Stock Transfer Restrictions in Close Corporations

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15 ATENEO L.J. 219 (1966)

TAG(S): COMMERCIAL LAW, CORPORATION LAW, STOCK TRANSFER RESTRICTIONS

This Article focuses on the discussion of the validity of stock transfer restrictions in close corporations. The free transferability of shares in close corporations serve the purpose maintaining the proportionate interests of the shareholders which is vital for the success of the business. It is this same subject which is the target of frequent litigation, exacerbated by the lack of legislation to cover the situation. Therefore, precedents have been used leading to the adoption of common law standards in dealing with stock restraint issues, which although the Author admits is satisfactory, still necessitates a more objective norm.

In elaborating on stock transfer restrictions, the Author first discusses the validity of the concept in general. Next, he details what are considered valid restrictions and the usual types of restrictions employed, particularly that of consent restraint and first option restraint. In comparing the two, he concludes that it is through consent restraint that a close corporation can more effectively achieve its objectives in imposing stock transfer restrictions. He also enumerates the statutory requirements in the statement of stock transfer restrictions in a stock certificate pursuant to the Uniform Stock Transfer Act and the Uniform Commercial Code, the reasons for such requirements, and the manner of construing laws on the subject. With regard to the validity of the transfer price of restrictive shares in option type restrictions, he notes that inadequacy of price alone does not constitute a ground for forfeiture or fraud. Instead, jurisprudence point towards ascertaining the merit of the corporation's goal in adoption such a restriction.

He also discusses the validity of stock transfer restrictions created or removed by charter amendment subsequent to incorporation and issuance of shares, noting that there is an evident conflict of opinions with regard to the extent of the reserved power to amend. The Author submits that the majority view, holding that such power extends to the contract between the corporation and the shareholder, subject to equitable limitations and including those who may have dissented, is more responsive both to the needs of a corporation itself and for the purpose in which restriction was established.