissolution of an old partnership and the formation of a new one upon a change in the number or identity of the partners, remarked, "Indeed, it is one of the leading objects of an incorporated body to avoid the operation and effect of this doctrine of the law of partnership. Accordingly, in this country shares in corporations are universally bought and sold without reference to the consent of the other shareholders."
through its board of directors or otherwise, or all or a specified percentage of its stockholders, are generally unenforceable, as well as prohibitions against transfer to competitors or other classes of persons. On the other hand, so-called "first options" or "first refusals"


Decisions reaching a contrary result have generally been confined to peculiar fact situations. E.g., Mason v. Mallard Telephone Co., 213 Iowa 1076, 240 N.W. 671 (1932) (small, privately-held local telephone company threatened with competition from larger companies); 68 Beacon Street, Inc. v. Sohier, 289 Mass. 354, 194 N.E. 303 (1935) (cooperative apartment house); Davis v. Proprietors of The Second Universalist Meeting House, 49 Mass. (8 Met.) 321 (1844) (religious organization); Penthouse Properties, Inc. v. 1158 Fifth Avenue, Inc., 256 App. Div. 685, 11 N.Y.S.2d 41 (1937) (cooperative apartment house); Wright v. Iredell Telephone Co., 182 N.C. 308, 108 S.E. 744 (1921) (local telephone company). Cf. Weisner v. 791 Park Avenue Corp., 7 App. Div. 2d 75, 180 N.Y.S.2d 734 (1958), noted in 25 Brooklyn L. Rev. 323 (1959) (cooperative apartment house, rev'd on other grounds); 6 N.Y.2d 426, 190 N.Y. S.2d 70 (1959). Other decisions involve farmers' cooperatives, which may be organized under special statutes permitting restrictions on transfer of shares to non-members. Healey v. Steele Center Creamery Ass'n., 155 Minn. 451, 133 N.W. 69 (1911); Chaffee v. Farmers' Co-operative Elevator Co., 39 N.D. 585, 168 N.W. 616 (1918). But see Herring v. Ruskin Co-op. Ass'n., 52 S.W. 327 (Tenn. Ct. Ch. App. 1899). In Massachusetts, absolute restrictions on transfer may be enforceable due, at least in part, to a statutory provision which has been construed as impliedly authorizing them and to the tendency of the courts to give effect to the restriction, if at all possible, as a contract between the stockholders. See note 15 supra and Longyear v. Hardman, 219 Mass. 405, 106 N.E. 1012 (1914). The court in the Longyear case drew an interesting but doubtful analogy between restrictions on transfers of stock and of church pews. Restrictions with respect to the latter are apparently enforceable in Massachusetts. Crocker v. Old South Society, 106 Mass. 469 (1871); French v. Old South Society, 106 Mass. 479 (1871).

21. Fisher v. Bush, 35 Hun. 641 (N.Y. Sup. Ct. 1885); White v. Ryan, 15 Pa. County Ct. 170 (1894); In re Klaus, 67 Wis. 401, 29 N.W. 982 (1886). Cf., Mann v. Schuman, 1 App. Div. 2d 678, 146 N.Y.S.2d 716 (1955). But see Hey v. Dolphin, 92 Hun. 230, 36 N.Y. Supp. 627 (Sup. Ct. 1895), where the stock was issued to two stockholders as joint owners and the court, following a dictum in Fisher v. Bush, supra at 643, upheld the restriction, drawing an analogy between this situation and a partnership. If the stock is issued to a holding company, its stockholders may agree that the stock of the subsidiary may not be disposed of without their consent. Baum v. Baum Holding Co., 158 Neb. 197, 62 N.W.2d 864 (1954), but it is doubtful that a similar restriction could be placed upon the stock of the holding company itself. Somewhat the same result may be achieved by means of a voting trust. See Tracey v. Franklin, 31 Del. Ch. 477, 6 A.2d 56 (Sup. Ct. 1949).

22. See, e.g., Kretzer v. Cole Bros. Lightning Rod Co., 193 Mo. App. 99, 181 S.W. 1066 (1916) (restriction invalid). The same effect may be achieved by means of an option to purchase, exercisable upon the stockholders proposing to sell to an outsider. If cast in this form, the restriction would be upheld in a majority of jurisdictions, at least if it were contained in the charter, and even if it were merely a by-law it might be enforceable as a contract between those stockholders who had assented to it. See cases cited in notes 28-30, infra. Gray suggested that a distinction must be made between transfer to certain designated individuals and a restriction on transfer to all persons other than a selected few. Certainly the latter type of restriction is considerably closer than the former to an absolute
providing for an option in favor of the corporation or its stockholders
to purchase stock upon the happening of some event in the future,
such as a proposal by a stockholder to sell to a third party,23 his
voluntary or involuntary termination of employment,24 death,25 or
removal to another geographical locale,26 are generally considered
valid if reasonable. This distinction seems fundamentally sound,
since restrictions of the "first refusal" variety are not so much restraints as
they are options exercisable upon the happening of a condition sub-
sequent. As such, they seem less repugnant to any policy which may
be thought to exist with respect to restraints on transfer generally,
provided of course that they are reasonable and not so bur-
densome in nature that, for all practical purposes they have the
effect of absolute restraints. But nonetheless, some of the early
holdings invalidated even the "first refusal" type of restriction, particu-
larly if the option were contained only in the by-laws27 and not in the

restraint and thus is more arguably invalid. See Gray, op. cit. supra note 6, at 30.
The distinction seems to have been recognized only indirectly by the cases in the
general rule that, the more burdensome the restriction, the more likely it is to be
declared invalid.

23. This seems to be the most frequently used form of restriction. See, e.g.,
corporation and employee stockholders upheld); Lawson v. Household Finance Corp.,
supra note 23 (charter provision upheld); Douglas v. Aurora Daily News Co., 160
Ill. App. 306 (1911) (provision in stock certificate upheld, except for restriction pro-
hibiting transfer without consent of board of directors, which was declared invalid);
Prindiville v. Johnson & Higgins, 92 N.J. Eq. 515, 113 Atl. 915 (Ch. 1921), aff'd,
Rollins & Sons, 22 Del. Ch. 394, 2 A.2d 249 (Ch. 1938).
25. New England Trust Co. v. Spaulding, 310 Mass. 424, 38 N.E.2d 672 (1941);
Krauss v. Kuechler, 300 Mass. 346, 15 N.E.2d 207 (1938); Feldstein's Estate, 25
Pa. Dist. 602 (Orphan's Ct. 1915). All of the foregoing involved by-law provisions
which were held to be enforceable. Lawson v. Household Finance Corp., 17 Del. Ch.
343, 152 Atl. 723 (Sup. Ct. 1930), sustained the validity of a charter provision.
Agreements between stockholders having the same effect have been upheld also. Krebs
v. McDonald's Ex'x., 266 S.W.2d 87 (Ky. Ct. App. 1953); Bohnsack v. Detroit Trust
Co., 292 Mich. 167, 290 N.W. 367 (1940). Generally restrictions of this type have been
held not testamentary in character and thus not invalid merely because of failure to
comply with statutes regulating wills and similar dispositions taking effect at or after
death. See O'Neal, Restrictions on Transfer of Stock in Closely Held Corporations:
Planning and Drafting, 65 Harv. L. Rev. 773, 782 n.43 (1952).
(by-law giving option to purchase in case of death of stockholder or his removal
from the City of Worcester).
27. See, e.g., Brinkerhoff-Farris Trust & Savings Co. v. Home Lumber Co.,
118 Mo. 447, 24 S.W. 129 (1893); Robertson v. L. Nicholes Co., 141 Misc. 610,
253 N.Y. Supp. 76 (Munip. Ct. 1931); Ireland v. Globe Milling & Reduction Co.,
19 R.I. 180, 32 Atl. 921 (1895); Petre v. Bruce, 157 Tenn. 131, 7 S.W.2d 43
Contra, Shumaker v. Utex Exploration Co., 157 F. Supp. 68 (D. Utah 1957);
232, 46 S.E.2d 122 (1948); People v. Galski, 233 Ill. App. 414 (1924); Doss v.
Yielding, 95 Ind. App. 494, 172 N.E. 801 (1930); Model Clothing House v.
Dickinson, 146 Minn. 367, 178 N.W. 957 (1920); Elson v. Schmidt, 140 Neb. 646,
1 N.W.2d 314 (1941); Baumohl v. Goldstein, 95 N.J. Eq. 597, 124 Atl. 118 (Ch.
charter. The reasoning in many of these opinions is confused, since the question of whether the restriction is binding upon those who have not consented to it (where, for example, a by-law is adopted by a majority of stockholders over the protest of the minority) is obviously distinct from the question of whether the restriction should bind those who have consented, and yet there seems to be a tendency to give as a reason for declaring a restriction invalid the fact that it is merely a by-law and not a charter provision. A much more desirable result has been reached in a number of decisions which have enforced by-laws on a contractual basis among those stockholders who have consented to them. A logical extension of this reasoning is that the restriction need not be cast in the form of a by-law if it meets the essential requirements of a valid agreement among stockholders and, conversely, the fact that an agreement appears in the form of a by-law is no impediment to its validity, except with regard to those who have not consented.


Assuming, then, that the current weight of authority is correct in enforcing so-called "first refusal" provisions, except with regard to non-consenting stockholders, whether they appear in the charter, by-laws, or a stockholders' agreement, there is of course an added requirement that the restriction be "reasonable" and not unduly burdensome or oppressive. This test of "reasonableness" is easy to state and, superficially speaking, easy of application. Beyond that, its usefulness as a criterion for determining the validity of restrictions seems somewhat doubtful. One of the best known cases, *Lawson v. Household Finance Corporation*, 31 is an illustration of this. The case concerned a "first refusal" type restriction in the certificate of incorporation and by-laws of a corporation which permitted it to repurchase its shares at a value, excluding good will, to be determined by appraisers. In holding the restriction valid, the court referred to Section 121 of the Delaware General Corporation Law, 32 providing that a corporation shall "exercise all the powers . . . expressly given in its charter or in its certificate under which it was incorporated, so far as the same are necessary or convenient to the attainment of the objects set forth in such charter or certificate of incorporation. . . ." The problem, in the court's view, was whether the restriction could be considered "necessary or convenient" to the attainment of the objects set forth in the certificate of incorporation. The restriction was held to be "necessary or convenient," since it was conducive to the development of experienced and trustworthy management personnel by providing them with an interest in the business (the making of loans), which the court described as "precarious" in nature. 33 The court analyzed the existing cases in terms of "reasonable" and "unreasonable" restraints and concluded that the restriction in question was not only "necessary or convenient" but "reasonable" as well.

Aside from characterizing various restraints as "reasonable" or "unreasonable," the reasoning of the *Lawson* case is not particularly helpful as a guide to determine whether a particular restriction is valid or invalid. Query whether the court would have reached a different conclusion if the defendant had not been engaged in the business of making loans but had been involved in an enterprise of a less "precarious" nature. In addition, the court compounded the confusion of its analysis by providing an alternative basis for the decision, holding that the charter provision was binding as a contract between the com-

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33. 17 Del. Ch. 343, 350, 152 Atl. 723, 726 (Sup. Ct. 1930).
pany and its stockholders and citing as authority Trustees of Dartmouth College v. Woodward.\textsuperscript{34} Obviously there was no lack of authority in addition to the Dartmouth College case to support the holding in this respect, and the court seemed to be well aware of this,\textsuperscript{35} but the alternative basis for the decision seems unnecessary and confusing, although perhaps justified by precedent if isolated from the rest of the opinion. If anything, the implication was that a charter provision which fails in some way to meet the test of being "necessary or convenient" or "reasonable" may yet be upheld solely due to its presence in the charter, as a contract binding upon the company and its stockholders. Are all charter provisions valid on this theory? If not, what determines their validity? Very likely the court did not intend to imply that "unreasonable" restrictions could be enforced on a contractual basis if they appear in the charter. On the other hand, it seems doubtful that the holding implies that the restriction must be not only "reasonable" but in the charter as well. Added to this is the problem of how one determines whether a particular provision is "reasonable" or "necessary or convenient." The resulting confusion and the number of questions left unanswered leave some doubt whether the Lawson holding succeeded in clarifying the existing law or did nothing more than muddy the waters.

The Lawson case was followed by another interesting decision which may have clarified the law somewhat, Greene v. E.H. Rollins & Sons.\textsuperscript{36} There the restriction, in addition to a "first refusal" feature, contained a provision purporting to give the corporation a right to purchase at any time any of its common stock, not owned or held by an employee, at "asset value," exclusive of good will or going concern value. Certain shares of common were expressly excluded from the effect of the restriction, namely those which might be issued upon conversion of the company's preferred stock and the first 30,000 shares of common which might otherwise be issued, the latter to be made subject to the restriction only after a given date. The court held the provision invalid and distinguished the Lawson case on the ground that "special circumstances" had there made the restraint reasonable, whereas Greene had features which were not present in Lawson. "Had it not been for the special circumstances involved in that case," the court said, "we must infer that even the milder clause

\textsuperscript{34} 17 U.S. (4 Wheat.) 517 (1819).
\textsuperscript{36} 22 Del. Ch. 394, 2 A.2d 249 (Ch. 1938), noted in 37 Mich. L. Rev. 1140 (1939), 87 U. Pa. L. Rev. 482 (1939) and 25 Va. L. Rev. 489 (1939).
there involved would have been declared to constitute an unlawful restraint upon alienation. It was emphasized that, in Greene, a portion of the common stock was expressly excluded from the restriction, and that the resulting scheme had no relation to any plan of identifying management personnel and employees with ownership. In addition, the court thought that the restraint in Lawson differed substantially from that involved in Greene since the latter had the effect of subjecting a non-employee stockholder to an indefinite call on his stock in favor of the corporation, which would invariably render the stock less attractive to prospective purchasers and constitute an undue burden. Finally, and what is perhaps most significant of all in view of the prior Lawson holding, the fact that the restriction was contained in the certificate of incorporation did not, in the court's view, prevent it from being held invalid if contrary to public policy.

The Lawson and Greene cases are significant not only as being fairly representative of the way in which stock transfer restrictions are now being dealt with in the courts but as illustrating some of the main difficulties involved in determining the validity of particular restrictions. The "reasonableness" test adopted by the court in Lawson was hardly an innovation in this area of the law, but the holding, at least when interpreted in the light of the subsequent Greene decision, suggests that a restriction may be reasonable and valid with respect to the affairs of one company and yet unreasonable and invalid with respect to the affairs of another. Reasonableness as a criterion seems to be little more than a judicial determination to resolve each new situation in terms of prevailing equities and, in view of the almost endless variety of possible restrictions and the infinite number of situations in which they may be applied, there is little to guide an attorney in advising his client concerning the validity of particular restrictions. In fact, if Greene is to be taken at its face value, even a "first refusal" option contained in the corporate charter may be invalid in the absence of "special circumstances," such as those present in Lawson, and the restriction might not be enforceable even as a contract between stockholders who have assented to it if contrary to "public policy."

37. Id. at 404, 2 A.2d at 254.
38. Id. at 402, 2 A.2d at 253. The restriction in Lawson applied only to a stockholder who ceased to be a director, officer, employee or agent, an executor or administrator of a deceased holder, and a purchaser of shares sold on execution or judicial sale. In addition, the term of the option was limited to twenty days after notice to the corporation of the value of the shares as determined by the appraisers.
39. Id. at 399, 2 A.2d at 251-52.
In determining stock fairness or reasonableness, no one characteristic of the restriction is necessarily determinative. For example, the disparity between the option price and the current value of the stock subject to a "first refusal" type restriction does not establish unfairness.\(^\text{41}\) One court has suggested that the difference must be "so great as to lead to a reasonable conclusion of fraud, mistake, or concealment in the nature of fraud."\(^\text{42}\) But if an option exercisable in favor of a corporation at the original cost to the stockholder of his investment is not "fraud,"\(^\text{43}\) it is difficult to conceive of a restriction which would be held invalid due to mere inadequacy of price.

Further uncertainties arise from the possibility that the validity of particular restrictions may be established only with respect to the specific fact situation in which the restriction is applied. Despite the suggestion of the court in *Palmer v. Chamberlin*\(^\text{44}\) that the validity of a contract should be decided "not merely by what has been done under the contract, but by what may be done under it,"\(^\text{45}\) a Massachusetts court recently upheld a charter provision permitting a corporation to purchase all or any of its common stock at any time at "book value."\(^\text{46}\) The possibilities of oppressive use of such a provision by those in control of the corporation to squeeze out minority interests are obvious\(^\text{47}\) and

\(^{41}\) Allen v. Biltmore Tissue Corp., 2 N.Y.2d 534, 141 N.E.2d 812 (1957). See Note, 72 HARV. L. REV. 555, 557 (1959), suggesting that, to the extent of the spread between the market and the option prices, a restriction may approach an absolute restraint, at least if there is a likelihood that subsequent purchasers may be bound, since, the more burdensome the restriction, the more unmarketable the stock will become. See also, Note, 57 COLUM. L. REV. 444 (1957). For an interesting and extensive discussion of various methods of determining the purchase price of securities subject to a "first option" see O'Neal, Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting, 65 HARV. L. REV. 773, 798 (1952).

\(^{42}\) Palmer v. Chamberlin, 191 F.2d 532, 541 (5th Cir. 1951), noted in 38 VA. L. REV. 103 (1952).


\(^{44}\) See note 42 supra.

\(^{45}\) Palmer v. Chamberlin, 191 F.2d 532, 540 (5th Cir. 1951).


\(^{47}\) See Note, 50 Nw. U.L. Rev. 558 (1955). A similar charter provision was held invalid in Greene v. E.H. Rollins & Sons, 22 Del. Ch. 394, 2 A.2d 249 (Ch. 1938). Cf. Starring v. American Hair & Felt Co., 21 Del. Ch. 380, 191 Atl. 887 (Ch. 1937), aff'd per curiam, 21 Del. Ch. 431, 2 A.2d 249 (Sup. Ct. 1937). Agreements, as distinct from charter or by-law provisions, among stockholders or between them and the corporation providing for an option to repurchase stock at any time have been enforced in at least two cases. Halsey v. Boomer, 236 Mich. 328, 210 N.W. 209 (1926); Boggs v. Boggs & Buhl, 217 Pa. 10, 66 Atl. 105 (1907). In the Boggs case, the option was exercisable upon a finding by a majority of stockholders that one of their number had "ceased to be a desirable associate either on account of incompetency or personal conduct." The court acknowledged the requirement that the finding must have been made in good faith but held that this had been done and enforced the option.
yet the court, relying on a finding of fact that the directors had acted in good faith, observed that "even a valid provision cannot be exercised oppressively or for the purpose of discriminating against a single stockholder or group of stockholders," implying, if anything, that charter provisions are, in themselves, neither valid nor invalid, but are only enforceable as applied to specific fact situations. Thus an option to purchase common stock "at any time" may be enforceable under some circumstances and unenforceable under other circumstances.

In view of the uncertainties and inconsistencies which have resulted from judicial efforts to determine the validity of restraints from the standpoint of a supposed "public policy" which has itself never been fully analyzed or enunciated, it seems desirable that the rules in this area be clarified by legislation. At a very minimum, in states which already have statutes expressly relating to restraints, existing policies should be clarified and the statutes made more explicit. Legislative inaction can only lead to a continuation of the present judicial tendency to justify decisions in terms of statutory provisions which were scarcely designed for the purposes for which they are being used.

Among the basic interests which should be taken into consideration in drafting legislation in this area are (1) rights of transferees who lack notice of restrictions, (2) rights of creditors and holders of securities having priorities with respect to stock on which the restraint may be imposed, and (3) rights of minority stockholders.

The provisions of the Uniform Stock Transfer Act protect the interests of transferees to some extent but they are by no means a complete safeguard. The fact that notice of the restriction appears on the stock certificate does not necessarily mean that the purchaser will in every instance be aware of the restriction, since the certificate may very well be delivered several days, or even weeks, subsequent to the date of the transaction and payment of the purchase price. If anything, the requirement of notice on the certificate has been useful in providing courts with a rationale for deciding in favor of the transferee when the statute has not been complied with and, conversely, refusing

49. See Note, 34 Neb. L. Rev. 717, 720 (1955), suggesting that "The prerogatives of ownership should be determinable at the time of purchase, by resort to the terms of the restrictions; while under the rule of the [Hood] case, i.e., where provisions are not invalid per se, they would be indefinite until the provision had been litigated."
51. Uniform Stock Transfer Act § 15.
him relief when, after having received a certificate with notice on it, he has failed to make timely protest either to his transferor or to the corporation.\footnote{If the restriction is not referred to on the certificate, it is generally regarded as unenforceable even against a transferee with notice of the restriction. See Security Life & Accident Ins. Co. v. Carlovitz, 251 Ala. 508, 38 So. 2d 274 (1949), noted in 48 Mich. L. Rev. 123 (1949); Age Publishing Co. v. Becker, 110 Colo. 319, 134 P.2d 205 (1943); Sorrick v. Consolidated Telephone Co., 340 Mich. 463, 65 N.W.2d 713 (1954), noted in 53 Mich. L. Rev. 620 (1955) and 8 Vand. L. Rev. 640 (1955); Costello v. Farrell, 234 Minn. 453, 48 N.W.2d 557 (1951), noted in 36 Minn. L. Rev. 269 (1952); Hopwood v. Topsham Telephone Co., 120 Vt. 97, 132 A.2d 170 (1957), noted in 26 Fordham L. Rev. 567 (1957) and 17 Mo. L. Rev. 353 (1957). Cf. Prudential Petroleum Corp. v. Rauscher, Pierce & Co., 281 S.W.2d 457 (Tex. Civ. App. 1955); Larson v. Superior Auto Parts, Inc., 270 Wis. 613, 72 N.W.2d 316 (1955) (dictum); In re Magnetic Mfg. Co., 201 Wis. 154, 229 N.W. 544 (1930) (dictum). Earlier decisions going the other way, such as Doss v. Yingling, 95 Ind. App. 494, 172 N.E. 801 (1930), noted in 17 Va. L. Rev. 293 (1931), and Baumohl v. Goldstein, 95 N.J. Eq. 597, 124 Atl. 118 (Ch. 1924), have generally been distinguished on the ground that the transferee occupied a fiduciary status due to his position as an officer or director of the company. The results reached in the majority of cases are probably defensible in view of the language of the statute. Query, however, whether the statute should be interpreted as having any significance other than to require notice of the restriction on the certificate, as distinct from constituting an implicit legislative sanction of "reasonable" restrictions.} Most of these difficulties would be avoided by a requirement that the certificate not only contain a notice of the restriction but that it be delivered immediately upon, or prior to, the payment of the purchase price. However, to make the validity of the restriction depend upon the time of delivery of the certificate would be to enable the transferor to sell the stock free of the restriction merely by failing to part with the certificate until after the sale. Another possibility would be to impose a duty on the transferor to notify the corporation of the proposed transfer prior to the date of the sale in order that the corporation or its stockholders may give the transferee notice of the restriction before he has suffered a change of position by paying the purchase price or otherwise committing himself. But essentially the same difficulty as that suggested above would arise upon failure of the transferor to give the required notice. In any case the latter may of course be liable to the transferee in damages for breach of contract, deceit, or on some other theory but he would doubtless be liable, or could be made to rescind the sale, even in the absence of a statute, and, in addition, the purchaser's remedy against his seller is likely to be inadequate in many instances. The fundamental difficulty is that all of the above devices place a duty on the transferor of giving notice of the restriction, and he is precisely the person who is least likely to give it. The corporation or its stockholders cannot give notice until they in turn have been notified of the proposed sale by the transferor.

To impose on the transferee a duty to obtain the certificate contemporaneously with the sale is another possibility, but this seems somewhat inconsistent with the way in which stock transfers are fre-
quently handled as a practical matter. Perhaps the only satisfactory solution would be some form of public record of the restriction which would be a condition of its validity and would bind all parties regardless of failure on anyone’s part to give or to obtain actual notice. This in turn suggests that the restriction should be set forth in the corporate charter and publicly recorded.

The rights of creditors and holders of senior securities and the means whereby those rights may be protected depend upon considerations which extend beyond the area of stock transfer restrictions and involve not only limitations on the purchase by a corporation of its own shares, but redemptions, dividends, partial liquidations and any other means whereby the “cushion” of corporate assets relied upon for protection may be diminished. Obviously, to the extent that a restriction on transfer gives rights to the stockholders directly, and not to or through the corporation, the holders of senior securities will have less reason to require notice or to object to the proposed enforcement of the restriction. Their rights vis-à-vis the corporation may be, and frequently are, set forth with some particularity in the corporate charter, indenture, or other instrument pursuant to which the securities have been issued, and it would seem that this is the most appropriate method of achieving the desired degree of protection.53

53. In addition, there has been some measure of judicial protection to the extent that corporations may be prohibited from purchasing their own shares. See, e.g., Steele v. Farmers’ & Merchants’ Mutual Telephone Ass’n, 95 Kan. 580, 148 Pac. 661 (1915); Petre v. Bruce, 157 Tenn. 131, 7 S.W.2d 43 (1928); State ex rel. Howland v. Olympia Veneer Co., 138 Wash. 144, 244 Pac. 261 (1926); Kom v. Cody Detective Agency, 76 Wash. 540, 136 Pac. 1155 (1913). Contra, Harker v. Ralston Purina Co., 45 F.2d 929 (7th Cir. 1930), cert. denied, 284 U.S. 619 (1931) (Missouri corporation); Winchell v. Plywood Corp., 324 Mass. 171, 85 N.E.2d 313 (1949).

In New York, where stock may be purchased only from “surplus,” repurchase agreements have been declared invalid for lack of mutuality of obligation even though there may be funds legally available for purchases at the time the repurchase agreement is executed. Topken, Loring & Schwartz, Inc. v. Schwartz, 249 N.Y. 206, 163 N.E. 735 (1928). Query whether the agreement should be enforced if there are funds legally available for the purchase at the time the option becomes exercisable. See Note, 11 W. Res. L. Rsv. 278, 283 (1960), suggesting that subsequent New York cases may have side-stepped the effect of the Topken decision, without expressly overruling it. One device which has had some measure of success has been to fund the repurchase price through life insurance. See Greater New York Carpet House, Inc. v. Herschmann, 238 App. Div. 649, 17 N.Y.S.2d 483 (1940). Section 5.15 of the proposed N.Y. Business Corporation Law, S. Int. 3124, Fr. No. 3316 (1960) provides that agreements of this type shall be enforceable when the corporation is not insolvent and the cost of the purchase of shares does not exceed the amount of surplus available therefor or reduce the net assets below the amount payable to holders of shares having equal or prior liquidation rights. In addition, a promise by a corporation, made contemporaneously with the issue of its shares, to repurchase them is enforceable under the above conditions and if it is “part of an agreement made in furtherance of the business of the corporation and executed by the corporation with the consent of the holders of a majority of the shares given at a duly convened meeting.” See Rohrlich, New York’s Proposed Business Corporation Law, 15 Record of N.Y.C.B.A. 309, 313 (1960).
Rights of minority stockholders would be best protected by requiring that restrictions be set forth in the corporate charter. Subscribers to an issue of stock would be bound as having acquired a security which has been made expressly subject to the restriction, and transferees would be protected by their presumed notice of the restriction as a matter of public record, as well as actual notice provided on the certificate itself as now required by the Uniform Stock Transfer Act.

If a restriction is imposed by means of a charter amendment only those stockholders who have voted in favor of the amendment should be bound.\textsuperscript{54} Otherwise a stockholder would be subject to having his interest cut down or burdened with conditions to which he has not given his assent. A principal difficulty with this approach is that it might result in two types of stock within a class, one subject to the restriction and the other freely alienable. An alternative would be to bind subsequent transferees of the stock of a non-assenting stockholder, although the latter might not be bound and could transfer to anyone regardless of the restriction. However, this would almost invariably have the effect of restricting the transfer of the stock in the hands of the non-assenting, since potential purchasers of the stock under such conditions would be more difficult to find, and its market value would in all likelihood be adversely affected. There seems to be no

\textsuperscript{54} See Wentworth v. Russell State Bank, 167 Kan. 246, 205 P.2d 972 (1949). Cf., Sandor Petroleum Corp. v. Williams, 321 S.W.2d 614 (Tex. Civ. App. 1959), noted in 14 Sw. L.J. 106 (1960) and 38 Texas L. Rev. 499 (1960) (by-law amendment held not to bind non-assenting stockholder whose shares were issued to him without restriction on transfer). Conversely, once the restriction has been validly adopted as an amendment to the charter, those who are bound by the restriction should not be permitted to avoid its effect by a further amendment deleting it. Johnson v. Tribune-Herald Co., 153 Ga. 204, 116 S.E. 810 (1923); Berger v. Amana Soc'y, 95 N.W.2d 509 (Iowa 1959), noted in 45 Iowa L. Rev. 615 (1960) (restriction giving corporation right to purchase, and stockholder right to sell, stock at "true value" in the event of death, sale or removal to another locality held not subject to modification by amendment so as to require stockholder to receive, instead of cash, stock of another class on resale of original stock to the corporation); Bechtold v. Coleman Realty Co., 367 Pa. 208, 79 A.2d 661 (1951). O'Neal has suggested that the corporate charter should provide against its subsequent amendment in a manner which would delete the restriction. 2 O'Neal, CLOSE CORPORATIONS: LAW AND PRACTICE § 7.14 (1958 ed.); O'Neal, Restrictions On Transfer Of Stock In Closely Held Corporations: Planning And Drafting, 65 Harv. L. Rev. 773, 786 (1952). See N.Y. Stock Corp. Law § 9, limiting the duration of such a prohibition against amendment to a period of ten years. See also Israels, The Close Corporation And The Law, 33 Cornell L.Q. 488, 503 (1948) and Note, 44 Cornell L.Q. 133, 140 (1958). For an argument that removal of restrictions should, in some instances, be permitted, see Clark, Charter or By-law Amendment to Remove or Impose Stock Transfer Restrictions, 2 Corp. Prac. Commentator 1 (1960). The proposed N.Y. Business Corporation Law apparently permits charter amendments of all types regardless of whether they are "fundamental" in nature, providing in certain situations for dissenter's appraisal rights. See sections 8.04(a)(2) and 8.07(a)(6) of the proposed statute, S. Int. 3124, Pr. No. 3316 (1960), and Rohrich, New York's Proposed Business Corporation Law, 15 Record of N.Y.C.B.A. 309, 319 (1960).
theoretical objection to a restriction's being applicable to some but not all stock in a class and the cases have in fact reached this result indirectly in holding by-laws valid on a contractual basis between those who have assented to them, or those who may for various reasons be estopped from objecting to them, and yet not binding on other stockholders. From a practical point of view, if the restriction were a matter of public record, transferees would be on notice of the possibility that transfer of the stock they intend to purchase may be restricted and hence would be under a duty to inquire concerning the rights of the transferor and his predecessors in interest vis-à-vis the company and its stockholders. The restriction should be prima facie applicable to all of the shares of a class, and the burden should be upon the transferee or his successors in interest to establish that his shares are free of the restriction.

Absolute prohibitions against transfer, or restrictions having the effect of conditioning the right to transfer upon the consent of one or more persons, should be permitted if limited in time. At the expiration of a designated period the restriction could be submitted again to the stockholders and those opposed to it could have their shares released from its effect. Options to purchase on a "first refusal" basis upon the happening of specified events, such as death, retirement, or proposed sale to a non-stockholder, could be unlimited in time since, unlike an absolute prohibition on transfer, or a requirement of consent, such restrictions do not have the effect of "freezing in" stockholders who wish to dispose of their shares and hence put them at the mercy of the majority, who is thus in a position to impose any conditions it considers desirable as a price of giving the requisite consent.

It is sometimes suggested that a statute expressly permitting restrictions on transfer should apply only to certain types of corporations or be restricted to so-called "private" or close corporations with a limited number of stockholders. This is perhaps more a matter of policy than anything else but there seems to be no real reason why any such arbitrary limits should be imposed. As a practical matter, large, publicly held corporations will seldom seek to restrict transfer of their

56. See, e.g., Winer, Proposing A New York "Close Corporation Law", 28 Cornell L.Q. 313 (1943), suggesting that special provisions be made applicable to all corporations whose stock is owned by not more than five persons. Compare this approach with that taken in civil law countries such as France and Belgium, as described by Winer on page 330 of the article, and also with that taken in Great Britain with respect to the so-called "private company." 6 Halsbury's Laws of England § 526 (3d ed. 1954). See also Gower, supra note 5, at 1378.
shares in view of the obvious difficulties of administration, listing requirements on stock exchanges and, what is perhaps the fundamental reason, the fact that the necessity for imposing a restriction is less likely to exist where the stock is not closely held and is already in the hands of an appreciable number of "outsiders." In such cases, the majority stockholders are more likely to resort to other methods of insuring perpetuation of control, such as voting trusts, pooling agreements, irrevocable proxies and the like.\(^5\)

Given the above assumptions, it would seem that most types of restrictions should be permitted. In any event, it would be well that supposed considerations of "public policy" in promoting free transfer of stock be crystallized in statutory form, perhaps along the lines suggested above, which would remove the uncertainties of the now outworn prohibition against "unreasonable" restraints. For the most part such a statute, in its result, would not differ radically from the net effect of the existing case law, except that vague criteria such as "reasonableness" and "convenience or necessity" would become inapplicable. Accordingly, a restriction would be considered enforceable upon compliance with the statutory conditions and any uncertainties arising from the possibility that a court might subsequently determine the restriction to be invalid as applied to a particular fact situation or business context would be eliminated.

The following is an illustration of what might be done in the way of drafting a statutory provision codifying some of the principles outlined above. Perhaps whatever deficiencies it may have will encourage another to draft an improved version which may eventually result in legislation:

"No restriction on transfer of stock shall be enforceable unless (1) it shall be set forth in the certificate of incorporation, and (2) it shall be set forth in full or in substance upon the certificate evidencing such stock, or satisfactory reference made upon such certificate to the appropriate portions of the certificate of incorporation containing such restriction and the place where such certificate of incorporation may be made available for inspection, provided however, that a failure to comply with subdivision (2) of the foregoing shall not render such restriction unenforceable with regard to a stockholder or transferee having actual notice of the restriction at the time he acquired such stock.

Notwithstanding any other provisions of this [Section, Article],

\(^5\) For an interesting discussion of this point, see Proceedings, Texas Business Corporation Act Institute, 144-45 (1955).
(a) no restriction having the effect of prohibiting the transfer of stock, or requiring that any such transfer be conditional upon the consent of one or more persons other than the holder thereof, shall be enforceable for a term in excess of 10 years from the date at which such restriction shall first become effective, except that such term may be extended for an additional 10 years upon the written consent or other authorization of a stockholder with respect to any shares held by him, but a stockholder not so consenting shall be entitled to transfer or otherwise dispose of his shares in the same manner as if such restriction had not been in effect;

(b) no restriction adopted by an amendment to a certificate of incorporation shall be enforceable against a stockholder, or his transferee, legatee, or successor in interest, who shall sustain the burden of proving that he objected to such amendment in writing and voted against it at a meeting of stockholders duly called for consideration;

(c) stockholders may enter into agreements restricting the transfer of their shares and such agreements shall be enforceable between the parties thereto, but not otherwise except in compliance with the provisions hereof; and

(d) restrictions adopted or entered into prior to the effective date of this [Section, Article] shall continue unaffected by the provisions hereof.”