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Corporate Law - Restrictions on Alienability of Stock

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the other hand, the court reasoned that plaintiff should be charged with the effects of administrative delays in service when the suit is filed in a court of incompetent jurisdiction, since he has the choice of the forum. Consequently, when a plaintiff chooses a forum of incompetent jurisdiction or improper venue, he should be required to bear the consequences of any administrative delays in service of citation.[13]

It is submitted that this decision was necessary and proper in the interest of efficient judicial administration. There is no doubt that the effects of the accrual of prescription can be harsh, as demonstrated by the instant case. On the other hand, prescription serves to prevent defendants from being harassed by long-delayed suits and suits with no foundation which are purposely delayed, so that evidence will be lost and the defendant encouraged to settle his case without going to trial. When viewed in this light, it appears that the court was wise in not relaxing the strict rules governing the interruption of prescription. In the future, in order to avoid a plea of prescription from being sustained when federal jurisdiction is uncertain, it would be prudent for plaintiff's attorney to verify the service of citation before the end of the prescriptive period. As an alternative, filing the suit in both the federal court and the state court within the prescriptive period would insure preservation of the plaintiff's cause of action; however, this latter procedure is more expensive for the plaintiff, and duplicate filing is scarcely conducive to efficiency and economy in judicial administration.

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CORPORATE LAW — RESTRICTIONS ON ALIENABILITY OF STOCK

Four non-stockholders desired to purchase a controlling interest in a corporation from defendant, a majority shareholder. The articles of incorporation contained the following restriction on the alienability of stock: before sale of stock to

13. This reasoning is in accord with the jurisprudence. See Conkling v. Louisiana Power & Light Co., 166 So.2d 68 (La. App. 4th Cir. 1964); Knight v. Louisiana Power & Light Co., 160 So.2d 832 (La. App. 4th Cir. 1964); Hidalgo v. Dupuy, 122 So.2d 639 (La. App. 1st Cir. 1960); Flowers v. Pugh, 51 So.2d 136 (La. App. 1st Cir. 1951).

any outsider, a thirty-day period must elapse during which the remaining shareholders can purchase the stock offered for sale, proportionally to their interests in the corporation.[1] Defendant notified the secretary of the corporation, who was a shareholder, of his intention to sell. The secretary duly informed the other stockholders. The secretary then demanded that defendant sell to her a proportionate share of the stock to be sold. No other shareholder made a similar offer within the prescribed thirty-day period. But since the four non-shareholders insisted on purchasing the entire block offered for sale, defendant refused to comply with the secretary's demand, and sold his entire controlling interest to the four non-shareholders. The block would not have been a controlling interest if the secretary had purchased a proportion. In an action by the secretary to set aside the sale, the trial court held the transfer to the non-stockholders valid. The Third Circuit Court of Appeals affirmed. *Held*, a stock restriction permitting shareholders to purchase proportionate shares of the stock to be sold by another shareholder does not give an individual shareholder the right to purchase merely his proportionate amount of the selling shareholder's block of stock when other shareholders evidence no desire to purchase the remainder. *Phillips v. Newland*, 166 So. 2d 357 (La. App. 3d Cir. 1964), *cert. denied*, 167 So. 2d 679 (La. 1964).

It is now well settled throughout the United States that reasonable restrictions may be imposed on the shareholder's right to transfer his stock.[2] Restrictions may be imposed by the articles of incorporation, the by-laws, or by an independent shareholder's agreement.[3] Additionally, the Uniform Stock

1. Pertinent parts of the instant restriction read as follows: "In the event any holder or holders (sic) of common stock of this corporation should desire to sell such common stock, or any portion thereof, such stock shall be first offered to the stockholders of record . . . and the stockholders of record shall be entitled to purchase such proportionate shares of the stock offered . . . as corresponds with their respective stockholdings . . . . [T]he stockholder shall be granted a period of thirty (30) days within which to accept or reject, in whole or in part, the offer of such stock. . . . [I]t is stipulated and provided that the common stock of this corporation shall not be sold to non-stockholders whenever there be a stockholder . . . of record desirous of purchasing said stock . . . at the same price which may have been offered by non-stockholders." 166 So. 2d at 359-60.

2. See, *e.g.*, Guaranty Laundry v. Pulliam, 198 Okla. 667, 181 P.2d 1007 (1947); *In re* Garvin's Estate, 335 Pa. 542, 6 A.2d 796 (1939); Ireland v. Globe Milling Co., 21 R.I. 9, 41 Atl. 258 (1898); BALLENTINE, CORPORATIONS § 336 (1946); FLETCHER, CYCLOPEDIA CORPORATIONS §§ 5452-5453 (1957); STEVENS, CORPORATIONS § 129 (2d ed. 1949).

3. See note 2 *supra*. See generally Annots., 65 A.L.R. 1159 (1930); 138 A.L.R. 647 (1942), 61 A.L.R.2d 1318 (1958). The Uniform Stock Transfer Act requires that the purchaser be put on notice of such restrictions by having the restriction on the stock certificate. UNIFORM STOCK TRANSFER ACT § 15.

Transfer Act requires that the stock restriction must appear on the stock certificate to bind purchasers.[4] Since most courts and the majority of writers treat corporate stock as the personal property of the stockholder,[5] there is a presumption that such personal property may be alienated at will in the absence of a clear and binding restriction to the contrary.[6] Such restrictions, although valid if reasonable, will generally be strictly construed.[7] In adopting the Uniform Stock Transfer Act,[8] Louisiana has impliedly taken the position that restrictions on the alienability of stock are valid. This implication arises from section 15 of the Uniform Act, which states that stock restrictions must appear on the stock certificate.[9] Similarly, La. R.S. 12:3(6) provides that restrictions on stock must appear in the articles of incorporation.[10] Nevertheless, prior to the instant decision the questions whether such restrictions were valid and whether the rule of strict construction would be followed in this jurisdiction had not been settled by the courts.[11]

Restrictions on the alienability of corporate stock which give the remaining stockholders the option to purchase any selling stockholder's shares, are generally held valid, so long as the restrictions are imposed in accordance with statutory procedures, and are not unreasonable.[12] Although no American cases have

4. The Uniform Stock Transfer Act imposes this requirement at § 15. Practically all states have adopted the act. See 6 UNIFORM LAWS ANNOTATED 7 (Supp. 1964).

5. See, *e.g.*, Howe v. Roberts, 209 Ala. 80, 95 So. 344 (1923); Tippecanoe County v. Reynolds, 44 Ind. 509, 15 Am. Rep. 245 (1873); Bloomingdale v. Bloomingdale, 107 Misc. 646, 177 N.Y. Supp. 873 (Sup. Ct. 1919); FLETCHER, CYCLOPEDIA CORPORATIONS § 5453 (1957).

6. See note 5 *supra*. Restrictions are justified on the basis of contract among the shareholders, or simple corporate regulations. See note 3 *supra*.

7. See, *e.g.*, Oakland Scavenger Co. v. Gandi, 51 Cal. App. 2d 69, 124 P.2d 143 (1942); McDonald v. Farley & Loetschek Mfg. Co., 226 Iowa 53, 283 N.W. 261 (1939); Guaranty Laundry v. Pulliam, 198 Okla. 667, 181 P.2d 1007 (1947).

8. LA. R.S. 12:521-543 (1950).

9. *Id.* 12:538.

10. See also *id.* 12:29B(9) stating that restrictions *may* be in the by-laws. Most writers agree that to be perfectly safe, the restriction ought to appear on the stock certificate, in the articles of incorporation, and in the by-laws. See note 2 *supra*.

11. See State *ex rel.* Scott v. Caddo Rock Drill Bit Co., 141 La. 353, 75 So. 78 (1917) (holding the provision inapplicable); Bartlett v. Fourton, 115 La. 26, 38 So. 882 (1905) (conceding *arguendo* that the provision was valid); Crescent City Seltzer & Mineral Water Mfg. Co. v. Deblieux, 40 La. Ann. 155, 3 So. 726 (1888) (restriction not applicable in case of pledge). State *ex rel.* Cabral v. Strudwick Funeral Home, Inc., 4 So.2d 760 (La. App. Orl. Cir. 1941) (restriction not applicable). See generally Note, 4 LA. L. REV. 441 (1942).

12. See note 2 *supra*. See also, *e.g.*, Sterling Loan & Inv. Co. v. Litel, 75 Colo. 34, 223 Pac. 753 (1924); *In re* Feldstein's Estate, 25 Pa. Dist. R. 602 (1916);

been discovered which deal with the precise issue of the instant case, the Ohio case of *Menke v. Gold Metal Oil Co.*[13] indicates that a restriction which clearly gives the remaining shareholders an individual right to purchase a proportion of a selling shareholder's stock will be enforced, each shareholder having a right to part of the stock regardless of any other shareholder's desires.[14] However, in the Ohio case, unlike the instant case, the provision was expressly drawn to confer on each stockholder this individual right. Moveover, the English case of *Ocean Coal Co. v. Powell Coal Co.*,[15] a restriction similar to the instant one, was held not to confer on the shareholders any right to purchase only a part of the offered stock.[16]

In the instant case the plaintiff argued that the restriction in question required the selling shareholder to sell a proportionate amount of his stock to all offering shareholders irrespective of whether the stockholders were willing to purchase the entire amount offered. The defense urged that the plaintiff's offer was really a counter-offer, and not an acceptance, to his original proposal. In rejecting plaintiff's contentions, the court accepted, without comment, the well-established principles of corporate laws that "the law favors unrestrained transferability of stocks and restraints on alienability must be strictly construed."[17] Adopting the defendant's counter-offer theory, the court argued that the instant restriction only gave the other shareholders the right to purchase "at the same price which may have been offered by non-shareholders,"[18] an impossibility when the shareholder or shareholders are unwilling to purchase the entire amount offered. Although this position is subject to the criticism that the words "at the same price" might refer to the price per share, the court's interpretation seems consistent with the policy of unrestrained transferability: in effect, the court

Moses v. Soule, 63 Misc. 203, 118 N.Y. Supp. 401 (1909), *aff'd*, 136 App. Div. 904, 120 N.Y. Supp. 1136.

13. 47 Ohio App. 180, 191 N.E. 472 (1933).

14. "It is agreed by the holder of the within shares of stock . . . that he will not dispose of any of the shares . . . without first offering the same . . . to the other shareholders of the Company of the same class, *to each*, that number of shares . . . which is proportional . . . to the number already held." *Id.* at 181, 191 N.E. at 473. (Emphasis added.)

15. 1 Ch. 654 (1932).

16. "In my judgement the offer is not accepted within the meaning of the article unless one or more members agree to take up the whole number offered." *Id.* at 662.

17. 166 So.2d at 360. See 18 C.J.S. *Corporations* § 391 (1939).

18. See note 1 *supra*.

gave every benefit to the selling shareholder. Particularly, the court was unwilling to preclude the defendant from selling his controlling interest as a block when a less restrictive interpretation was available.[19]

Thus, while the instant case only assumes the validity of restrictions on the alienability of stock,[20] it increases the likelihood that such restrictions will be accepted in Louisiana. Moreover, the case clearly aligns Louisiana with the majority position that such restrictions will be strictly construed.

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INCOME TAX — TAXABLE INCOME — CONTRIBUTIONS OF SERVICE AND PROPERTY TO CORPORATION

Appellee, a geologist, agreed with others in a partnership to look for and buy potentially productive oil and gas properties in return for a monthly drawing salary and expenses and a partnership interest in the properties after the others recovered their costs. The arrangement proved successful, and when it became evident that costs would be recovered, the original agreement was terminated and all the oil and gas properties that had been acquired were transferred to a newly-formed corporation. Appellee received 13% of the stock but included no part of the value of the stock in his income tax return for that year.[1] The Commissioner ruled that the fair market value of the stock should have been included in gross income and assessed a defi-

19. 166 So.2d at 360: "To uphold plaintiff's position would be to put Newland in a position where he would be unable to sell a controlling interest in the corporation."

20. The court in the instant case, 166 So.2d at 360, states that "restrictions are valid under Louisiana law," citing State *ex rel.* Scott v. Caddo Rock Drill Bit Co., 141 La. 353, 75 So. 78 (1917). The *Scott* case, however, expressly avoided ruling upon the validity of the provision in question. *Id.* at 359, 75 So. at 80.

1. The facts in the court of appeal opinion are stated very briefly, but according to the district court opinion it appears that from February 9, 1951, through March 31, 1955, the partnership advanced capital in the sum of $1,245,106 and recovered from oil and gas production on the properties the sum of $1,008,613. The partnership expected the properties to be paid out by November 30, 1955, and accordingly the corporation was formed to which were transferred all the properties acquired through the efforts of appellee under the agreement, with each party receiving "shares of stock in the corporation proportionate to his respective interest in the properties." Frazell v. United States, 213 F. Supp. 457, 460 (W.D. La. 1963). The 13% stock interest of appellee in the newly-formed corporation was determined to have a fair market value of $91,000.