Michigan Law Review

Volume 48 | Issue 5

1950

TRUSTS-RESTRAINTS ON ALIENATION-INVALIDITY OF VOTING TRUST WHEREIN VOTING TRUST CERTIFICATES WERE MADE INALIENABLE

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TRUSTS—RESTRAINTS ON ALIENATION—INVALIDITY OF VOTING TRUST WHEREIN VOTING TRUST CERTIFICATES WERE MADE INALIENABLE—Two stockholders, controlling a majority of the class B stock of the X corporation, transferred their stock to themselves jointly as trustees for a ten-year period. The trustees were to vote the stock as a unit, and had full voting powers on all matters affecting the corporation. Trustees agreed not to transfer the stock without the approval of both holders, and the holders agreed not to sell their stock or the voting trust certificates. Moreover, on the death of one holder-trustee, the other had an option to purchase all his interest in the stock. In an action in equity to prevent one of the holders from voting his own stock, the bill was dismissed.[1] On appeal, *held,* affirmed. The restraint on alienation of the voting trust certificates was an invalid restraint and being inseparable from the rest of the agreement invalidated the entire trust. *Tracey v. Franklin,* (Del. 1949) 67 A. (2d) 56.

The court in this case recognized that restraints upon the alienation of corporate stock are generally treated in a more lenient manner than restraints upon other forms of personalty. It cited a number of cases in which restraints established in the charters of corporations were upheld as reasonably necessary to the operation of the corporations.[2] Indeed, the court cited with approval several cases in which stockholders agreed to restrain their own powers of alienation in order to

[1] Tracey v. Franklin, (Del. Ch. 1948) 61 A. (2d) 780.

[2] Lawson v. Household Finance Corp., 17 Del. Ch. 343, 152 A. 723 (1930); New England Trust Co. v. Abbott, 162 Mass. 148, 38 N.E. 432 (1894); Nicholson v. Franklin Brewing Co., 82 Ohio St. 94, 91 N.E. 991 (1910); Baumohl v. Goldstein, 95 N.J. Eq. 597, 124 A. 118 (1924); Casper v. Kalt-Zimmers Mfg. Co., 159 Wis. 517, 149 N.W. 754, 150 N.W. 1101 (1914); Sweetland v. Quidnick Co., 11 R.I. 328 (1876); Garrett v. Phil. Lawn Mower Co., 39 Pa. Super. 78 (1909); Searles v. Bar Harbor Trust Co., 128 Me. 34, 145 A. 391 (1929).

further a joint purpose.[3] However, it insisted that in the instant case the only valid purpose was the creation of a voting trust, as such were expressly authorized by statute.[4] It found that in furtherance of such a purpose, a restraint upon the stock itself was necessary, but not the restraint placed upon the beneficial ownership of the stock. For the latter, the court could find no good reason, and held it to be arbitrary and void. In so doing, the express option of purchase in the survivor was dismissed as being merely "incidental" and subordinate to the restraint. The approach of the court herein is difficult to understand. The stated reason for creating the trust was "to prevent the acquisition of control of said Class B stock by sundry other interests" in order to "secure competent and able management."[5] It is hard to see why, in accordance with that purpose, it would not be permissible to restrain alienation of the beneficial interest in the stock for the period of the trust. Considering the option together with the restraint provisions, the entire agreement seems aimed at maintaining legitimate control during the period of the trust, and at insuring against the loss of control immediately upon the trust's termination because an outsider had purchased a beneficial interest during its term. The Massachusetts Supreme Court, speaking through Justice Holmes, has held that "there seems to be no greater objection to retaining the right of choosing one's associates in a corporation than in a firm."[6] Yet the Delaware court could find no substantial reason for the restraint. The court refused to consider the trust as a spendthrift trust because it was created by the beneficiaries for themselves, although no such distinction was made by the statute recognizing such trusts.[7] In this view the court was supported by substantial common law authority,[8] although a Michigan case has held that a trust created by a settlor for his own benefit could create valid restraints upon voluntary aliena-

[3] Williams v. Montgomery, 148 N.Y. 519, 43 N.E. 57 (1896) allowed four stockholders to place 99% of the company's stock in a bank, with agreement not to sell any of it until the treasury stock had been sold, or six months had passed. The court said this aided the holders by not glutting the market, and aided the company by helping it sell treasury stock so it was all right. Cook Ry. Signal Co. v. Buck, 59 Colo. 368, 149 P. 95 (1915) permitted a restraint on stock sale while a contract for the sale of treasury stock to a third party was in effect. Penthouse Properties, Inc. v. 1158 Fifth Ave., 256 App. Div. 685, 11 N.Y.S. (2d) 417 (1939) authorized restraint upon the assignment of lease or stock in a co-operative apartment without the consent of the directors or two-thirds of the stockholders.

[4] Del. Rev. Code (1935) §2050.

[5] Tracey v. Franklin, supra, note 1.

[6] Barrett v. King, 181 Mass. 476 at 479, 63 N.E. 934 (1902). Casper v. Kalt-Zimmers Mfg. Co., supra, note 2, at 522, contains the language: "The personal element is as important in the make-up and management of a corporation as it is in almost every other undertaking." Moses v. Soule, 63 Misc. 203, 118 N.Y.S. 410 (1909) indicates that a quarreling directorate is an evil thing, and that restraints which tend to prevent this are good. See also F.S. III, "Restraints on Alienation of Corporate Stock," 26 VA. L. REV. 354-362 (1940) for a survey of the situation and arguments for permitting restraints, at least in close-held corporations. If these opinions do not apply in all cases, they would appear to be pertinent in an instance like the present where two men held a majority of one class of stock, with voting rights.

[7] Del. Rev. Code (1935) §4415.

[8] TRUSTS RESTATEMENT §156 (1), and comment *e* (1935); 54 AM. JUR., Trusts §166 (1945); Byrnes v. Comr., (C.C.A. 3d, 1940) 110 F. (2d) 294, following Pennsylvania law.

tion, albeit not upon seizure by creditors.[9] Moreover, Professor Griswold, while recognizing that the common law rule is otherwise, has urged that there is no reason to differentiate between trusts created by others and those created by the beneficiary. Thus a settlor ought to be able to guard against his own creditors, provided that a limit to the size of the trust be set.[10] If one takes the view that a property owner ought not to be allowed to defeat his creditors, it still does not necessarily follow that he ought not to be able to transfer from himself such control over his property as ordinarily enables him to alienate it. On the other hand, if one agrees with Professor Griswold as to involuntary alienation, surely a settlor should be able to restrain his own alienation. Had either of these two views been adopted by the court, there would have been no need for its investigation of the reasonableness of the restraints. Finally, while the court agreed that the provisions of contracts might be severed, it refused to separate the fatal restraint on alienation of the voting trust certificates from the valid restraint on the stock itself. Had this been done, the former might have been struck down while the remainder of the voting trust would have survived. However, the court said that the restraint on the certificates was an essential part of the agreement, and that without it to effectuate the "reasons expressed in the recitals," the contract would never have been made. It is difficult to understand how this squares with the previous statements of the court that there was no good reason for this restraint. Either it was unimportant and severable, or it was a necessary incident of the trust comparable to the valid restraint on alienation of the stock itself and should have been upheld. On either ground, not to mention the spendthrift trust possibilities, it would seem that this trust ought to have been sustained and enforced.

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[9] Hackley v. Littell, 150 Mich. 106, 113 N.W. 787 (1907). See also Brahmey v. Rollins, 87 N.H. 290, 179 A. 186, 119 A.L.R. 8 (1935) to the effect that a differentiation ought to be made between voluntary and involuntary restraints.

[10] GRISWOLD, SPENDTHRIFT TRUSTS §557 (1947); Costigan, "Those Protective Trusts Which are Miscalled 'Spendthrift Trusts' Reexamined," 22 CAL. L. REV. 471, 492 (1934).