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Corporations - Validity and Necessity of Strict Compliance with Restrictions on Right to Transfer Stock

R. O. R.

Notes

CORPORATIONS—VALIDITY AND NECESSITY OF STRICT COMPLIANCE WITH RESTRICTIONS ON RIGHT TO TRANSFER STOCK—Relator sought a writ of mandamus to compel defendant corporation to transfer eight shares of stock, standing on the corporate books in the name of W. Wallace, to the relator's name. Defendant corporation contended that the stock had not first been offered to the corporation as required by one of its by-laws. The stock was originally issued to the relator in payment of attorney's fees, but was put in his negro chauffeur's name for the convenience of the corporation, which was composed of negro stockholders. *Held,* while the by-law might prevent the relator's sale of the stock unless he complied with its provisions, it could not prevent the transfer of the stock from the negro chauffeur to the relator, who was the true owner. *State ex rel. Cabral v. Strudwick Funeral Home, Incorporated,* 4 So. (2d) 760 (La. App. 1941).

Corporate by-laws and articles frequently embody various types of restrictions on the transfer of shares. An attempt to condition the transfer upon the consent of officers or other stockholders of the corporation is almost universally held to be an invalid restraint upon alienation.[1] Only in exceptional cases, where the stockholders are restricted to persons of special talent or to family members,[2] have such restrictions been upheld.

A substantial number of decisions have even held invalid a requirement that the stock be offered to the corporation before it is sold to an outsider.[3] However, the weight of authority and the

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a condition of things such as would show a "fault" on the part of the defendant, accompanied by a claim of resulting damage therefrom, and upon the trial of the case to establish the truth of his allegations. Does the word "damage" mean strictly material damage resulting in pecuniary loss or will the Louisiana courts in an appropriate case construe it to include mental and emotional damage *(le préjudice moral)* as well?

It might well be argued that since Louisiana jurisprudence recognizes the so-termed "moral injury" of the French law, a recovery is justified where insulting language, though not amounting to legal slander, has caused mental and emotional damage. See notes 11 and 12, supra.

1. McNulta v. Corn Belt Bank, 164 Ill. 427, 45 N.E. 954 (1897); Miller v. Farmers' Milling & Elevator Co., 78 Neb. 441, 110 N.W. 995 (1907); Petoe v. Baure, 157 Tenn. 131, 7 S.W.(2d) 43 (1928); In re Klaus, 67 Wis. 401, 29 N.W. 582 (1886).

2. Longyear v. Hardman, 219 Mass. 405, 106 N.E. 1012 (1914); Blue Mountain Forest Ass'n v. Borrowe, 71 N.H. 69, 51 Atl. 670 (1901); Wright v. Iredell Telephone Co., 182 N.C. 308, 108 S.E. 744 (1921).

3. Victor G. Bloede Co. v. Bloede, 84 Md. 129, 34 Atl. 1127 (1896); Ireland

tendency of the more recent decisions are to uphold the validity of such requirements as reasonable restrictions upon the transfer or sale of stock either as permissible corporate regulations[4] or as valid contracts with the corporation.[5]

The validity of the restriction apparently does not depend upon whether it is incorporated in the corporate articles or only in the by-laws.[6] Under the provisions of the Uniform Business Corporations Act, the effect of a restriction, otherwise valid, probably is not affected by the fact that it is mentioned only in the corporate by-laws.[7] However, in jurisdictions where the Uniform Stock Transfer Act has been adopted, the restriction must be stated in the stock certificate to bind good faith purchasers.[8]

The Louisiana court has never ruled definitively on the validity of imposing, as a prerequisite to the transfer of stock, the requirement of a prior offer to the corporation or its stockholders. The court has held that such a restriction has no effect upon an otherwise valid pledge, at least until the pledgee seeks to enforce his rights by sale or transfer of the stock.[9]

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v. Globe Milling Co., 21 R.I. 9, 41 Atl. 258 (1898). A by-law prohibiting sale of stock to a competitor was held invalid in Kretze v. Cole Bros. Lightning Rod Co., 193 Mo. App. 99, 181 S.W. 1066 (1916). Cf. Steele v. Farmers' & Merchants' Mutual Telephone Ass'n, 95 Kan. 580, 148 Pac. 661 (1915) (Kansas statute prohibiting a corporation purchasing its own stock).

4. Searles v. Bar Harbor Banking & Trust Co., 128 Me. 34, 145 Atl. 391 (1929); Barrett v. King, 181 Mass. 476, 63 N.E. 934 (1902). 12 Fletcher, Cyclopedia of the Law of Private Corporations (perm. ed. 1932) 225, § 5456. Cf. Sterling Loan & Investment Co. v. Litel, 75 Colo. 34, 223 Pac. 753 (1924).

5. Sterling Loan & Investment Co. v. Litel, 75 Colo. 34, 223 Pac. 753 (1924); New England Trust Co. v. Abbott, 162 Mass. 148, 38 N.E. 432, 27 L.R.A. 271 (1894); Model Clothing House v. Dickinson, 146 Minn. 367, 178 N.W. 957 (1920); Cowles v. Cowles Realty Co., 201 App. Div. 460, 194 N.Y.Supp. 546 (1922). Cf. Blue Mountain Forest Ass'n v. Borrowe, 71 N.H. 69, 51 Atl. 670 (1901).

6. In a majority of jurisdictions apparently no distinction is made, since the limitation arises from public policy against restriction of the right to alienate property rather than from the manner of adoption of the provision. See 12 Fletcher, op. cit. supra note 4, at 218-226, §§ 5454-5456; Notes (1895) 27 L.R.A. 271, (1921) 5 Minn. L. Rev. 312, (1930) 65 A.L.R. 1159. But see Ireland v. Globe Milling Co., 21 R.I. 9, 41 Atl. 258, 79 Am. St. Rep. 769 (1898). If the restriction is passed as a by-law after the stock is acquired, some courts will not uphold it on the ground that it deprives minority stockholders of their rights without their consent. Model Clothing House v. Dickinson, 146 Minn. 367, 178 N.W. 957 (1920).

7. See Uniform Business Corporation Act, § 26. And see particularly La. Act. 250 of 1928, § 29 (II)(i) [Dart's Stats. (1939) § 1109 (II)(i)]: "By-laws. . . may include provisions in respect to: . . .(i) the sale or transfer of shares, or the reservation of lien thereon. . . ."

8. Uniform Stock Transfer Act, § 15; La. Act 180 of 1910, § 15 [Dart's Stats. (1939) § 1194]. See also La. Act 250 of 1928, § 21 [Dart's Stats. (1939) § 1101].

9. ". . . this provision refers only to transfers of ownership, and not to pledges, its object being to prevent the disposition of the stock to strangers without first giving the corporation or its members the opportunity of pur-

In *State ex rel. Scott v. Caddo Rock Drill Bit Company*[10] the court "assumed" the validity of a requirement that no stock be sold until the other stockholders had an opportunity to purchase it during a ten day period following notice to the company of intention to sell.[11] Nevertheless, the corporation was ordered to transfer the stock on its books to the relator's name despite the fact that the relator's transferor had not complied with the restriction. The facts of the case justify the seemingly anomalous decision. At the time the relator asked for a transfer of the stock to his name, he also tendered written notice to the corporation of his intention to sell the stock. This notice, though one step belated, complied with the spirit, if not the letter, of the restriction. It afforded other shareholders an opportunity to buy the stock and thereby prevented a third person from becoming a shareholder.[12]

An analogous situation is presented in the *Strudwick Funeral Home*[13] case. Here again the court refused to pass directly upon the validity of the restriction, but held it inapplicable to the case. The corporate officers themselves had requested that they be allowed to place the stock in the relator's chauffeur's name to prevent prospective subscribers from learning that a white person owned stock in the corporation. The court, looking to the real nature of the transaction, recognized that the relator was intended to be the real owner when the stock was originally issued, and held that there was no reason to insist upon compliance with the restriction when he demanded the transfer.

In view of the limited number and complex nature of the Louisiana decisions, any summary of the Louisiana law is somewhat conjectural. However, it is probable that the Louisiana courts will uphold generally the validity of an option restriction,[14]

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chasing. . . ." Crescent City Seltz & Mineral Water Mfg. Co. v. Deblieux, 40 La. Ann. 155, 156, 3 So. 726, 727 (1888). See also Factors' & Traders' Insurance Co. v. Marine Dry Dock & Shipyard Co., 31 La. Ann. 149 (1879).

10. 141 La. 353, 75 So. 78 (1917).

11. See also Bartlett v. Fourton, 115 La. 26, 38 So. 882 (1905). In Martin v. McCloskey, 155 La. 604, 611, 99 So. 477, 480 (1924), the court more definitely indicates the validity of such a restriction by a dictum statement that the obligation bound the plaintiff not to sell said stock without first offering it to the company at par.

12. It was stressed that "it was of no concern to the other stockholders . . . that the notice of the intention to sell . . . was given by Geo. C. Scott [relator] instead of G. H. Jumason [the original stockholder]. . . ." State ex rel. Scott v. Caddo Rock Drill Bit Co., 141 La. 353, 359, 75 So. 78, 80 (1917). In the absence of this circumstance, the court could not have found a substantial compliance with the spirit of this restriction.

13. State ex rel. Cabral v. Strudwick Funeral Home, Inc., 4 So.(2d) 760, 761 (La. App. 1941).

14. See note 12, supra.

but that a strict compliance with its terms will not be required where the facts or exceptional cases justify a deviation or where the substantial purpose of the requirement has been met.

R.O.R.

LEGISLATION—CONSTITUTIONALITY OF AMENDMENT BY IMPLICATION—Act 26 of 1914 provided for defrayal of the expenses and salary of the State Fire Marshal from the proceeds of a tax therein levied on fire insurance companies doing business in the state.[1] The fire marshal drew warrants against the proceeds of this tax. The state treasurer refused to honor the warrants, relying upon provisions in the 1940 general appropriation act[2] which repealed all laws providing for continuing appropriations[3] and made an appropriation to the State Fire Marshal conditioned upon his surrender of all unencumbered funds in his possession or thereafter collected.[4] On suit of the fire marshal for mandamus, *held*, the writ was properly issued to compel payment of the warrants. The provisions of the general appropriation act cannot be considered as amending Act 26 of 1914, for such a result would violate the provision of the Louisiana constitution relating to amendment of a prior law by reference.[5] *State ex rel. Fournet v. Tugwell*, 5 So. (2d) 370 (La. 1941).[6]

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1. La. Act 26 of 1914, § 7 [Dart's Stats. (1939) § 3545].

2. La. Act 44 of 1940.

3. Id. at § 11: "All continuing appropriations in existence at the time of the adoption of this Act are hereby expressly discontinued and any provision of law making or purporting to make any such appropriation is hereby repealed with a view to compliance with the provisions of the Constitution prohibiting the making of any appropriation for a longer period than two years."

4. Id. at § 5: "There are hereby appropriated from the State General Fund, the following amounts. . . ; provided, however, that such appropriations shall be payable out of the State General Fund only on the condition that there shall have been deposited in the State General Fund, all unencumbered balances on hand as of June 30, 1940, and on the further condition that all fees and other receipts of the respective agencies which shall be collected during the period July 1, 1940, through June 30, 1942, shall be deposited with the State Treasurer to the credit of the State General Fund. The transfer of such balances and departmental receipts to the State General Fund is hereby authorized and directed by the Legislature." The State Fire Marshal is thereafter listed for a specified appropriation.

The general appropriation act also contained the familiar repealing clause, applying to "all laws or parts of laws in conflict herewith." La. Act 44 of 1940, § 15.

5. La. Const. of 1921, Art. III, § 17.

6. It is the purpose of this note to consider only the rationale of the decision, not the correctness of the result. In addition to the argument relied upon by the court, relator's counsel contended that (1) the legislature in-