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incorporation, to be paid in before the corporation was to commence business.[35] Nevertheless, statutes of this type offer some protection to third parties who have dealt with such corporations. In addition to this protection, an awareness of this problem by persons who deal with corporations and inquiry by them as to the financial condition of such corporations should do much to protect third parties in this situation.

WILLIAM L. STOCKS

Corporations—Restricted Stock Transfers—First Options Consequent Upon the Death of Shareholder

In the recent case of *Globe Slicing Mach. Co. v. Hasner*,[1] the Court of Appeals for the Second Circuit held that a bylaw[2] prohibiting the sale or disposition of the capital stock by a shareholder without first offering the same to the corporation or remaining shareholders was inapplicable to a transfer consequent upon the death of a shareholder and effected pursuant to the shareholder's will. The court, interpreting the bylaw provisions under the New York policy of construing first option restraints narrowly, stated: "First option provisions in order effectively to restrain dispositions by will must specifically so provide. This was not done here."[3]

The question now arises whether or not a narrow construction of such bylaw restrictions is justifiable in view of the reasons for their existence.[4] The usual purpose of such restrictions is to main-

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[35] See note 34 *supra*. *But see* S.C. CODE § 12-14.6(b) (Supp. 1964), which provides:

> If a corporation has transacted any business in violation of this section, any person (whether a promoter, incorporator, shareholder, subscriber, or director) who has participated therein, shall be jointly and severally liable for the debts or liabilities of the corporation arising therefrom.

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[1] 333 F.2d 413 (2d Cir. 1964).

[2]
> No sale or disposition of any shares of the capital stock of this corporation by any stockholder shall be valid unless and until he shall give notice in writing of such intention to the corporation, and to all the present stockholders of the company . . . whereupon the company and all of said stockholders shall jointly and/or severally have the option and right to purchase the same within thirty days after receiving such notice . . . .

Id. at 414.

[3] *Id.* at 415.

[4]
> In the management of corporations few things are more apparent than the desire to keep the control in the same hands of people

tain harmonious control within the corporation. This question becomes especially acute in the case of a close corporation,[5] where the members or shareholders are working as an incorporated partnership.[6] The prime objective of the close corporation is to remain close by being able to choose new "partners" in the event of retirement or death of a present shareholder.[7]

In general, the validity of reasonable restrictions[8] upon the transfer of stock of a corporation where they are imposed by the

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> who are congenial to the enterprise and to those who manage its affairs. A quarreling directorate is a misfortune to the stockholders of any corporation. When such situations occur, as they often do, there is no objection to the purchase by the corporation of the shares of the disgruntled stockholders and the resale to those more in harmony with the enterprise. In the organization of corporations it is frequently provided in the articles or bylaws that a stockholder shall not sell his stock without first giving a stated period with which the corporation or other stockholders may have an opportunity to purchase. I find nothing in all this against public policy. On the contrary, it has to do solely with common sense and practical business.

Moses v. Soule, 63 Misc. 203, 209, 118 N.Y. Supp. 410, 414 (Sup. Ct.), *aff'd*, 136 App. Div. 904, 120 N.Y. Supp. 1136 (1909).

[5] A close corporation is an enterprise in corporate form in which the management and ownership are substantially identical and the identity results almost in a partnership. See Israel, *The Close Corporation and the Law*, 33 CORNELL L.Q. 488 (1948).

[6] *Ibid.*

[7] Mr. Chief Justice Holmes stated that "Stock in a corporation is not merely property. It also creates a personal relation analogous otherwise than technically to a partnership. . . . [T]here 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, 479, 63 N.E. 934, 935 (1902).

[8] In Brown v. Little, Brown & Co., 269 Mass. 102, 168 N.E. 521 (1929), the court stated, as to the validity of stock restrictions, "Restrictions on the sale of shares of stock in a corporation are valid and binding. . . . No restrictions can be declared void, unless palpably unreasonable." *Id.* at 110, 168 N.E. at 525. And the court in First Nat'l Bank v. Shanks, 34 Ohio Op. 359, 73 N.E.2d 93 (C.P. 1945), observed "that in practically all of the cases where restrictions have been invalid, the courts have based their judgments on the fact that the restriction was a permanent prohibition." *Id.* at 360, 73 N.E.2d at 95. Examples of the types of restrictions which have been upheld are: (1) consent restraints, requiring the approval of transfers by shareholders or directors or both, (2) first option provisions granting the corporation or other shareholders a pre-emptive right to shares the holder decides to sell or transfer, (3) buy and sell arrangements for the transfer of a deceased holder's shares to the corporation or to other shareholders at a stipulated price or valuation determined by formula, and (4) provisions limiting the transfer to a specific class of persons. See 2 O'NEAL, CLOSE CORPORATIONS: LAW AND PRACTICE §§ 7.05-.14 (1958).

charter or articles of incorporation,[9] or by the bylaws,[10] has been upheld: provided, however, the certificate itself complies with section 15 of the Uniform Stock Transfer Act.[11] But first option sale or transfer restraints have been held not to apply to a sale between shareholders,[12] to a sale by a receiver pursuant to a court order,[13] nor to a sheriff's sale on execution against a shareholder.[14] Although it would appear that these provisions have been interpreted rather restrictively, the corporation would in all probability remain status quo ante with regard to control and management of its affairs on a sale to a shareholder, if the shareholder acted in good faith and in the interest of the corporation.[15] This would also be true on a sale by a sheriff or receiver, since the corporation could repurchase the stock by becoming the highest bidder at the sheriff's or receiver's sale.[16] But the corporation is not always able to repurchase the shares where the shareholder dies and bequeaths his stock to a legatee who would, in all likelihood, have no interest in the affairs of the corporation; that is, where the legatee would be an "outsider" to the corporation.

Where the restrictive provisions expressly provided that on the death of a shareholder his stock would automatically become the

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[9] Bloomingdale v. Bloomingdale, 107 Misc. 646, 177 N.Y. Supp. 873 (Sup. Ct. 1919).

[10] Doss v. Yingling, 95 Ind. App. 494, 172 N.E. 801 (1930).

[11] UNIFORM STOCK TRANSFER ACT § 15 provides:

> There shall be no lien in favor of a corporation upon the shares represented by a certificate issued by such corporation and there shall be no restriction upon the transfer of shares so represented by virtue of any bylaws of such corporation, or otherwise, unless the right of the corporation to such lien or the restriction is stated upon the certificate.

Section 15 is in force in nearly all states. See, *e.g.*, N.C. GEN. STAT. § 55-89 (1960).

[12] Gibbon v. 3920 Lake Shore Drive Bldg. Corp., 310 Ill. App. 385, 34 N.E.2d 109 (1941); Rychwalski v. Baranowski, 205 Wis. 193, 236 N.W. 131 (1931). *Contra*, Casper v. Kalt-Zimmers Mfg. Co., 159 Wis. 517, 149 N.W. 754 (1914).

[13] *In re* Trilling & Montague, 140 F. Supp. 260 (E.D. Pa. 1956); McDonald v. Farley & Loetscher Mfg. Co., 226 Iowa 53, 283 N.W. 261 (1939).

[14] Barrows v. National Rubber Co., 12 R.I. 173 (1878).

[15] A stockholder may purchase the shares in order to become the majority stockholder with the sole intention of "freezing out" the minority stockholders. Such action by the stockholder would, in all likelihood, be unbeneficial to the corporation. For a discussion of majority transactions which "freeze out" the minority, see 35 N.C.L. REV. 271 (1957).

[16] *In re* Trilling & Montague, 140 F. Supp. 260 (E.D. Pa. 1956); Barrows v. National Rubber Co., 12 R.I. 173 (1878).

property of the corporation,[17] or that the corporation or remaining shareholders would have the right to purchase the shares,[18] the courts have consistently held such restrictions valid and binding upon the executor of the deceased shareholder.[19] These provisions have been held valid both on the ground that they were reasonable, in view of the particular corporation,[20] and on the ground that they were not testamentary in character and thus not void for failure to comply with the formal requirements of statutes governing wills.[21]

On the other hand, when the provisions did not specifically provide for the death of a shareholder, as in *Globe Slicing Mach. Co.*, the courts generally have held that the provisions are inapplicable to a transfer consequent upon the death of the shareholder.[22] This

[17] In Krauss v. Kuechler, 300 Mass. 346, 15 N.E.2d 207 (1938), the bylaw provided that the stock "shall automatically become the property of the corporation by paying to the estate of the deceased a sum agreed upon by the remaining stockholders." *Id.* at 347, 15 N.E.2d at 208.

[18] Schaffer v. Below, 174 F. Supp. 505 (D. V.I. 1959); Oakland Scavenger Co. v. Gandi, 51 Cal. App. 2d 69, 124 P.2d 143 (1942); Allen v. Biltmore Tissue Corp., 2 N.Y.2d 534, 141 N.E.2d 812, 161 N.Y.S.2d 418 (1957); First Nat'l Bank v. Coldwell, 286 App. Div. 1079, 145 N.Y.S.2d 674 (1955) (agreement between shareholder and corporation); *In re* Mather's Estate, 410 Pa. 361, 189 A.2d 586 (1963); Covey v. Covey's Little Am., Inc. 378 P.2d 506 (Wyo. 1963).

[19] The executor must first offer the shares to the remaining shareholders or to the corporation, or otherwise, pursuant to the terms of the provision, before he may distribute to the designated legatees. This raises a collateral problem; that is, how does the corporation afford the price of transfer? In most states the corporation may only repurchase its shares out of surplus. See, *e.g.*, N.C. GEN. STAT. § 55-52(c) (Supp. 1963). This generally means that the corporation must establish a sinking fund if their surplus is small. The method recognized as being most advantageous to the corporation is the taking out of business insurance on the shareholder's life. *Cf.* Bohnsack v. Detroit Trust Co., 292 Mich. 167, 290 N.W. 367 (1940). In North Carolina, insurance taken out by a corporation is regulated by statute and provides that it may only be taken out on the life of an officer or employee of the corporation. N.C. GEN. STAT. § 55-17(b)(4) (1960); see note 42 *infra*. But since shareholders in a close corporation are usually either officers or employees, insurance is still a workable method for paying the transfer price of the shares. See generally 2 O'NEAL, CLOSE CORPORATIONS: LAW AND PRACTICE §§ 7.25-.28 (1958).

[20] Allen v. Biltmore Tissue Corp., 2 N.Y.2d 534, 141 N.E.2d 812, 161 N.Y.S.2d 418 (1957).

[21] Thompson v. J. D. Thompson Carnation Co., 279 Ill. 54, 116 N.E. 648 (1917) (shareholders' agreement); Chase Nat'l Bank v. Manufactures Trust Co., 265 App. Div. 406, 39 N.Y.S.2d 370 (1943) (agreement between two shareholders).

[22] Stern v. Stern, 146 F.2d 870 (D.C. Cir. 1945); Elson v. Security State Bank, 246 Iowa 601, 67 N.W.2d 525 (1954); Taylor's Adm'r v. Taylor, 301 S.W.2d 579 (Ky. 1957); Kentucky Package Store, Inc. v. Checani, 331 Mass. 125, 117 N.E.2d 139 (1954); Lane v. Albertson, 78 App.

conclusion is most often reached by way of either a strict construction[23] or by holding that the provisions were inapplicable at the time of the shareholder's death, since transmission or devolution of the shares was inevitable.[24] In either case, the resolution is congruent and indifferentiable, since the holdings mean that the restrictions only allude to a voluntary sale or transfer and not to one caused by operation of law.[25] Extrapolation by the courts has not been evident,[26] and their failure to examine the intent of the provisions and the reasons for their existence have led to cursory interpretations. This in turn has opened the door for the entrance of many legatees into the corporate affairs, sometimes causing disharmony[27] or liquidation. The provisions were designed and inserted to prevent precisely these contingencies.

The plain objectives of the bylaw provisions require an interpretation that imposes the restrictions on the stock in the hands of the executor notwithstanding the failure to use express, all inclusive, and limiting language.[28] Similar provisions, which did not provide for the obvious eventuality of death, have been interpreted as being applicable to the shares at the death of the shareholder and binding upon the executor.[29] The court in *Boston Safe Deposit & Trust Co. v. North Attleborough Chapter of Am. Red Cross,*[30] in very persuasive language, said:

Div. 607, 79 N.Y. Supp. 947 (1903). *Cf.* Vogel v. Melish, 46 Ill. App. 2d 465, 196 N.E.2d 402 (1964); Storer v. Ripley, 12 Misc. 2d 622, 178 N.Y.S.2d 7 (Sup. Ct. 1958).

[23] In Taylor's Adm'r v. Taylor, 301 S.W.2d 579 (Ky. 1957), the court stated, "The terms of the bylaw . . . seem to be limited to a voluntary sale, although 'transfer' and 'sale' are stated as alternatives. The use of the word 'transfer' looks to a sale and has no natural application to any other disposition." *Id.* at 583. Compare BALLINTINE, CORPORATIONS § 321 (rev. ed. 1946); UNIFORM STOCK TRANSFER ACT §§ 1, 22.

[24] Stern v. Stern, 146 F.2d 870 (D.C. Cir. 1945); Elson v. Security State Bank, 246 Iowa 601, 67 N.W.2d 525 (1954).

[25] See notes 23 & 24 *supra.*

[26] See note 22 *supra.*

[27] One source of disharmony would be the legatee's failure to consent to an election made by the corporation pursuant to subchapter S of the Internal Revenue Code of 1954 dealing with election of certain small business corporations to their taxable status. See INT. REV. CODE OF 1954 § 1372.

[28] Mathews v. United States, 226 F. Supp. 1003 (E.D. N.Y. 1964). This case exemplifies the interrelated problem of evaluation of the shares for the purpose of gift and estate taxation.

[29] Boston Safe Deposit & Trust Co. v. North Attleborough Chapter of Am. Red Cross, 330 Mass. 114, 111 N.E.2d 447 (1953); Garrett v. Philadelphia Lawn Mower Co., 39 Pa. Super. 78 (1909).

[30] Boston Safe Deposit & Trust Co. v. North Attleborough Chapter of Am. Red Cross, 330 Mass. 114, 111 N.E.2d 447 (1953).

> The executors are the present holders and can make the required transfers. Their title to the stock, although it was specifically bequeathed, vested in them upon their appointment. . . . It passed to them by operation of the law notwithstanding the restrictions. . . . Although they hold the stock in the right of another rather than in their own right . . . their power to transfer is not thereby enlarged. . . . They have no greater rights in the stock than did the testatrix and they hold the shares subject to the same restrictions on the transfer which were in effect at the time of her death. . . . [T]he executors are . . . bound by the conditions under which the stock was issued and by the contract of their testatrix.[31]

The court in this case proceeded on the theory that the provisions represented a valid contract[32] between the testatrix and the corporation. Many courts[33] have proceeded on the basis that a bylaw is a contract between the shareholder and the corporation and have gone so far as to hold that an invalid bylaw can still be a valid contract as between the shareholder and the corporation.[34] On contract and plain objective theory, one court[35] has taken issue with

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[31] *Id.* at 117, 111 N.E.2d at 449.

[32] The English courts rely almost exclusively on the theory of contract, and, hence, more extensive corporate restrictions on the transfer of stock is allowed. For example, in *In re* Smith & Fawcett Ltd., [1942] 1 Ch. 304, Lord Greene, M.R., in upholding a provision which in part provided, "the directors may at any time in their absolute and uncontrolled discretion refuse to register any transfer of shares," stated:

> Private Companies are in law separate entities just as much as are public companies, but from the business and personal point of view they are much more analogous to partnerships than to public corporations. Accordingly, it is to be expected that in the articles of such a company the control of the directors over the membership may be very strict indeed.

Id. at 306. A private company is a company which: by its articles restricts the right to transfer its shares; limits the number of members to fifty, not including employees and former employees, and where two or more hold one or more shares jointly, they are a single member; prohibits any invitation to the public to subscribe for any shares or debentures of the company. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, §§ 28, 455(1). See generally 6 HALSBURY'S LAWS OF ENGLAND § 526 (3d ed. 1954).

[33] *E.g.*, Palmer v. Chamberlin, 191 F.2d 532 (5th Cir. 1951); Casady v. Modern Metal Spinning & Mfg. Co., 188 Cal. App. 2d 728, 10 Cal. Rep. 790 (1964); Evans v. Dennis, 203 Ga. 232, 46 S.E.2d 122 (1948); Bechtold v. Coleman Realty Co., 367 Pa. 208, 79 A.2d 661 (1951) (where the contract theory received its ultimate exposition); Garrett v. Philadelphia Lawn Mower Co., 39 Pa. Super. 78 (1909).

[34] New England Trust Co. v. Abbott, 162 Mass. 148, 38 N.E. 432 (1894); Blue Mountain Forest Ass'n v. Borrowe, 71 N.H. 69, 51 Atl. 670 (1901).

[35] Mathew v. United States, 226 F. Supp. 1003 (E.D. N.Y. 1964).

the "canon of interpretation that requires expansive clarity of expression"[36] in the bylaws to achieve the desired ends and stated:

> [T]he presence or absence in the contract of the words like "executors and assigns" or of expressions to the effect that the contract is to bind the executors and estate of each party, do not operate, *ex proprio vigore,* to make the contract "binding" on the executors after the contracting party's death (for it binds them without those words) . . . .[37]

Thus, the court in disregarding the narrow interpretation has given effect and vitality to the desired ends and plain objectives of the bylaw provisions.

In North Carolina, no cases have arisen that finally determine this issue. In fact, only one case has reached the supreme court concerning restrictions on the transfer of stock.[38] In that case, the court adopted a liberal position as to "consent"[39] restrictions and held such a restriction valid and not contrary to public policy. The legislature, in the 1955 North Carolina Business Corporation Act,[40] has provided that a corporation may, if it so desires, place certain restrictions upon the transfer of its stock.[41] The act also provides

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[36] *Id.* at 1007.

[37] *Id.* at 1006.

[38] Wright v. Iredell Tel. Co., 182 N.C. 308, 108 S.E. 744 (1921).

[39] A "consent" restriction is generally one in which the directors, officers or shareholders of the corporation must consent to a proposed sale or transfer by a shareholder of his stock. This type of restriction is the most advantageous to the corporation, since it does not have to expend any of its surplus or take out business insurance on the shareholders as in a first option or buy and sell arrangement. The consent restriction is also the most disfavored by the courts because it is usually highly arbitrary in its effectuation. See Finch v. Macoupin Tel. & Tel. Co., 146 Ill. App. 158 (1908); Miller v. Farmers Mill & Elevator Co., 78 Neb. 441, 110 N.W. 995 (1907), where it was held to be an unreasonable restraint. See generally O'Neal, *Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting,* 65 HARV. L. REV. 773 (1952).

[40] N.C. GEN. STAT. §§ 55-1 to -175 (1960).

[41] N.C. GEN. STAT. § 55-16(c) (1960), provides:

> The bylaws may contain any provisions for the regulation and management of the affairs of the corporation, including the transfer of its shares, and restrictions on such transfer, not inconsistent with the law or the charter.

N.C. GEN. STAT. § 55-52(c) (Supp. 1963), provides:

> Subject to the provisions of subsections (e) and (f) of this section, a corporation may, by the action of its board of directors, purchase and pay for its shares, but only out of surplus and only in the following cases: . . . .
>
> (4) From any shareholder in the exercise of the corporation's right to purchase the shares pursuant to restrictions upon the transfer thereof.

a very healthy climate for the close corporation.[42] The climate includes provisions for business insurance on an employee's life,[43] which is the general method by which the corporation is enabled to finance repurchase of the deceased shareholder's stock.[44] In view of its liberal position on the "consent" restriction and the favoritism shown the close corporation by the legislature, it would seem anomalous for the court to interpret narrowly a bylaw provision restricting the "sale or transfer" of shares of stock merely because there was no provision for the obvious eventuality of death.

It is submitted that the court in *Globe Slicing Mach. Co.* was unjustified in its narrow construction of the bylaw provision.[45] In view of the reasons for their existence, the broad language seemed quite sufficient to bind the executor and to prohibit from entering the corporate affairs those legatees who could bring disharmony to

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Subsections (e) and (f) provide generally that the corporation cannot purchase or redeem its shares if the corporation is unable to meet its obligations as they become due in the ordinary course of business, liabilities would exceed the assets, there is an unpaid accrued dividend on shares entitled to preferential dividends ahead of shares to be purchased, etc. N.C. GEN. STAT. § 55-52(e), (f) (1960).

[42] N.C. GEN. STAT. § 55-73(b) (1960), provides:

> Except in cases where the shares of the corporation are at the time or subsequently become generally traded in the markets maintained by securities dealers or brokers, no written agreement to which all of the shareholders have actually assented, whether embodied in the charter or bylaws or in any side agreement in writing and signed by all the parties thereto, and which relates to any phase of the affairs of the corporation, whether to the management of its business or division of its profits or otherwise, shall be invalid as between the parties thereto, on the ground that it is an attempt by the parties thereto to treat the corporation as if it were a partnership or to arrange their relationships in a manner that would be appropriate only between partners.

For a discussion of this section and the close corporation, see Latty, *The Close Corporation and the New North Carolina Business Corporation Act,* 34 N.C.L. REV. 432, 438 (1956).

[43] N.C. GEN. STAT. § 55-17(b)(4) (1960), provides:

> In connection with carrying out the purposes stated in its charter . . . every corporation shall also have power: . . . .
> (4) To procure for its benefit insurance on the life of any employee, including any officer, whose death might cause financial loss to the corporation, and to this end the corporation is deemed to have an insurable interest in its employees and officers.

[44] See text accompanying note 19 *supra.*

[45] In this diversity case, the court was compelled to follow the New York law. See Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938). In so doing, they relied primarily on Lane v. Albertson, 78 App. Div. 607, 79 N.Y. Supp. 947 (1903), which was similar in many respects to the present case. But query whether that case established, as a matter of law, the policy of narrow construction of bylaw provisions in New York.

the close corporation and frustrate its continuance. While it is difficult to understand the objectives achieved by the decision, it is in accord with the weight of authority.[46] It further demonstrates the necessity of providing for every possible contingency which might adversely affect the affairs of the corporation in a sale or transfer of its shares of stock.[47]

THOMAS C. WETTACH

Labor Law—Secondary Consumer Boycotts, Picketing, and Publicity—The Landrum-Griffin Amendment to the Labor Management Relations Act

In two recent cases, the United States Supreme Court has examined statutory restrictions on secondary boycott activity and, for the first time, the extension of these restrictions in the labor reform legislation of 1959. The Court held in *NLRB v. Fruit & Vegetable Packers*[1] that Congress did not intend that the 1959 Landrum-Griffin amendments[2] to section 8(b)(4) of the Labor Management

[46] See note 22 *supra*.

[47] The need for providing for every contingency is shown in Albert E. Touchet, Inc. v. Thompson, 259 Mass. 220, 156 N.E. 41 (1927), where the court held that even though the bylaw of the corporation was binding on the shareholder, his executor, administrator, or assignee to offer the stock for appraisal with rights to purchase it in the corporation, it was not binding on the deceased shareholder's special administrator, since the special administrator had not been provided for in the bylaw. *But see* Guaranty Laundry Co. v. Pulliam, 198 Okla. 667, 181 P.2d 1007 (1947), where the court in effect held that restrictions are usually construed to permit the widest range under the language used.

[1] 377 U.S. 58 (1964).

[2] (b) It shall be an unfair labor practice for a labor organization or its agents—

. . . .

(4) (*i*) to engage in, or to induce or encourage any individual employed by any person engaged in commerce or in any industry affecting commerce to engage in, a strike or a refusal in the course of his employment to use, manufacture, process, transport, or otherwise handle or work on any goods, articles, materials, or commodities or to perform any services; or (*ii*) to threaten, coerce, or restrain any person engaged in commerce or in an industry affecting commerce, where in either case an object thereof is—

. . . .

(B) forcing or requiring any person to cease using, selling, handling, transporting, or otherwise dealing in the products of any other producer, processor, or manufacturer, or to cease doing business with any other person, or forcing or requiring any other employer to recognize or bargain with a labor organization as the representative of his employees unless such labor organization has