Subscriptions to Stock in a Corporation to be Organized

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a real clearing house for the ideas of the bar and perform a function which few state law quarterlies are able to perform because they do not have supporting them such an active and interested bar as there is in West Virginia.

Needless to say in asking for comment on the various proposals discussed in the Quarterly the editorial staff desires adverse comment as well as favorable comment. It is only by publishing the adverse opinions as well as the favorable opinions on any proposition that any real benefit can be accomplished.

**Subscriptions to Stock in a Corporation to be Organized.**—A group of persons may acquire the privilege of being a corporation by organization under the general corporation statutes but since the corporation to be formed must have stockholders, subscriptions to the stock must be secured in advance. This is commonly done by drawing up a subscription paper and having the subscribers sign the same. Under our law these subscribers cannot be bound by contract to a non-existent corporation. The courts in suits involving subscriptions to stock in corporations to be formed, have usually held that the subscription amounts to an offer by the subscriber to the corporation to take the amount of stock indicated, which offer the corporation, after it comes into being, may accept or reject, but being a mere offer it is revocable by the subscriber at any time before its acceptance by the corporation.\(^2\)

The corporate promoter is a relatively new legal phenomenon.\(^3\) Prior to his appearance on the scene as an active business agency, the law had not had to deal with any situation where a person was negotiating and entering into large and important business arrangements for the benefit of a legal personality yet to be brought into existence but which such person, if his scheme succeeds, can bring into being. Hence the difficulty in fitting the activities of the promoter into the mosaic of legal rules and principles. But presumably the promoter is with us to stay, and since some

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1 The discussion does not include subscribers who sign the corporation paper as subscribers under the provisions of Ch. 54 § 6 of the Code. Such subscribers must be held bound from the time such incorporation paper is filed. See Greenbrier Industrial Exp. v. Rodes, 37 W. Va. 738, 17 S. E. 365 (1893).

2 See 14 C. J. 512-13; MACHEN, CORP., §249.

one has to assume the burden of organizing new corporate enterprises, it is only fair that the law afford the promoter some means of binding the subscribers to their promises in an effective manner. It will be assumed that it is desirable that the law do this. The question is how may this result be best accomplished?

So far as the cases in this state go there appears to be no serious obstacle in the way of working out such result provided the courts can be persuaded the result is desirable, but no one has so far shown the way. Such subscription contracts as happen to be quoted in the decided cases in the state show little evidence of any attempt to so bind the subscriber. While it may be uncertain whether it is possible to draft a subscription contract which the courts will hold effectively binds the subscriber, it is certain that there is nothing to be lost by making the attempt, and if the attempt be intelligently made there seems an excellent chance of success.

It will occur to almost any lawyer that the subscription paper may be so worded as to make the various subscribers contract with each other to take the various amounts of stock as promised, yet this is almost useless, since if one subscriber makes a breach the others can neither specifically enforce the contract, nor can they usually recover more than nominal damages. Certainly they cannot recover the full amount of the subscription. The same is also to be said as to making a contract between the subscriber and the promoter, for if the latter sues at law for a breach he will be unable to secure as damages anything near this amount of the subscription, and frequently he will get no more than nominal damages.

It is plain that any effective means of binding the sub-

4 "Not less apparent than the legal right to take subscriptions is the utility of the procedure. The procurement of articles of incorporation and the organization effected under them, involve labor and expense. Hence it is both advantageous and desirable to have a guaranty of the success of the proposed organization before entering upon it. This is no more than an ordinary business precaution, the right to which ought not to be denied in the absence of a legal prohibition thereof." Windsor Hotel Co. v. Schenk, 76 W. Va. 1, 5, 84 S. E. 911 (1915).

5 See Martin v. Cushwa, 86 W. Va. 615, 104 S. E. 97 (1920); Martin v. Rothwell, 81 W. Va. 631, 95 S. E. 189 (1918); Windsor Hotel Co. v. Schenk, supra, n. 4; Clarksburg Board of Trade Land Co. v. Davis, 77 W. Va. 70, 86 S. E. 929 (1915); Greenbrier Industrial Exp. v. Rodes, supra, n. 1; Railroad Co. v. Applegate, 21 W. Va. 172 (1895); Kimmins v. Wilson, 8 W. Va. 594 (1876).

6 No serious attempt seems to have been made to draft a contract under which the subscribers may be prevented from withdrawing without the consent of promoters or other subscribers before incorporation is completed.

7 See 14 C. J. 526.
scriber must be one under which the full amount of the subscription may be recovered—in effect specific enforcement of the subscription contract. Under the present well settled law if the corporation is duly formed and accepts the subscriber's offer, it may then tender the stock and recover the amount of the subscription in an action at law, thus in effect securing specific enforcement, so if some way can be devised by which the corporation may complete the contract or may enforce payment of the promised amount the desired result may be accomplished. A sealed offer running to the proposed corporation would be of doubtful value for, while an offer under seal is generally held irrevocable, yet the sealed instrument must take effect on delivery and at that time a designated obligee must exist. A sealed contract between subscriber and promoter would probably not be of any advantage whatever since, there is here usually no difficulty in so drawing the agreement as to furnish sufficient consideration to support the promise of the subscriber and thus bind him by simple contract.

1. It has been suggested that if the subscription contract binds the subscriber to the promoter, it is a contract made for the benefit of the proposed corporation, and therefore the corporation after organization may sue on said contract as a beneficiary. Our Court of Appeals has said such a contract is enforceable under our sole beneficiary statute, but it may be argued that such contract is not made for the sole benefit of the corporation and hence will not fall within

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8 See 14 C. J. 537; Railroad v. Applegate, supra, n. 5.
9 The effect of seals is abolished as contracts involving real estate. W. Va. Code Ch. 72, §26.
10 WILLISTON, CONTRACTS (2d ed.) §61.
12 See cases cited in MACHEN, CORPS., §249.
13 "The subscribers do not promise to pay one another. On the contrary each promises to pay the corporation the amount of his subscription and no other person. The promise is clearly one for the sole benefit of the corporation to be formed and brings it within the scope and operation of §2, ch. 71 Code, serial §3740. That the corporation had at the date of the contract only a potential existence, seems to be immaterial." Windsor Hotel Co. v. Schenk, supra; n. 4, at page 6.
14 To the effect that it is not necessary that the beneficiary be in existence at the time the beneficiary contract is made see WILLISTON, CONTRACTS, §378.
the statute. But assuming the corporation may sue as beneficiary on the contract between subscriber and promoter, can it recover the amount of the subscription as damages? Suppose the subscriber, before the organization of the corporation declares to the promoter he will never perform. Since the time of performance is still in the future, this can be treated by the promoter as an anticipatory breach of the contract but is the promoter compelled to so treat it? The point is in doubt. It is arguable that he may treat the contract as still in force, bring the corporation into being and it then may consider the contract as still existing. Failure by the subscriber to pay, when payment was actually due, would be an actual breach of the contract for which the corporation should be able to sue and recover full damages. This would then be a method by which the desired result might possibly be accomplished. Its chief defects lie in the doubt as to whether it is a sole beneficiary contract and within the statute, and in whether or not the corporation could recover the full amount of this subscription as damages.

2. The contract between the subscriber and the promoter may be so worded and to make it clear to the subscriber, for a valuable consideration moving from the promoter, makes an offer to the proposed corporation to subscribe for stock, the offer to remain open a stated time. This would seem to give to the proposed corporation an option

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14 While the Court of Appeals in Windsor Hotel Co. v. Schenk, supra, n. 4, said such a contract falls within the statute, the point is certainly arguable. Machen asserts the contract is clearly not solely for the benefit of the proposed corporation. See Machen, supra., §249. But his argument is that the promoters and subscribers have great interest in enforcing the contract. This is true enough but it must be noted that the direct benefit is to the proposed corporation and nothing will even be payable unless it is duly organized. The promise thus runs directly to it. The benefit which the promoter and other subscribers will derive comes indirectly as a result of the formation of the corporation. The contract seems not to belong either to the debtor-creditor type or the sole beneficiary type of beneficiary contract. See note in The Bar, Nov. 1916, 424. If a contract is not a sole beneficiary contract—if the other party has a pecuniary interest in its performance, though an indirect one, then this sort of contract does not fall within the statute and the court's dictum seems erroneous.

15 Logically the mere fact one party chooses to repudiate before the time for performance ought not necessitate a recognition of such repudiation as a final breach of the contract, and in England it seems to be so held. Frost v. Knight, L. R. 7 Ex. 111 (1872). But in this country it is held, that after breach the injured party must not go on with the contract, where the result will be to enhance the damages, and by reason of the application of this rule damages a result contra to the English view is reached in very many cases. But this particular rule of damages does not prevent the injured party proceeding where the result will be to lessen the damages. At least in the case of the subscription under discussion there is a serious question whether or not the promoter must treat repudiation as a breach or whether he may go on with the corporate organization and refuse to recognize such breach. Unless the corporation can sue on the contract and recover the amount of the subscription, this theory is not of great value. As to whether or not the repudiation must be recognized by the injured party, see Williston, Contracts, §§1298, 1299.
to accept the subscription at any time before the option expires. Since an option given by one contracting party to the other for a valuable consideration is irrevocable, no reason is seen why the fact the offer or option runs to a third party—the proposed corporation—should change the rule. If this option is irrevocable by the subscriber then the corporation after it comes into existence may accept it, thus making a contract between the subscriber and the corporation, which the latter may sue upon and recover the amount of the subscription. Here then is a second method by which the desired result might possibly be accomplished.

3. Another method is to have the subscriber contract with the promoter and in said contract have the subscriber expressly make the promoter his attorney to make the subscription for the subscriber after the corporation comes into being, with an express stipulation that this power of attorney is to be irrevocable. Declaring a power of attorney is to be irrevocable of course does not necessarily make it so, but such declaration may nevertheless be an aid in inducing a court to so hold. At least it makes the intention of the parties clear. There is authority to the effect that a power of attorney such as suggested above is irrevocable by the subscriber, though probably these cases go about as far as any in the books in holding powers of attorney irrevocable. But if we are right in assuming the subscriber ought to be held to his promise, then there seems no reason

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16 See Williston, Contracts, §61.
17 That where there is a contract among subscribers to take stock this constitutes an offer to the corporation which is irrevocable, see Minneapolis Threshing Machine Co. v. Davis, 40 Minn. 110, 41 N. W. 1026 (1889); Nebraska Chickory Co. v. Lednick, 79 Neb. 587, 113 N. W. 246 (1907). Contra are usually cited Packet Co. v. Webb, 156 Ala. 551, 46 So. 977 (1908); Bryant's Pond Steam-Mill Co. v. Folt, 87 Me. 234, 32 Atl. 583 (1896); Hudson Real Est. Co. v. Tower, 161 Mass. 10, 36 N. E. 659 (1894); Muney Track. Engine Co. v. Green, 143 Pa. 239, 15 Atl. 747 (1888). Even in the cases in accord the right of the corporation to recover as beneficiary, and its right to recover because it has accepted the offer or option, irrevocable because on consideration furnished by the subscribers, have not been clearly noted by the court. The decisions are something of a reliance on both. On the other hand many of the cases cited as being contra, admit that if the subscriber is bound by contract to the other subscribers, or to the promoter, then the offer to the proposed corporation is irrevocable. No good reason seems to be given in any of them why, if it is clear there is a contract with the promoter by which the subscriber agrees to extend an offer to the corporation, such offer or option should be revocable. Our court in Windsor Hotel Co. v. Schenck, supra, n. 4, by way of dictum asserted the option would be irrevocable.
18 See discussion of irrevocable powers in Mecham, Agency, §§677 et seq. It would seem this is a power coupled with a contract as given in his analysis and therefore might be held irrevocable by the party during his lifetime though it would probably be revoked by his death.
why the courts should not hold such a power of attorney irrevocable. If it be irrevocable, then the promoter may enter the subscription for the subscriber and the corporation may accept it, thus making a valid contract between the subscriber and the corporation, under which the latter could recover the amount of the promised subscription.

4. In one jurisdiction it seems established law that the subscribers may bind themselves to pay the money over to a trustee who undertakes to turn it over to the corporation after organization, and to get stock in exchange for the same, which stock he agrees to give to the subscriber, and under this agreement the trustee may sue for the money and recover it after the time for payment has arrived. Furthermore the contract may be made to provide for the payment of money at any time the parties desire, and this need not await the completion of the corporate organization. If this should be sustained by our court it would furnish an excellent method of procedure for the promoter, in so far as the legal possibilities of binding the subscribers effectively are concerned. Whether as a practical matter subscribers could be induced to sign is another consideration.

It is not contended the above list of suggestions are exhaustive. Others as good or better may occur to the practitioner. It may be noted that the first three of the above suggestions may be incorporated in the same subscription paper so that the corporation, after its organization, may assert its right against the subscriber on three distinct theories, all of which, if the matter necessitates an action at law, could probably be set up in one action. The language may be so worded as to (1) bind the subscriber by contract to the promoter and to this should be added an express statement that the contract is intended to be for the sole benefit of the proposed corporation; (2) provide that the subscriber therein makes an offer to the proposed corporation said offer to remain open and irrevocable for a stated period; (3) provide that the subscriber give to the promoter express authority to enter into the subscription contract with the corporation for said subscriber, with a
further provision declaring this power of attorney is to be irrevocable. Needless to say such a subscription paper ought to be very carefully drafted. Among other things it should make clear there is sufficient consideration supporting all promises of the subscriber, and also that the offer to the corporation is an option given it, supported by consideration moving from the promoter. The fourth suggested method of procedure probably cannot be advantageously combined in the same subscription paper with the other three even though the promoter were expressly named as trustee.

In conclusion one may say that any of the above suggested methods might lead to success, but the manner in which the Court of Appeals will look upon such an attempt will depend largely upon the degree to which the attorneys in charge are able to convince the court of the desirability of having a method by which the promoter of a corporation can bind the subscribers effectively. One might venture to hope that if a choice be made it will not be the beneficiary contract theory but rather one of the others. There seems no reason why there might not be such a thing as an irrevocable power of attorney to make a subscription contract with a corporation to be formed. Certainly a promoter may secure an option for the proposed corporation and it should be permitted to take advantage of such option.

—JAMES W. SIMONTON.

CHANCERY HEARINGS IN OPEN COURT.—At its meeting in Wheeling on October 7 the West Virginia Bar Association unanimously went on record as in favor of a proposed amendment to §26 of chapter 131 of the present Code. This section, as will be remembered, provides that chancery causes may, by leave of the court, and by agreement of counsel for the parties, be heard and determined in open court. The proposed amendment provides that hereafter they may be heard in open court by leave of the court on motion of either counsel or shall be so heard on the motion of counsel for all parties. In other words, whereas the present situation provides for a hearing in open court on con-

22 But the language of the court in Windsor Hotel Co. v. Schenk, supra, n. 4, is encouraging.