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Close Corporation Stock as a “Security” Under Uniform Commercial Code Article 8: North Carolina Embraces the Statute of Frauds in *Stancil v. Stancil*

Article 8 of the Uniform Commercial Code attempts to ensure full negotiability for all types of investment securities. The statutory definition of the term “security” identifies the instruments to which Article 8 applies. One requirement of the definition is that the instrument be “[o]f a type commonly dealt in on securities exchanges or markets or commonly recognized in any area in which it is issued or dealt . . . as a medium for investment.” Because the special characteristics of closely held companies make their shares ill-suited to securities exchange trading, state and federal courts have questioned whether close stock falls within the Uniform Commercial Code’s definition of “security.” In *Stancil v. Stancil* the North Carolina Supreme Court held that Article 8’s definition of a “security” includes the stock of close corporations. By applying the Code definition of a “security” to close stock, the supreme court rendered oral agreements for the sale of shares in close corporations subject to the strictures of Article 8’s statute of frauds.

This Note analyzes the supreme court’s decision to include close corporation stock within the Code’s definition of a security. The Note surveys the treatment of closely held shares under Article 8 by state and lower federal courts throughout the country. It also examines two decisions in which the United

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1. U.C.C. § 8-101 official comment (1977); cf. N.C. GEN. STAT. § 25-8 N.C. comment (1986) (“Article 8’s premise is that all types of investment securities, whether bonds or stocks, are sufficiently similar that they can all be governed by the same uniform statute.”); Folk, *Some Problems Under Article 8 of the Uniform Commercial Code*, 5 ARIZ. L. REV. 193, 193 (1964) (discussing Article 8’s unitary treatment of all forms of securities). Article 8 does not address those aspects of investment securities governed by corporation laws, “blue sky” laws, or federal securities statutes. N.C. GEN. STAT. § 25-8 N.C. comment (1986); id. § 25-8-101 official comment (1986 & Supp. 1990).

2. N.C. GEN. STAT. § 25-8-102 official comment (1986). The definition reads: A “security” is an instrument which
   (i) is issued in bearer or registered form; and
   (ii) is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and
   (iii) is either one of a class or series or by its terms is divisible into a class or series of instruments; and
   (iv) evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.

   *Id.* § 25-8-102(1)(a). The North Carolina General Assembly adopted the 1977 amendments to § 25-8-102(a)(ii) in 1989. For the full text of the amended definition, see *infra* note 44.


4. “[N]o satisfactory all-purpose definition of a close corporation appears ever to have been worked out . . . .” Israels, *The Close Corporation and the Law*, 33 CORNELL L.Q. 488, 491 (1948). One oft-quoted definition states that a close corporation is one “in which the stock is held in a few hands, or in a few families, and wherein it is not at all, or only rarely, dealt in by buying and selling.” Galler v. Galler, 32 Ill. 2d 16, 27, 203 N.E.2d 577, 583 (1964) (citing Brooks v. Willeuts, 78 F.2d 270, 273 (8th Cir. 1935)).


6. *Id.* at 770, 392 S.E.2d at 376.

7. *Id.*
States Supreme Court held that the stock of close corporations constitutes a “security” for purposes of the federal securities laws. The Note concludes that in Stancil the North Carolina Supreme Court properly insisted that a modicum of certainty and reliability mark informal agreements between close corporation participants. It further concludes that another important policy consideration—the protection of individual investors—supports the court’s decision to define closely held shares as “securities” under both negotiable instruments laws and securities “police” statutes.

Bruce Stancil incorporated Bruce Stancil Refrigeration, Inc. under North Carolina law in 1973. Seven years later Howard Stancil, Bruce’s brother, became employed with Bruce Stancil Refrigeration as office manager and bookkeeper. Shortly after Howard joined the company, Bruce and Howard engaged in a series of discussions and negotiations that culminated in Howard’s purchase of fifty percent of the outstanding stock of Bruce Stancil Refrigeration. The brothers’ working relationship eventually deteriorated, and Howard left the company in 1984.

Two years later Bruce filed suit against Howard, claiming that during their negotiations Howard orally had agreed to sell his stock back to Bruce if Howard became unable to perform his business duties, left the company, or could not work amicably with Bruce. Bruce sought specific performance of the agreement. Howard responded that Article 8 of the Uniform Commercial Code makes oral contracts for the sale of investment securities unenforceable and moved for summary judgment. The trial court granted Howard’s motion, and Bruce appealed.

11. Stancil, 326 N.C. at 767, 392 S.E.2d at 374. Although Bruce Stancil ran the company as a one-man operation, he did not own the fifty percent equity interest that he ultimately transferred to Howard until shortly before the brothers concluded their deal. See Defendant-Appellant’s New Brief at 2, Stancil (No. 299PA89).
12. Other litigation resulted from the collapse of the brothers’ business relationship. In Stancil v. Bruce Stancil Refrigeration, Inc., 81 N.C. App. 567, 344 S.E.2d 789, cert. denied, 318 N.C. 418, 349 S.E.2d 601 (1986), Howard brought suit against Bruce over the conduct of a shareholders’ election of directors. Id. at 568, 344 S.E.2d at 790. As in Stancil v. Stancil, Howard and Bruce owned the stock in the corporation equally. With both brothers voting their shares cumulatively, Howard cleverly cast his votes for only two of his three nominees (himself and his wife), thus assuring those candidates control of the three-member board. Id. at 570, 344 S.E.2d at 791. The North Carolina Court of Appeals upheld the trial court’s ruling that the election was valid. Id. at 577, 344 S.E.2d at 795. Cf. R. Robinson, Robinson on North Carolina Corporation Law § 7.4, at 116 n.20 (1990) (stating that Stancil v. Bruce Stancil Refrigeration, Inc. offers “a good example of how careful strategy in cumulative voting can reward the diligent”).
14. Id.
15. Id.
16. Id. at 766, 392 S.E.2d at 374.
17. Id. at 767, 392 S.E.2d at 374. Howard also denied that an agreement to resell the stock to Bruce ever existed. See Defendant-Appellant’s New Brief at 2-3, Stancil (No. 299PA89).
The North Carolina Court of Appeals reversed and remanded the case for trial on the merits.\(^{19}\) The court reasoned that the stock of a closely held corporation does not constitute a "security" and therefore is not subject to the requirements of the Uniform Commercial Code's statute of frauds.\(^{20}\) Relying on the Official Comment to Article 8's definition of a "security," the court of appeals explained that organized stock exchanges and over-the-counter markets would be unlikely to consider closely held shares suitable for trading.\(^{21}\) The court of appeals followed the North Carolina Supreme Court's decision in *Penley v. Penley*,\(^{22}\) in which a preincorporation oral agreement between husband and wife to share in the ownership of a close corporation was held to be enforceable as a matter of simple contract law.\(^{23}\) Recalling the supreme court's well-known discussion of the differences between publicly held corporations and close corporations in *Meiselman v. Meiselman*,\(^{24}\) the court of appeals decided that the

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20. Because Article 8 of the Uniform Commercial Code, which contains its own statute of frauds, governs the negotiability of investment securities, an instrument must satisfy Article 8's definition of "security" before other Article 8 provisions can control its sale or transfer. N.C. GEN. STAT. § 25-8 N.C. comment (1986) ("The coverage of [A]rticle 8 rests upon the broad definition of the term 'security' . . . ."); id. § 25-8-102 official comment (1986) (purpose of § 25-8-102 is to "define the basic term of this Article, 'security,' and so to identify the instruments to which this Article applies").

The text of Article 8's statute of frauds reads:

A contract for the sale of securities is not enforceable by way of action or defense unless

(a) There is some writing signed by the party against whom enforcement is sought or by his authorized agent or broker sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price;

(b) Delivery of a certificated security or transfer instruction has been accepted, or transfer of an uncertificated security has been registered and the transferee has failed to send written objection to the issuer within 10 days after receipt of the initial transaction statement confirming the registration, or payment has been made but the contract is enforceable under this provision only to the extent of such delivery or payment;

(c) Within a reasonable time a writing in confirmation of the sale or purchase and sufficient against the sender under paragraph (a) has been received

Within ten days after its receipt; or

(d) The party against whom enforce to whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract was made for sale of a stated quantity of described securities at a defined or stated price.

Id. § 25-8-319 (Supp. 1990).


22. 314 N.C. 1, 332 S.E.2d 51 (1985). In *Penley*, the plaintiff claimed that the defendant had asked him to work at her restaurant after she became ill. *Id.* at 5, 332 S.E.2d at 54. He alleged that the defendant had promised that if he would devote his full time to the business, the parties would operate it jointly, sharing equally in the assets and profits. *Id.*

23. *Id.* at 19, 332 S.E.2d at 62. The *Penley* court rejected as "narrow and inflexible" the argument that the North Carolina Business Corporation Act requires shareholders' agreements to be in writing. *Id.* at 23, 332 S.E.2d at 64. In deciding *Stancil*, the court of appeals also relied on its own decision in *Loy v. Lorm Corp.*, 52 N.C. App. 428, 441, 278 S.E.2d 897, 906 (1981), in which it had held an oral preincorporation agreement enforceable despite the absence of a writing. *Stancil*, 94 N.C. App. at 322, 380 S.E.2d at 426.

24. 309 N.C. 279, 307 S.E.2d 551 (1983). In *Meiselman*, the supreme court recognized that "[c]lose corporations are often little more than incorporated partnerships." *Id.* at 288, 307 S.E.2d at 557 (quoting Comment, *Oppression as a Statutory Ground for Corporate Dissolution*, 1965 DUKE L.J. 128, 138). The court also stated that close corporations are frequently "based on personal
“dynamics of the close corporation” demand liberal treatment of oral agreements.26

Howard Stancil appealed to the North Carolina Supreme Court,27 contending that the court of appeals had erred in refusing to bring the parties' oral agreement within Uniform Commercial Code Article 8's statute of frauds.28 The defendant argued that the court of appeals had made the close corporation a "creature of statutory exception"29 despite the Code drafters' intent to accommodate both publicly held and close corporations under a single statutory umbrella.30 The informality of oral agreements between close corporation participants, he claimed, could "only be extended so far before the floodgates of fraud are opened and virtually limitless litigation ensues."31

The North Carolina Supreme Court accepted Howard's argument and reversed the decision of the court of appeals, rejecting that court's reliance on corporate law doctrine as a proper basis for excluding closely held stock from the Uniform Commercial Code's definition of "security."32 Justice Mitchell, writing for a unanimous court, stated that such considerations were "inapposite" to the central issue in the case:

[It] is inconsequential whether the shares of stock in question are in fact suitable for trading or have ever been traded on an exchange or market. The statutory definition only requires . . . that instruments be "of a type" that is dealt in on securities exchanges or markets in order to be deemed investment securities. Since stock exchanges and markets generally facilitate the trading of shares of corporate stock . . . the shares of a corporation—whether publicly or closely held—are instruments "of a type" commonly dealt in on securities exchanges or


25. Stancil, 94 N.C. App. at 323, 380 S.E.2d at 426.
26. Id. at 322-23, 380 S.E.2d at 426.
27. See Petition for Discretionary Review at 6, Stancil (No. 299PA89).
29. Defendant-Appellant's New Brief at 15, Stancil (No. 299PA89).
30. Petition for Discretionary Review at 4-5, Stancil (No. 299PA89); cf. Defendant-Appellant's New Brief at 13, 15-16, Stancil (No. 299PA89) (arguing that removing the stock of closely held corporations from within the U.C.C.'s definition of "security" encourages "predatory practices" by shareholders).
31. Petition for Discretionary Review at 6, Stancil (No. 299PA89).
33. Stancil, 326 N.C. at 768, 392 S.E.2d at 375.
34. Id.
markets.\textsuperscript{35}

Dismissing contrary decisions by the highest courts of three other states,\textsuperscript{36} the North Carolina Supreme Court joined a growing majority of state courts that place closely held stock within the strictures of Article \textsuperscript{8}.\textsuperscript{37} The court held that because the stock of Bruce Stancil Refrigeration constituted a “security,” the statute of frauds provision in Article \textsuperscript{8} rendered any oral agreement for its sale unenforceable.\textsuperscript{38}

The drafters of the Uniform Commercial Code promulgated the model statute in 1962.\textsuperscript{39} Over the following decade unprecedented increases in the volume of commercial paper involved in exchange and over-the-counter trading, in addition to the rapidly expanding use of “paperless securities,” made actual delivery of certificates of ownership cumbersome.\textsuperscript{40} At the urging of securities dealers and exchanges, in 1977 the Uniform Laws Commissioners approved a number of revisions to Article \textsuperscript{8}.\textsuperscript{41} The original Code definition of “security”\textsuperscript{42} became the bifurcated statute of today, with separate subsections for “certificated” and “uncertificated” securities.\textsuperscript{43} Despite the division, however, the basic verbal formula remained the same for both terms.\textsuperscript{44}

\begin{enumerate}
\item Id. Justice Mitchell noted that, although not controlling, the comments to the amended version of § 25-8-102 include the stock of close corporations within the definition of “security,” Id. at 770, 392 S.E.2d at 376; see N.C. GEN. STAT. § 25-8-102 amended official comment (Supp. 1990).
\item \textit{Stancil}, 326 N.C. at 770-71, 392 S.E.2d at 376-77.
\item 7 W. Hawkland, R. Alderman & W. Schneider, \textit{Uniform Commercial Code Series}, § 8-101:03, at 6. “Paperless securities” are traded solely on the books of specialists on the exchange floor; delivery of the actual instruments seldom occurs. Id.
\item Id. § 8-101:03, at 6-7; see also R. Robinson, \textit{supra} note 12, § 10.9, at 190-93 & nn.23-24 (citing articles that debated the proposed revisions).
\item For the full text of the original definition, see \textit{supra} note 2.
\item See N.C. GEN. STAT. § 25-8-102(1)(a), (b) (Supp. 1990).
\item Id. The definitions read:
\begin{enumerate}
\item (a) A “certificated security” is a share, participation, or other interest in property of or an enterprise of the issuer or an obligation of the issuer which is:
\begin{enumerate}
\item (i) Represented by an instrument issued in bearer or registered form,
\item (ii) Of a type commonly dealt in on securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment, and
\item (iii) Either one of a class or series or by its terms divisible into a class or series of shares, participations, interests, or obligations.
\end{enumerate}
\item (b) An “uncertificated security” means a share, participation, or other interest in property or an enterprise of the issuer or an obligation of the issuer which is:
\begin{enumerate}
\item (i) Not represented by an instrument and the transfer of which is registered upon books maintained for that purpose by or on behalf of the issuer,
\item (ii) Of a type commonly dealt in on securities exchanges or markets,
\item (iii) Either one of a class or series or by its terms divisible into a class or series of shares, participations, interest, or obligations, and
\item (iv) Not a partnership interest in a limited partnership, unless the partnership is approved for trading on a national securities exchange registered under the
\end{enumerate}
\end{enumerate}
The North Carolina General Assembly adopted the Uniform Commercial Code in 1965.45 The legislature did not, however, add the 1977 amendments to Article 8 until 1989,46 when it promulgated the new Business Corporation Act.47 The definitions of “certificated” and “uncertificated” securities in the North Carolina version48 differ somewhat from the 1977 uniform revision, principally by the addition of subsection (1)(b)(iv). This subdivision removes from the definition of “uncertificated security” limited partnership interests not traded on a national securities exchange or quoted on an automated quotation system such as the National Association of Securities Dealers Automated Quotation System (NASDAQ).49

During the period between North Carolina’s adoption of the Code and the supreme court’s decision in Stancil, North Carolina courts addressed the applicability of Article 8 to close corporations only indirectly. In Oakley v. Little50 the North Carolina Court of Appeals held that a memorandum prepared by the plaintiff during negotiations over the purchase of stock in a close corporation failed to satisfy the writing requirement of Article 8’s statute of frauds.51 The plaintiff alleged that the defendant, who owned one-half of the company’s stock, federal securities laws or for quotation in the automated quotation system of a national securities association registered under the federal securities laws.

Id.; see also id. amended official comment (“These definitions are functional rather than formal. At the core is the notion that a security is a share or participation in an enterprise or an obligation that is of a type commonly traded in organized markets for such interests or is commonly recognized as a medium for investment.”).

The primary difference between the old and new definitions is the absence of the phrase “or commonly recognized in any area in which it is issued or dealt in as a medium for investment” in the definition of an “uncertificated security.” The Commissioners omitted this language because they feared that interests not commonly traded, such as bank checking and savings accounts, would be thought to fall within the “uncertificated” portion of the definition. Id. A secondary difference is the requirement that “uncertificated securities” be registered upon books “maintained for that purpose”; since no paper exists to represent an uncertificated interest, the interest cannot be “issued in bearer or registered form.” Id. § 25-8-102(1)(a)(i), (b)(i).


49. Id. § 25-8-102(1)(b)(iv). The legislature considered the change desirable “in order to avoid imposing on North Carolina partnerships obligations . . . which are not otherwise required by the North Carolina Revised Uniform Limited Partnership Act. For limited partnership interests which are not traded on an active market, the requirements of North Carolina partnership law were considered sufficient.” Id. N.C. comment.

50. 49 N.C. App. 650, 272 S.E.2d 370 (1980).

51. Id. at 654-55, 272 S.E.2d at 373-74. For the full text of Article 8’s statute of frauds, see supra note 20. When the North Carolina General Assembly adopted the 1977 amendments to the Uniform Commercial Code, it inserted several minor emendations to bring the statute of frauds provision into conformity with the amendments to the definition of “security” in § 8-102. N.C.
had agreed to buy the remainder of the stock from its owner and resell it to the plaintiff.\textsuperscript{52} The court of appeals reasoned that the memorandum was only a "working tool"\textsuperscript{53} that the defendant had not signed; consequently, the document failed to satisfy the statute of frauds.\textsuperscript{54} The court of appeals never addressed the question whether the shares at issue were "investment securities" within the meaning of Article 8;\textsuperscript{55} it simply assumed that Article 8 applied to the transaction.\textsuperscript{56}

Since the promulgation of the Uniform Commercial Code,\textsuperscript{57} at least twenty-one state and federal courts have examined the scope of Article 8's definition of an "investment security." The majority view, endorsed by sixteen jurisdictions\textsuperscript{58} in addition to North Carolina,\textsuperscript{59} is that close stock falls within the definition; a minority of four courts\textsuperscript{60} holds that it does not. The outcome of the debate rests upon a simple question: whether the phrase "of a type commonly dealt in upon securities exchanges or markets" expresses a legal, as opposed to a factual, characteristic of investment securities.

Equitable considerations within the close corporation have led a few courts to construe the definition of a "security" in Article 8 as excluding close stock.\textsuperscript{61} Difficulties typically occur when management, fraudulently or in good faith, en-
prises a prospective employee to join the company with the promise of selling her an equity interest. In Blasingame v. American Materials, Inc., for example, the owner of a majority of the shares in a closely held asphalt and concrete business orally agreed to sell the plaintiff twenty-five percent of the company’s stock as an inducement for him to accept employment. After six years of work and several unsuccessful attempts to secure the promised shares, the plaintiff left the company and sued to enforce the oral agreement. Affirming the trial court’s decision for the plaintiff, the Tennessee Supreme Court denied the defendant the protection of Article 8’s statute of frauds. The court held that the corporation’s stock did not fall within the definition of “security” in Article 8, reasoning that because no “market” existed for American Materials stock, it could not constitute an instrument “of a type commonly dealt in upon securities exchanges or markets.”

A second common scenario involves a shareholders’ agreement to buy, sell, or offer the whole interest owned by a single stockholder to the other investors or to the corporation itself when certain events occur. In the illustrative case of Zamore v. Whitten, a husband and wife brought suit against the majority shareholder of a family-owned business to recover damages for defendant’s alleged breach of an oral contract to purchase their shares for a stipulated

62. See Donahue v. Rodd Electrotype Co., 367 Mass. 578, 586, 328 N.E.2d 505, 511 (1975); 1 F. O’NEAL & R. THOMPSON, O’NEAL’S CLOSE CORPORATIONS § 1.02, at 3-4 (3d ed. 1986) (shareholders often perform the daily management duties of closely held concerns). The Donahue court listed three characteristics that close corporations frequently possess: “(1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the corporation.” Donahue, 367 Mass. at 586, 328 N.E.2d at 511 (emphasis added). For a discussion of the definition of a close corporation, see supra note 4.

63. 654 S.W.2d 659 (Tenn. 1983).
64. Id. at 660.
65. Id. at 660-61; see also Note, supra note 45, at 582 (observing that because the equities in the case clearly lay with the plaintiff, the result “represents a classic example of the old adage ‘hard cases make bad law’” (quoting Northern Sec. Co. v. United States, 193 U.S. 197, 400 (1904) (Holmes, J., dissenting))).
66. Blasingame, 654 S.W.2d at 668.
67. Id. at 664. Observing that only one sale of shares had occurred in the corporation’s existence, the court concluded that “the history of defendant corporation’s stock . . . rendered it impossible for defendant to show that its stock was dealt in by securities exchanges or was commonly recognized as a medium for investment.” Id. The Blasingame court relied in part on a Texas case in which the appellate court held that “whether the stock of a corporation was dealt in upon securities exchanges or commonly recognized as a medium for investment, or otherwise came within the definition of a security” was a question of fact. Id. (citing Kenney v. Porter, 557 S.W.2d 589, 591-92 (Tex. Civ. App. 1977) (emphasis added). On appeal after trial on the merits, the appellate court in Kenney withdrew its earlier description of the definition as a “question of fact” and decided as a matter of law that close corporation shares are “securities” for purposes of U.C.C. § 8-102(1)(a)(ii). Kenney v. Porter, 604 S.W.2d 297, 301-02 (Tex. Civ. App. 1980).
68. Blasingame, 654 S.W.2d at 664. The court considered the lack of an established value for the company’s stock persuasive: “The proof adduced on the value of the stock makes it clear that there was no market available for this stock.” Id.
69. The litigation in Stancil resulted from just such an agreement. See supra notes 14-18 and accompanying text.
70. 395 A.2d 435 (Me. 1978).
71. Plaintiffs owned 75 shares, a one-third interest in the company’s capital stock; defendant, who was the brother of one of the plaintiffs, owned 150 shares, a two-thirds interest. Id. at 438.
Despite the defendant's repeated assurances that the transaction soon would take place, nearly a year passed fruitlessly. The trial court granted the defendant's motion for judgment notwithstanding the verdict on the ground that the plaintiffs had failed to establish that an enforceable contract existed as a matter of law. The Supreme Judicial Court of Maine affirmed. Although the court expressly noted that one of the "underlying purposes" of the Code is "to simplify, clarify and modernize the law governing commercial transactions," it created an exception to these broad concerns in Zamore by concluding that the stock of close corporations does not fall within the Code's definition of a "security." Like the Tennessee Supreme Court in Blasingame, the Maine court in Zamore decided that the Article 8 definition of a "security" demands what does not exist—an actual "market" for close stock. Indeed, the Zamore court called for something that never could exist, because a close corporation is, by definition, a corporation with few shareholders whose stock is not widely traded.

In support of its decision to refuse close corporation shares status as "securities," one court has observed that the motive for investing in a closely held company often differs from the impetus for buying publicly traded stock.

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72. Id. One of the plaintiffs had been employed as general manager of the company before defendant fired him. The defendant later sent the plaintiffs a letter offering to buy their shares if money became available. Id.

73. Id. at 438-39. Throughout the period in which the plaintiffs attempted to secure the payment by private negotiation, financial difficulties plagued the corporation, and the value of the stock was "nominal." Id. at 439.

74. Id. at 438.

75. Id. at 439.

76. Id. at 444. The court agreed that the plaintiffs had failed to adduce evidence "of any intention on their part to be bound by any contract to sell their stock to [the defendant]." Id. at 443.

77. Id. at 441 (quoting U.C.C. § 1-102(2)(a) (1977)).

78. Id. It is noteworthy that the Zamore court quoted the Uniform Commercial Code incorrectly: "Although the record is silent thereon, it is apparent that the [p]reference stock in this close family corporate business is not of a type 'commonly dealt in upon securities exchanges or markets,' nor is it commonly recognized in any area securities exchanges or markets as a medium for investment." Id. (emphasis added). The statute correctly reads: "A 'security' is an instrument which . . . is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment . . . ." U.C.C. § 8-102(a)(ii) (1977) (emphasis added). The misquotation may have been the source of the court's misguided holding; an instrument may be viewed as a medium for investment in the area where it is issued without being the object of trading on an exchange. Note, supra note 45, at 589. The Zamore court relied on Silverman v. Alcoa Plaza Assocs., 37 A.D.2d 166, 171, 323 N.Y.S.2d 39, 43 (N.Y. App. Div. 1971), in which a New York appellate tribunal held that the term "security" as defined in Article 8 does not include co-operative apartment stock. The Maine court went on to ask itself whether the shares might be considered "goods," so that Article 2 of the U.C.C. would apply to their transfer, but then abandoned the question. Zamore, 395 A.2d at 441-43.

79. See supra notes 63-68 and accompanying text.

80. Cf. Note, supra note 45, at 590 ("The common thread running through cases holding that closely held stock is not a security is a focus on the requirement that this stock be 'of a type commonly dealt in upon securities exchanges and markets or commonly recognized in this area as a medium for investment.'") (footnote omitted) (quoting U.C.C. § 8-102(a)(ii) (1977)).

81. See Rhode Island Hosp. v. Collins, 117 R.I. 535, 538, 368 A.2d 1225, 1227 (1977). In Collins the court noted that
While public corporations are operated by strangers for the benefit of shareholders and provide return in the form of dividends, close companies often depend for profits on the business or professional skills of the investors themselves. For example, in Gulf Mortgage & Realty Investments v. Alten the plaintiff, a judgment creditor, discovered that his debtor owned seventy-five percent of the stock of a professional corporation and sought to reach the stock under the authority of the Uniform Commercial Code. The court held that the Code's definition of a security was inapposite on the ground that professional corporation shares are "not commonly dealt in upon securities exchanges or markets." The majority of jurisdictions brings close stock within Article 8's definition of a "security." Most courts stress that all types of corporate stock constitute instruments "commonly dealt in upon securities exchanges or markets," or are at least "dealt in as a medium for investment." In Wamser v. Bamberger, for example, the plaintiff submitted a written offer to purchase the stock of Masco Corporation to the defendant, the sole shareholder. The defendant orally accepted the offer, assuring the plaintiff that there was no need to close the deal for four days. Later the same day, the defendant informed the plaintiff that he had accepted a competing offer and therefore was cancelling the deal. The plaintiff brought suit, seeking either specific performance of the agreement or the damages he had sustained by the defendant's breach. The defendant responded by arguing that the statute of frauds rendered any contract, if one ever had existed, void and unenforceable. On appeal from the trial court's grant of summary judgment for the defendant, the Wisconsin Court of Appeals rejected the plaintiff's argument that a factual dispute existed over the issue of whether Masco stock constituted a "security" for purposes of the Code. Although plaintiff urged that Masco was a small, family-owned company whose

Id.

82. Note, supra note 45, at 590; cf. Donahue v. Rodd Electrotype Co., 367 Mass. 578, 586, 328 N.E.2d 505, 511 (1975) (close corporations often feature substantial shareholder participation in the management and operation of the business); F. O'NEAL & R. THOMPSON, supra note 62, § 1.02, at 3-4 (shareholders often perform the daily management duties of closely held companies).


86. See cases cited supra note 58.

87. 101 Wis. 2d 637, 305 N.W.2d 158 (Ct. App. 1981). The Wamser decision is noteworthy because, unlike in most "security" definition cases, the stock in question did not contain transfer restrictions. Id. at 646, 305 N.W.2d at 162.

88. Id. at 639, 305 N.W.2d at 159.

89. Id.

90. Id.

91. Id.

92. Id. Reasoning that the Masco stock constituted a "security" under § 8-102(1)(a)(ii) of the Uniform Commercial Code, the trial court granted the defendant's motion for summary judgment on the ground that the Code's statute of frauds (embodied in U.C.C. § 8-319) barred the plaintiff from enforcing the agreement. Id. at 639-40, 305 N.W.2d at 159.

93. Id. at 639, 305 N.W.2d at 159.

94. Id. at 645, 305 N.W.2d at 161.
stock was difficult to sell\textsuperscript{95}—the very factual argument that had carried the day in decisions embracing the minority position\textsuperscript{96}—the court viewed the question not as an issue of fact, but as a matter of law to be decided by examining the underlying policies of the Uniform Commercial Code.\textsuperscript{97} After quoting the Official Comment to Article 8's definition of a "security,"\textsuperscript{98} the court observed that the drafters' expansive language plainly shows that the Code calls for employing a broad definition of "security."\textsuperscript{99} Holding that the "undisputed evidence clearly brings the Masco stock within the definition of a security,"\textsuperscript{100} the court concluded that the Code's statute of frauds was applicable to the case and affirmed the trial court's grant of summary judgment.\textsuperscript{101}

The issue of the proper Code definition of the term "security" also arises in the context of shareholders' agreements that attempt to restrict the transferability of close corporation stock.\textsuperscript{102} A New York case, Pantel v. Becker,\textsuperscript{103} illustrates one such agreement—an oral promise between shareholders to confer first refusal rights on one another should anyone decide to sell his interest. The plaintiff, the owner of forty percent of the stock of a close corporation,\textsuperscript{104} sued to enforce the oral contract.\textsuperscript{105} The defendants responded by asserting the Uniform Commercial Code statute of frauds, arguing that the agreement was not enforceable because no writing proved its existence.\textsuperscript{106} The court agreed.\textsuperscript{107}

\textsuperscript{95} Id. at 645, 305 N.W.2d at 162. The court framed the issue thus: "In essence, [the plaintiff] argues that the stock was not of the type sold in exchanges or markets and not a 'medium for investment.'" Id.

\textsuperscript{96} See supra note 60 and accompanying text.

\textsuperscript{97} Wamser, 101 Wis. 2d at 645-46, 305 N.W.2d at 162.

\textsuperscript{98} Wisconsin had adopted the 1977 version of Article 8. For a discussion of the history of the Uniform Commercial Code, see supra notes 39-44 and accompanying text. Although section 8-102(1)(a)(ii) is identical in the 1977 and 1962 versions of the Code, the drafters revised the Official Comment to the 1977 version, clarifying their original intention to include the stock of closely held corporations in the definition. See N.C. GEN. STAT. § 25-8-102 amended official comment (Supp. 1990).

\textsuperscript{99} Wamser, 101 Wis. 2d at 646, 305 N.W.2d at 162 ("[N]umerous other cases have held that corporate stock which was 'restricted,' i.e., even less salable than the stock here, was a 'security' under the Uniform Commercial Code provision involved in this case. These holdings support our conclusion.") (citing E.H. Hinds, Inc. v. Coolidge Bank & Trust Co., 6 Mass. App. 5, 372 N.E.2d 259 (1978); Pantel v. Becker, 89 Misc. 2d 239, 391 N.Y.S.2d 325 (N.Y. Sup. Ct. 1977); Previti v. Rubenstein, 3 U.C.C. Rep. Serv. (Callaghan) 882 (N.Y. Sup. Ct. 1966)).

\textsuperscript{100} Id.

\textsuperscript{101} Id. at 647, 305 N.W.2d at 162.

\textsuperscript{102} Besides the practical difficulty of finding a buyer for less than controlling blocks of closely held companies, shares in these corporations are frequently subjected to the legal limitations of share transfer restrictions. H. HENN & J. ALEXANDER, LAWS OF CORPORATIONS § 281, at 756 (1983). Share transfer restrictions attempt to ensure that the corporation retains its "closely held" status and strive to achieve, within the limited-liability shelter of the corporate form, the partnership hallmark of \textit{delectus personae}—a partner's right to choose new members of the firm. See BLACK'S LAW DICTIONARY 383 (5th ed. 1979). The restrictions may aim also to preserve a close corporation's existing management structure or to maintain secrecy in the conduct of corporate affairs. \textit{Id.; see also} T. HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 20.5, at 458 (2d ed. 1990) (shareholder restrictions attempt to preserve current management in power).

\textsuperscript{103} 89 Misc. 2d 239, 391 N.Y.S.2d 325 (N.Y. Sup. Ct. 1977).

\textsuperscript{104} Id. at 240, 391 N.Y.S.2d at 325.

\textsuperscript{105} Id. at 240, 391 N.Y.S.2d at 325-26. The contract provided first refusal rights to the extent that a continuing stockholder might purchase from the seller so many shares as would bring his interest to 50% of the total number of outstanding shares. \textit{Id.}

\textsuperscript{106} Id. at 241, 391 N.Y.S.2d at 326.
Although it acknowledged that securities exchanges and markets seldom deal in the stock of close corporations,\(^1\) the court nevertheless held that close stock is "certainly commonly recognized by many people as a medium for investment."\(^2\) Similarly, in *Jennison v. Jennison*\(^3\) a Pennsylvania court held that close corporation stock constitutes a "security" under Article 8 of the Code even when burdened with share transfer restrictions.\(^4\)

Bankruptcy courts also have answered affirmatively the question whether close stock constitutes a "security" for purposes of the Uniform Commercial Code. In one notable case, *In re Sandefer*,\(^5\) the debtor was the sole shareholder of a closely held corporation that followed him into bankruptcy.\(^6\) After the corporation's assets were sold and its creditors paid, the trustee in bankruptcy transferred the surplus from the sale to the debtor's bankruptcy estate.\(^7\) A creditor, seeking to satisfy a portion of its judgment lien against the shareholder-debtor from the surplus, argued that the lien had attached to the debtor's stock in the corporation.\(^8\) The United States Bankruptcy Court for the Northern District of Alabama, noting that the Uniform Commercial Code was the only statute purporting to govern the circumstances under which shares of stock

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\(^1\) Pantel was not the first New York decision to examine § 8-102(1)(a)(ii). In *Previti v. Rubenstein*, 3 U.C.C. Rep. Serv. (Callaghan) 882 (N.Y. Sup. Ct. 1966), the plaintiff claimed that the defendant had breached their oral agreement to sell each other the 50% interests they each owned in two separate close corporations. *Id.* at 883. The defendant pleaded the U.C.C. § 8-319 statute of frauds, and the plaintiff responded that the statute did not apply to close corporation shares. *Id.* The court disagreed, observing that the definition of "security" was intended to include all shares of stock, not merely those traded by security brokers and their customers. *Id.* at 883-84. *Previti*, apparently the earliest case to construe the Code's definition of "security," expresses succinctly the construction of the statute adopted by a majority of courts. See cases cited supra note 58.

\(^2\) To hold otherwise, the court noted, would work a "strained construction of the statute." *Id.* It is interesting to note the court's reliance on the phrase "medium for investment"; by viewing closely held stock simply as one type of investment medium, fewer courts might have resorted to the strained analysis found in cases like *Zamore* and *Blasingame*.

\(^3\) *Jennison* involved facts identical to those of *Blasingame*, discussed supra notes 63-68 and accompanying text. The defendant lured the plaintiff into the management of his company with 50 shares of stock and the promise that the plaintiff would be able to acquire a controlling interest in the future. *Jennison*, 346 Pa. Super. at 49-50, 499 A.2d at 303. When the time came to transfer the final installment of shares, the defendant indicated that he wanted to retain voting rights for a substantial period of time. *Id.* at 50, 499 A.2d at 303. The plaintiff brought suit, but the defendant successfully pleaded the statute of frauds. *Id.* at 50-53, 499 A.2d at 303-305.

\(^4\) The court stated:

> Shares of stock in a closely held corporation are, after all, shares of stock, which are clearly instruments "of a type" commonly dealt in on securities exchanges or markets. They also fall within the commonly recognized meaning of an "investment" ... The fact that a corporation may be closely held or the shares bear a transfer restriction may affect the ease and frequency with which the stock is traded or the desirability of the stock as an investment but it does not make it something other than a "security."

*Id.* at 53, 499 A.2d at 304.

\(^5\) *Bankr.* 133 (Bankr. N.D. Ala. 1985) (mem.).

\(^6\) *Id.* at 135.

\(^7\) *Id.*

\(^8\) *Id.* at 136. Historically, in the absence of statute, shares of stock in closely held corporations have been viewed as intangibles, incapable of caption and delivery, and therefore immune to levy and sale under execution. *Id.*
can be levied by execution, 116 reasoned that it had to decide whether close corporation shares are "securities" before it could apply the Code. 117 On the ground that close stock, like publicly traded stock, represents an interest in a corporate enterprise, the court decided that closely held shares are "of a type" publicly traded and, therefore, constitute a "security" under the Code. 118 Because the stock was neither "certificated" nor "seized" by the sheriff, however, as the statute required, the court held that the creditor's judgment lien did not attach to the close corporation stock. 119

Similarly, the outcome of In re Domestic Fuel Corporation 120 rested on the definition of close corporation stock within the meaning of Article 8. A creditor sold its debtor all the stock in two wholly owned corporations. 121 Pursuant to an agreement, the parties placed the stock in escrow for ten years while the debtor made payments toward the balance. 122 When the debtor filed a petition for reorganization in bankruptcy court, the creditor sought relief from the automatic stay of bankruptcy on the theory that, as a secured creditor, his interest in the escrowed stock was inadequately protected. 123 The debtor argued that because closely held shares are not a "security" under the Article 8 definition, the creditor's interest was unsecured and therefore not entitled to protection. 124 After a thorough analysis of all the elements of section 8-102, 125 the bankruptcy court concluded that certificates of stock in closely held corporations are instruments "of a type" that may be publicly traded or "dealt in as a medium for investment." 126

117. Sandefur, 47 Bankr. at 137.
118. Id. at 138. The court reasoned that the stock of closely held corporations differs from that of publicly traded companies in two fundamental ways. First, investors in publicly traded stocks expect to obtain profits in the form of dividends "generated by the corporation through the entrepreneurial or managerial efforts of others." Id. (citing Rhode Island Hosp. v. Collins, 117 R.I. 535, 538, 368 A.2d 1225, 1227 (1977)). Second, the trading of closely held companies differs greatly from that involving publicly traded enterprises both in the number of shares and stockholders and in the general size of the business. Nevertheless, the court observed, a share of stock always represents an ownership interest in an enterprise, an instrument "of a type" traded upon securities exchanges or markets. Id.
119. Id. at 140.
120. 70 Bankr. 455 (Bankr. S.D.N.Y. 1987).
121. Id. at 456.
122. Id.
123. Id. at 459. The creditor argued that a security interest had been perfected when the bank placed the stock certificates in escrow. Id. at 460.
124. Id. at 459-60.
125. Id. at 461-62.

The United States Bankruptcy Court for the District of Maine also has challenged the minority view that close corporation shares are not "securities" for purposes of Article 8. In In re Kontaratos, 10 Bankr. 956 (Bankr. D. Me. 1981), the court recognized that the Supreme Judicial Court of Maine, in Zamore v. Whitten, 395 A.2d 435, 441 (Me. 1978) (discussed supra notes 70-80
The complex and often unique needs of close corporation participants present difficulties for the drafter of commercial statutes. As human circumstances change, informal agreements and unspoken expectations among close corporation participants may lead to disappointment and feelings of betrayal. The North Carolina position—applying the term “security” to close corporation stock—is a sensible answer to an uncomplicated but difficult problem. Holders of close stock now must insist on a writing to ensure performance of an agreed-upon transaction. Close corporation participants can blame the law and secure their rights without risking the loss of trust and good feeling that could accompany a unilateral demand for a writing to prove the existence of an agreement.

The movement among state courts toward considering close corporation stock a “security” under the Uniform Commercial Code parallels United States Supreme Court companion decisions holding close stock to be a “security” for purposes of the federal securities laws. In *Landreth Timber Co. v. Landreth* the Court confronted the question whether selling all of the stock in a

and accompanying text), had removed close stock from the Code definition of a “security.” The bankruptcy judge, however, urged that

compelling policy considerations militate against extension of the *Zamore* rule. Simplicity, clarity and uniformity in the law governing commercial transactions are not prompted by a rule dictating different collateral classifications on the basis of the presence or absence of a family relationship among stockholders. The Uniform Commercial Code implies no such distinctions. It classifies certain types of instruments as “investment securities,” without regard to the identity of the holders, and without reference to the size or function of the enterprise.

Id. at 960-61 (footnotes omitted).


128. 471 U.S. 681 (1985). In *Landreth* the defendants, a father and his sons, owned all the outstanding stock of a family lumber mill business. They offered their stock for sale through local and out-of-state brokers, and secured a purchaser who bought the business. Id. at 683-84. When the mill failed to satisfy expectations, the purchaser filed suit against the sellers, claiming that the defendants had widely offered and sold their stock without registering it as required by the Securities Act of 1933, and that the defendants had materially misrepresented the worth and prospects of the company in violation of the Securities Exchange Act of 1934. Id. at 684. The district court granted the defendants’ motion for summary judgment on the ground that the “sale of business” doctrine removed the transaction from the purview of the federal securities acts, and the Ninth Circuit affirmed. Id. at 684-85.

Citing its opinion in United Housing Found., Inc. v. Forman, 421 U.S. 837 (1975), the United States Supreme Court reversed, recognizing that the stock in question had all the characteristics usually associated with common stock, i.e., “(i) the right to receive dividends contingent upon an apportionment of profits; (ii) negotiability; (iii) the ability to be pledged or hypothecated; (iv) the conferring of voting rights in proportion to the number of shares owned; and (v) the capacity to appreciate in value.” *Landreth*, 471 U.S. at 686 (citing Forman, 421 U.S. at 851). The Court also observed that the sale of stock in a corporation is “typical of the kind of context to which the [federal securities] acts normally apply,” so that an investor in this context would likely believe herself protected by the federal securities laws. Id. at 687. Thus, interpreting close corporation stock to fall within the federal securities acts’ definition of “security” comports with the purpose of the acts themselves—“compelling full and fair disclosure relative to the issuance of ‘the many types of instruments that in our commercial world fall within the ordinary concept of a security.’” Id. (quoting H.R. REP. NO. 85, 73d Cong., 1st Sess. 11 (1933)); cf. id. at 697-700 (Stevens, J., dissenting) (stating
close corporation constitutes the sale of a "security,"129 which implicates the antifraud provisions of the Securities Act of 1933130 and the Securities Exchange Act of 1934.131 Justice Powell, writing for the majority, reasoned that when the instrument is traditional stock, there is no need "to look beyond the characteristics of the instrument to determine whether the Acts apply."132 The same reasoning prevailed in Stancil, despite the decision's different statutory context. As Justice Mitchell observed, "'[s]hares of stock in a closely held corporation are, after all, shares of stock, which are clearly instruments "of a type" commonly dealt in on securities exchanges or markets.'"133 The United States Supreme Court rejected directly the same argument that the North Carolina Supreme Court spurned indirectly—that proper construction of the definition of a "security" always requires analysis of the "economic substance" of the transaction involved.134 Under the Supreme Court's reasoning, when the instrument involved in a transaction is "traditional stock," a "plain meaning" approach to the statutory language is required.135

In Gould v. Ruefenacht136 the Supreme Court held that the sale of fifty percent of the stock in a closely held company is the sale of a "security."137 As in Landreth, the companion decision to Gould, the Court refused to look beyond the word "stock" to decide whether close corporation shares are "securities" subject to regulation under federal laws. Justice Powell refused to permit a trial court's factual determination of whether a given transaction effected a "sale of business"—the passing of corporate control to a stock purchaser—to govern the application of the 1933 and 1934 securities acts.138

A comparison of the Landreth, Gould, and Stancil opinions reveals the sim-
ilar reasoning employed by courts construing the term “security” in different statutory contexts. The comparison raises in turn the question whether state courts should look to federal decisions interpreting the definition of “security” as persuasive authority for their own deliberations, and vice versa. Although entirely different statutes produced the Landreth, Gould, and Stancil litigation, the underlying issue in each case was the protection of investors. The federal securities acts directly embrace this goal, and Article 8 of the Uniform Commercial Code indirectly advances a similar aim: the assurance that parties can accomplish transfers of investment securities, and agreements to transfer them, with certainty and order. Article 8 therefore effectively ensures that close corporation participants who reduce their share transfer agreements to a sufficient writing are “protected” from anxiety that the transaction may not occur because they are unable to prove its existence. Although federal case law may not always provide an answer to state securities law questions, the attorney in search of an argument to lay before a state appellate court might profit from consulting federal decisions on the definition of a “security.”

The North Carolina Supreme Court’s holding in Stancil is a major development in commercial law for attorneys whose clients include close corporations. The decision firmly establishes the rule that an agreement to sell close stock will not be enforceable unless the parties satisfy the requirements of the Uniform Commercial Code’s statute of frauds for the sale of investment securities. The statute requires a writing, signed by the party against whom enforcement is sought, sufficient to indicate that a contract exists for the sale of a stated quantity of securities at a defined or stated price. Absent such a writing, the “reasonable expectations” of parties to contracts for the sale of close stock will avail them nothing. Informality in the operation and management of close corporations may be judicially acceptable, but the solemnity and certainty of a writing are necessary for contracts to sell close stock to be enforceable.

139. Cf. Gould, 471 U.S. at 706 (purpose of federal securities acts is to protect investors); Landreth, 471 U.S. at 696-97 (prospect that “parties to a transaction may never know whether they are covered by the Acts until they engage in extended discovery and litigation” is daunting).

140. N.C. GEN. STAT. § 25-8 N.C. comment (1986) (“Article 8's basic object is to give investment securities full and complete negotiability . . .”).

141. See id. § 25-8-319 (Supp. 1990), quoted in full supra note 20. Although the supreme court framed the “central question” in Stancil as whether to include close corporation stock within Article 8’s definition of a “security,” Stancil, 326 N.C. at 768, 392 S.E.2d at 375, the effect of the decision is to require all agreements to sell close stock to be provable by a sufficient writing. Id. at 770-71, 392 S.E.2d at 376.

142. It is important to note that the contract must be for the sale of securities. “Purchase” and “sale” are not the same under the Code. As the definition of “purchase” in § 1-201(32) shows, giving a gift or taking a security interest would constitute a “purchase” under the Code. U.C.C. § 1-201(32) (1977). Thus, “[a]lthough all sales are purchases, the reverse is not true.” W. HAWKLAND, R. ALDERMAN & W. SCHNEIDER, supra note 40, § 8:319:02, at 384. Section 8-319 of the U.C.C. applies to sales only. Id.


144. The “reasonable expectations” test, familiar to North Carolina corporate lawyers from the supreme court’s decision in Meiselman v. Meiselman, 309 N.C. 279, 299, 307 S.E.2d 551, 563 (1983), has no application to questions of commercial law. See Stancil, 326 N.C. at 767-68, 392 S.E.2d at 375 (reliance on Meiselman inapposite to the question whether close corporation stock is a “security” for purposes of Article 8 of the Uniform Commercial Code).
The North Carolina Supreme Court's holding in *Stancil* is more than an intelligent response to the realities of close corporation stock ownership. A clear majority of state and federal courts now favors the view that closely held stock constitutes a "security" for purposes of Article 8.145 Indeed, the amended comments to the 1977 version of Article 8's definition of a "security" reveal that the drafters of the Uniform Commercial Code intended close stock to fall within the definition of a "security."146 Judicial attempts to make close corporation stock an exception create an anomaly: close stock may ripen into an Article 8 security if the number of shareholders grows, even though the nature of the interest remains the same.

Commentators often suggest that close corporations are the most common form of incorporated enterprise.147 Closely held companies provide many North Carolinians with far more than "media for investment"; successful close corporations frequently constitute the backbone of family financial health. Thus the supreme court's decision in *Stancil* is a positive development. The requirement that purchasing and selling shareholders satisfy the statute of frauds will promote certainty in transfers of close corporation stock. Attorney vigilance is a small price to pay for financial security.

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145. See cases cited supra note 58.
146. See N.C. GEN. STAT. § 25-8-102 amended official comment (Supp. 1990) ("Interests such as the stock of closely-held corporations, although they are not actually traded upon securities exchanges, are intended to be included within the definitions of both certificated and uncertificated securities by the inclusion of interests 'of a type' commonly traded in those markets.'").
147. One writer suggests that approximately 95% of all incorporated businesses have 10 or fewer shareholders. See Conard, *The Corporate Census: A Preliminary Exploration*, 63 CALIF. L. REV. 440, 458-59 (1975).