CORPORATIONS — CAPITAL STOCK — WHAT CONSTITUTES A BREACH OF AGREEMENT RESTRICTING ALIENATION THEREOF

A stockholders' agreement provided that no stockholder would transfer his shares of voting stock without first giving other holders to that already held by them. Defendants transferred their stock to voting trustees without notice to plaintiffs and without according plaintiffs an opportunity to acquire it. Was this transfer violative of the restrictive agreement? *Held*: No. When stock is transferred to voting trustees, the transferor retains the beneficial ownership and is merely asserting his voting control in another form. *Gamson v. Robinson*, 284 App. Div. 945, 135 N.Y.S.2d 505 (1954).

The courts generally have upheld reasonable restrictions on the alienation of stock against the contention that such restrictions contravene the public policy in favor of unfettered disposition of property. *Lawson v. Household Finance Corporation*, 17 Del. Ch.343, 152 Atl. 723 (1940). "First option" restrictions, *i.e.*, those requiring that prior to sale, pledge or other disposition by a stockholder, he must offer such stock to the corporation or other stockholders, are usually upheld as not unreasonable restraints on stock transfer. *Lawson v. Household Finance Corporation, supra.* Contra, *Victor G. Bloede Co. v. Bloede*, 84 Md. 129, 34 Atl. 1127, 33 L.R.A.107 (1896). Also, for a thorough discussion of the validity of restrictions generally, see Annotation, 65 A.L.R.1159 (1930), supplemented in 138 A.L.R. 647 (1942). As all restraints on alienation, even those that are reasonable, are regarded with disfavor, they are strictly construed and will not be enlarged by implication. *Guaranty Laundry Company v. Pulliam*, 198 Okla. 667, 181 P.2d 1007, 2 A.L.R.2d 738 (1947). Thus, first option provisions do not apply to a sale by one stockholder to another, the purpose of the restriction being to exclude "outsiders." *Rychwalski v. Milwaukee Candy Co.*, 205 Wis. 193, 236 N.W.131 (1931). Where the restrictions do not expressly prohibit a pledge, they do not apply to a pledge of the stock by a stockholder to a pledgee as there is no transfer of title in such case. *Crescent City Seltzer & Mineral Water Mfg. Co. v. Deblieux*, 40 La.An.155, 3 So.726 (1888). But where the pledgee sells at auction under the power contained in the contract of pledge, the restrictive provisions must be complied with. *Monotype Composition Co. v. Kievnan*, 319 Mass. 456, 66 N.E.2d 565 (1946). Where the transfer is effected by operation of law or without the voluntary act of the stockholder, the provisions do not apply. *Barrows v. National Rubber Co.*, 12 R.I.173 (1878) (sheriff's sale on execution—restric-

tion prohibition "sale"); *McDonald v. Farley & Loetscher Mfg. Co.*, 226 Iowa 53, 283 N.W.261 (1939) (judicial sale-restriction prohibited transfer by "sale"); *Stern v. Stern*, 146 F. 2d 870 (D.C. Cir. 1945) (testamentary disposition — language of restriction appears broad enough to cover all transfers). But where the language of the provisions restricting alienation is sufficiently broad to cover all transfers of stock, an executor desiring to transfer the stock to the specific legatee must comply with them. *Boston Safe Deposit & Trust Co. v. North Attleborough Chapter of American Red Cross*, 330 Mass 114 111 N.E. 2d 447 (1953).

The primary purpose of having restrictions on the alienation of corporate stock is to retain for the benefit of the original shareholders the power to choose their future business associates. See O'Neal, *Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting*, 65 HARV.L.REV.773 (1952). Thus, the stockholders can have the corporate advantage of limited liability coupled with the partnership advantages of choosing their associates. A corporation with such restrictions on the alienation of its stock has been referred to as an "incorporated partnership." BALLANTINE, CORPORATIONS § 337 (rev.ed.1946). Chief Justice Holmes approved this objective when he said, "there seems to be no greater objection to retaining the right of choosing one's associates in a corporation than in a firm." *Barrett v. King*, 181 Mass. 476, 63 N.E.934 (1902). Presumably, the attainment of this object was the purpose of the restrictions in the instant case. However, the effect of the holding is to lodge the power to make management and policy decisions in outsiders denominated as "voting trustees," whereas the restriction contemplated that such power would be exercised only by persons acceptable to all the original stockholders. Using legal concepts of property, the decision is probably defensible as the transferor retains the beneficial interest, but viewing it from the needs of the particular business organization and the purposes sought to be accomplished by the agreement, the holding is unacceptable. Undoubtedly the intent of the parties to the contract is not satisfied when they are merely assured that the original shareholders and their approved transferees are the only ones who are sharing in the profits of the business. Seemingly, they should be assured that the voting control remains intact in order to satisfy their purpose. The holding in the instant case again emphasizes to the legal profession the necessity for thoughtful planning and careful drafting in order to effectuate fully the business of the clientele.

CHARLES M. CORK, JR.