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LIABILITY OF SUBSCRIBER TO STOCK OF A CORPORATION BEFORE ITS ACTUAL FORMATION

In view of the great impetus given to manufacturing concerns throughout the country within the past few years, and the ever-increasing number of corporations being formed every year, the question of just what the liability of a subscriber to stock of a corporation before its actual formation is one which has grown proportionally in importance and complexity. And this complexity is increased by the diversity of the corporation laws of the various states, and the conflict in the decisions of the chief tribunals of the states of the United States.

But before proceeding to take up the liability of the subscribers to a corporation before its inception and actual formation, it may be well to distinguish between an agreement or promise to subscribe in the future and a present actual irrevocable subscription.

An agreement or promise to subscribe in the future to the stock of a corporation before formation is not irrevocable and binding on the person subscribing in the sense that it is a continuing offer which can be accepted by the corporation at any time in the future and makes the person agreeing to subscribe liable as a subscriber, for the full value of the stock. As was said in *Thrasher v. Pike County R. Co.*, 25 I. 393, where the defendants signed a paper as follows; "We, the undersigned, agree to subscribe to the stock of the Pike County Railroad, the sums set against our names, when the books may be opened for subscriptions," and the plaintiffs endeavored to hold the defendants for the par value of the shares for which they had agreed to subscribe, the court held that "an undertaking to subscribe a certain amount of stock when books shall be opened does not make the subscriber a stockholder and as such liable to calls." But the court in this case went further and said, "Such a promise is like an agreement to purchase any specific article of property; if there has not been a delivery of or an offer to deliver the stock, the measure of damages is not the value of the stock, but only such damages should be awarded as would result from the loss of a bargain." This same opinion is voiced in *Mt. Sterling Coalroad Co. v. Little*, 14 Bush (Ky.) 429, *Rhey v. Ebensburg, etc., Plank Road Co.*, 27 Pa. 261, and in *Van Schaick v. Mackin*, 113 N. Y. S. 408.

Whether a contract for subscription of stock is a mere agreement to subscribe for stock in the future or is a present subscription requiring

no further action or agreement by the parties signing is a question of construction and intention. And it is now almost universally held that unless a contrary intention is clearly shown, an agreement to subscribe to the stock of a corporation to be newly organized is a continuing offer to the corporation, in other words a present subscription which becomes of binding effect when the corporation is organized as proposed and accepts the offer. This view is sustained in *Bullock v. Falmouth, etc.*; *Turnpike Road Co.*, 85 Ky. 184, 3 S. W. 129; *Shelby County R. Co. v. Crow*, 137 Mo. App. 461, and *Snodgrass v. Zander*, 106 Ark. 462, 154 S. W. 212.

Now let us return to the chief subject under discussion, namely, the "Liability of a subscriber to stock of a corporation before its actual formation." In 14 *Corpus Juris*, Sec. 753, it is said, "Properly speaking, subscriptions to the capital stock of a corporation are mutual agreements made upon the formation of a corporation to take and pay for the shares of its capital stock. They are usually in the shape of a mutual agreement in anticipation of incorporation, written and signed by those desiring to be incorporators and stockholders, and it is well established, both upon natural reason and legal authority, that such a subscription to the stock of a corporation is a contract between the corporation on the one side, when expressly or impliedly accepted by it, and the subscriber on the other, and that as such, the courts of justice will enforce it for or against either party." Thus we see that a stock subscription may be a purely common law contract between the subscriber and the corporation, enforceable upon its formation. And this is the view accepted in *Planters, etc., Independent Packing Co. v. Webb*, 144 Ala. 666; *Nebraska Chicory Co. v. Leduicky*, 79 Nebr. 587; *Pacific Mill Co. v. Inman*, 46 Or. 352; *McDowell v. Lindsay*, 213 Pa. 591, 63 Atl. Rep. 130, and *Blunt v. Walker*, 11 Wis. 334.

This general proposition stated above is nevertheless subject to two interpretations, the one being that the signing of the papers is a contract between the subscribers for the benefit of the corporation when formed. So in effect the courts inclinings toward this view really consider the contract of subscription a trilateral contract; an undertaking not only with the corporation but also with the rest of the subscribers to the stock, and furthermore even though the contract is fraudulent as between two of the parties, it is still enforceable for the benefit of the third party. This is the conception of the proposition as laid down by the courts of the state of Missouri in *DeGiverville Land Co. v. Thompson*, 190 Mo. App. 682, and *Shelby County R. Co. v. Crow*,

137 Mo. App. 461. Other cases supporting this view are *Marles Carved Molding Co. v. Stubb*, 215 Pa. 91, and *Philadelphia, etc., R. Co. v. Conway*, 177 Pa. 364. In *Planters & Merchants I. P. Co. v. Webb*, 39 So. 562, it was held: "An agreement by which a person shows an intention to become a stockholder in a corporation is sufficient as a contract of subscription as against both him and the corporation." And in *Nebraska Chickory Co. v. Leduicky* (1907) 79 Neb. 587, the court said: "A subscription by a number of persons to the stock of a corporation to be thereafter formed by them, constitutes a contract between the subscribers themselves to become stockholders when the corporation is formed, upon the condition expressed in the agreement, and as such it is binding and irrevocable from the date of the subscription."

Proceeding now to the second interpretation of the previously announced general proposition we find it to be in substance and to the effect that the signing of the papers by a prospective subscriber is a mere offer to contract. But proceeding further it is more than that, it is a continuing offer becoming binding upon the formation of the corporation. As stated in 14 *Corpus Juris*, Sec. 766. Before the corporation is formed, the subscriptions, as we shall see, are not binding at common law between the subscriber and the proposed corporation, for there is no consideration or mutuality; and, besides this, the other party to the contract, the corporation, is not yet in existence; but the formation of the corporation and express or implied acceptance of the subscriptions by its supply the element of consideration and the other party, and render them binding." This is the doctrine laid down in *McNaught v. Fisher*, 96 Fed. 168; *Danbury, etc., R. Co. v. Wilson*, 22 Conn. 435; *Richelieu Hotel Co. v. International Military Encampment Co.*, 140 Ill. 248. In *McNaught v. Fisher*, 96 Fed. 168, Judge Thomas in speaking of the contract of subscription says: "This contract, until accepted by the corporation, existed only as to the subscribers thereto, but upon such acceptance, the corporation became a party to it, and it became binding according to its terms." So we plainly see that according to this theory the signing of the papers of subscription is a continuing offer to contract, becoming binding upon the formation of the corporation.

But now recurring once more to the general proposition that a stock subscription may be a common law contract between the subscriber and the corporation when formed, we find that said doctrine also has its limitations, in fact, is hedged about by many limitations, the most important of which is that like any other contract, the terms

of the contract must be strictly fulfilled by both parties, and a breach or nonfulfillment of the contract by the corporation will release the subscriber from liability. As Judge Brace stated in *Haskell v. Worthington*, 94 Mo. 560, "Where a corporation, incorporated under the general law requiring that the amount of its stock be stated in the certificate of incorporation, enters into active business with less capital stock subscribed than the amount thus stated, a subscriber, who is not estopped by his acts from making such defense, cannot be held to his subscription." These words from this Missouri case plainly show that the terms of the contract must be strictly fulfilled in order to make the contract of subscription of binding effect, and other cases supporting this doctrine are *Salem Mill-dam v. Roper*, 6 Pick 23; *Cabut and West Springfield Bridge v. Chapin*, 6 Cush. 50, and *Worcester and Nashua R. R. Co. v. Hinds*, 9 Cush. 110. And this is the prevailing rule throughout the country and is sustained by the decisions of most of the tribunals which have passed upon that subject.

E. C. H.