

NOTES and COMMENT

Restrictions on the Right to Transfer Corporate Stock

By LUIS J. GONZAGA

THE Corporation Law (Act 1459 as amended) makes shares of stock personal property. (Section 16 provides, *inter alia*, "shares of stock * * * are personal property and may be transferred by delivery".) As incident of his ownership, every stockholder has the right to transfer his shares of stock. Although inherent, the right may not be absolute—it may be restricted by the general law, the corporate charter, a by-law, or by an agreement. (6 Fletcher, Cyc. Corps., section 3758.) The validity of the last two restrictions has been challenged in every jurisdiction where the general law has not expressly authorized their imposition by the corporation. They have been assailed on the ground that they constitute undue limitations of the right of ownership and are, therefore, in restraint of trade. (See Padgett vs. Babcock and Templeton, Inc., 32 O.G. 2296.) Ordinarily, however, such restrictions should not be stricken down as unlawful unless *palpably unreasonable*. (Longyear v. Hardman, 219 Mass. 405, 106 N.E. 1012; 68 Beacon St. Inc. v. Sohier, 194 N.E. 303; Brown v. Little, Brown & Co., 269 Mass. 102, 168 N.E. 521). It is said that there are many obvious reasons why it may be to the inter-

est of the stockholders and not violative of any public policy that the right be restricted. In Casper v. Kalt-Zimmers Mfg. Co. (159 Wis. 517, 149 N.W. 754), the State Court declared, "that the restrictions should be held lawful as promotive of good management and sound business enterprise." Similar view was expressed by Chief Justice Holmes in Barrett v. King (181 Mass. 476, 63 N.E. 934-935) when he said that "stock in a corporation is not merely property. It also creates a personal relation analogous otherwise than technically to a partnership. * * * There seems to be no greater objection to retaining the right of choosing one's associates in a corporation than in a firm." In Farmers' Mercantile and Supply Co. v. Laun (146 Wis. 252, 131 N.W. 366), the Wisconsin Supreme Court, explaining the expediency of the restrictions, said, "It is sometimes necessary and often desirable that a corporation protect itself against the acquisition of shares of its stock by rivals in business, or other disturbers, who might purchase shares merely for the purpose of acquiring information which might thereafter be used against the interests of the company." It is believed, therefore, that restrictions on the right which are reasonable

--those calculated to protect the welfare of the corporation and help assure business success, are not only legally permissible but highly desirable. This is especially true with small business corporations and cooperative associations where success depend to a great extent upon the deep personal interest and devotion of the constituency. (See *Lawson v. Household Finance Corp.* 152 Atl. 723).

Under the Philippine Corporation Law, two such restrictions may be imposed upon the right to alienate shares of stock, namely, voting trusts and pooling agreements, and the so-called option contracts. The former is expressly authorized by Section 36 (Act 1459), while the latter, as its name indicates, is based upon contract. A voting trust is an agreement whereby one or more stockholders transfer their shares to a trustee or trustees for the purpose of vesting in the latter the right to vote or other rights pertaining to such shares for a period not exceeding five years. (Section 36, Act 1459). This agreement may enable a corporation to have a unified control of its affairs and to pursue a consistent policy. "It also makes it possible for a majority group of shareholders to dispose of the beneficial interest in a large proportion of their shares and still retain control." (Fisher, *Phil. Law of Stock Corps.* Sec. 139). The clear statutory provision in this jurisdiction does not require discussion as to the validity of this particular restriction.

An option contract is an agreement between stockholders that no one of them shall alienate his stock to outsiders without giving the other parties an opportunity to acquire the same. In *Fleischer vs. Botica Nolasco Co.* (47 Phil. 583, 9 P.D. 856.), our Supreme Court

declared that a by-law imposing such restriction was void. In that case, the by-law required a stockholder who desired to sell his stock to notify the secretary-treasurer. The corporation was given a preferential right to purchase the shares of the retiring stockholders. In holding the by-law void, the Court referred to section 35 of the Corporation Law and declared that the restriction is in conflict with that section. It argued that, "shares of stock, being personal property, the holder thereof may transfer the same without unreasonable restrictions." Emphasizing the stockholder's right to transfer his shares, the Court said, "the owner of a corporate stock has the same *uncontrollable* right to sell or alienate, which attaches to the ownership of any other species of property." Unfortunately, the High Court, in its effort to make the right secure against any restriction, has ignored the force and effect of contracts and incidentally denied, in effect, the stockholders of a right equally inherent in ownership—that of entering into contracts. In *New England v. Abbott* (162 Mass. 148, 38 N.E. 432, 271 L.R.A. 271.), the Massachusetts Supreme Court, deciding a similar situation as involved in the *Fleischer* case, held: "We have not found it necessary to consider the validity of the by-law. We think the case may well stand on the ground that the defendant's testator entered into an agreement with the plaintiff to do what the latter now seeks to compel his executor to do. What may not be good as a by-law may well stand as a contract." (In accord, see 6 *Fletcher, Cyc. Corps.* sec. 3762 and the cases cited therein; *Weiland v. Hogan* 177 Mich. 628, 143 N.W. 599; 3 *Clark and Marshall, Priv. Corps.* p. 1728; Cent-

ury Digest sec. 468; 42 Harvard L. R. 557-558.) The contract is not one in restraint of trade. The stockholder is not prevented from alienating his stock. Neither is his right restricted beyond reasons suggested by a consideration of the welfare of the corporation. "The restrictions do not prevent the ultimate alienation of the stock." (*Nicholson v. Franklin Brewing Co.*, 82 Ohio St. 94, 91 N.E. 991, 137 Am. St. Rep. 764, 19 ann. cas. 699.)

Two exceptions in the application of the restriction may be noted. The restriction cannot be made available to defeat the rights of third persons. (*Farmers' and Merchants Bank of Lineville v.*

Wasson, 48 Iowa 336). Thus, in the *Fleischer* case, the restriction was held unenforceable against the plaintiff because he had no knowledge of the by-law. (It is believed that the only plausible reason advanced by the Court in support of its decision was the necessity of protecting the rights of the plaintiff as an innocent purchaser for value and not that the by-law was ineffective even as a contract.) To make the restriction effective against third persons, the agreement must be noted on the back of the certificate. (See, *Lawson v. Finance Corp.*, *supra*.) And the restriction being contractual in nature, non-assenting stockholders are, of course, not bound by it.

REAL SERVICE

“FOR anything worth having one must pay the price, and the price is always work, patience, love, and self-sacrifice. No paper currency, no promise to pay—but the gold of real service.”—JOHN BURROUGHS.