TWO POINTS OF REFORM OF PHILIPPINE CORPORATE LAW

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FORMATIVE SUBSCRIPTIONS

It is generally recognized that there are essential differences between subscriptions before and after incorporation. The binding effect of subscriptions after incorporation is well settled,[1] which is not the case with those before. American courts are in irreconcilable conflict as to the legal character of subscriptions before incorporation. The question is frequently presented in case subscribers withdraw their subscriptions before incorporation is completed. Whether the subscribers in this case may do so with impunity or not is much disputed. And whether after incorporation the corporation must signify, expressly or impliedly, acceptance of the subscription made before incorporation also creates some difference of opinion.[2] Because of the peculiar nature of subscriptions before incorporation, we are limiting this discussion to them. And for a proper evaluation of the policies behind the conflicting views, we begin by presenting the theories to which courts have adhered.

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[1] On subscriptions after incorporation, see FLETCHER, CYCLOPEDIA OF CORPORATIONS, 1931. Permanent edition, sec. 1414. "Where subscriptions for shares are made after a corporation has been formed, the shares are 'issued' or created by agreement and the subscriber becomes an owner of shares forthwith simply by mutual assent, even though the rights of a shareholder of record may be withheld as security . . . The effect of a present subscription when a company is in existence is to make the subscriber liable as a debtor to pay the subscription price for the shares." BALLANTINE ON CORPORATIONS, 1946, p. 450. See also 1 MACHEN, MODERN LAW OF CORPORATIONS, 1908, sec. 182; 1 MORAWETZ, PRIVATE CORPORATIONS, 2nd ed., sec. 60.

[2] "Whether the mere fact of incorporation amounts to such an acceptance of the subscription as will render the same binding and irrevocable is a question that seems to be definitely settled in the United States. There is a formidable array of authorities to the effect that the formation of the corporation does have this effect, without any positive act of acceptance on the part of the corporation. There is apparently only one American case, and that from a territorial jurisdiction, which expressly holds that the corporation must do some positive act of acceptance after it comes into existence, in order to render a subscription binding." BALLANTINE, STERLING, AND BUHLER, CALIFORNIA CORPORATION LAWS, 1949, p. 162, citing *Gillespie v. Camacho*, 28 Haw. 32. See discussion, *infra*, however.

The "Offer" Theory.

Most American courts, following the "offer" theory, construe the subscriptions as only continuing offers to the proposed corporation which do not ripen into contracts until accepted by the corporation when organized. And this is true even should the subscriptions be in terms to and with each of the subscribers.[3] The obvious result of this theory is to allow withdrawal of subscribers at least before the corporation comes into existence and accepts the offer, as before this time no contract is perfected. Thus, a subscriber can gamble, at no risk to himself, about the results of his investment. If the issue be popular and therefore oversubscribed, he can take his shares and sell them at a premium. But if, on the other hand, he believes the issue will not be popular, he may withdraw without any liability attaching to his act. These considerations naturally seriously impair the efforts of those who are trying to organize the corporation, specially as our law requires a definite amount of subscription before the articles may be filed.[4] The unjust working of this unilateral arrangement is justified in *Bryant's Pond Steam Mill Co. v. Felt* [5] by "the fact that such subscriptions are often obtained by over persuasion, and upon sudden and hasty impulses" and, therefore, the rule of law may not be said to be "founded in wisdom." [6] The only trouble with this reason is that while it applies equally to post-incorporation subscriptions, a different conclusion is reached here, for a contract at once results. Again, it may be asked whether the policy of the law should not rather be to attribute intelligence to one person as much as to another and let everybody suffer from or reap the benefits of his acts. There are many things that can be said against a rule of law that allows a person to give his consent and then investigate afterwards and in favor of one that compels him to investigate first and then decide afterwards.[7]

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[3] FLETCHER, *op. cit.*, secs. 1425 and 1427; STEVENS, HANDBOOK OF THE LAW OF PRIVATE CORPORATIONS, 1936, secs. 83 and 84; BALLANTINE, MANUAL OF CORPORATION LAW AND PRACTICE, 1933, sec. 33; Rufe, Pre-incorporation Subscriptions Versus Present Subscription to Stock, 26 Georgetown Law Journal, 753; Notes, 34 West Virginia Law Quarterly, 79; 61 A. L. R. 1497.

[4] See Edmund Belsheim, The Need for Revising the Texas Corporation Statutes, 27 Texas Law Review, 659, 666.

[5] 87 Me. 234, 32 Atl. 888, 33 L. R. A. 593, 47 Am. St. Rep. 323.

[6] This is quoted with approval in *Collins v. Morgan Grain Co.* (1926: C. C. A. 9th), 16 F. (2d) 253. See also Frey, Modern Development in the Law of Pre-incorporation Subscriptions, 79 University of Pennsylvania Law Review, 1005, 1012-1013.

[7] "I would conjure the Legislature not to trench upon that sacred and golden principle of political economy—not to interfere with the mode in which individuals employ, or even squander their money, not to lay restrictions upon that freedom for the paltry object of protecting those who will not use their energies or their sense to

The "offer" theory is worked out from the law of contracts. The analogy, however, fails for while in ordinary contracts there are both offerors and offerees, in our case the contemplated corporation has not yet come into existence. To consider the offer as continuing and, therefore, as if made at the time the corporation comes into existence is a twisting of the facts, for it is not so made in fact. Neither may analogy be drawn between the contemplated corporation and a conceived child [8] for no one ever imagines contracting with it, except, perhaps, giving a gift to it, which does not come within the purview of contract law. It is not any good to consider the subscriptions as made with an agent of the proposed corporation, for then there would be an agent for a principal that does not exist.[9] Again, if we grant the legal possibility of there being an agent of a non-existing principal, this destroys the theory, as the subscriptions become perfected contracts between two able parties.[10] The Bryant case indicated, though holding otherwise, that there must be an offeree, for the formative subscription is a "mere *nudum pactum*,—a promisor without a promisee; a contractor without a contractee. In fact every element of a binding contract is wanting."[11]

The subscription contract, even in those jurisdictions following the "offer" theory, may, however, be so worded as to create a present binding obligation among the subscribers and thus become irrevocable.[12] It was, however, pointed out that the effect of the contract

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protect themselves." Leguleine, quoted in HUNT, THE DEVELOPMENT OF THE BUSINESS CORPORATION IN ENGLAND, 1800-1867, 1936, p. 40.

[8] In *Cagayan Fishing Development Co., Inc. v. Sandiko*, 36 O. G. 1118, 1119, the Supreme Court said: "A corporation, until organized, has no life and therefore no faculties. It is, as it were, a child *in ventre sa mere*." The Supreme Court refused to recognize the contract of sale of several parcels of land entered into by an organization, five months before it was incorporated, as a valid act of the corporation after its incorporation.

[9] "For reasons that are self-evident, these promoters could not have acted as agents for a projected corporation since that which had no legal existence could have no agent." *Cagayan Fishing Development Co., Inc. v. Sandiko, supra.* See also *Kelner v. Baxter*, L. R. 2 C. P. Cas. 174; *Abbott v. Hapgood*, 150 Mass. 248.

[10] See Lukens, The Withdrawal and Acceptance of Pre-incorporation Subscriptions to Stock, 76 University of Pennsylvania Law Review, 423, 425-427; Schwenk, Pre-incorporation Subscription: The Offer Theory and What Is an Offer? 29 Virginia Law Review, 460, 469; Morris, The Legal Effect of Pre-incorporation Stock Subscriptions, 34 West Virginia Law Quarterly, 219; Frey, *op. cit.*

[11] New York courts entertain the same view. *Avon Springs Sanitarium Co. v. Weed*, 119 App. Div. 560, 104 N. Y. Supp. 58 (4th Dept. 1907, reversed 189 N. Y. 557, 82 N. E. 1123); *Avon Springs Sanitarium Co. v. Kellog*, 121 App. Div. 928, 106 N. Y. Supp 1116 (4th Dept.), after reargument, 125 App. Div. 51, 109 N. Y. Supp. 153 (S. Ct. 1908), affirmed, 194 N. Y. 567, 88 N. E. 1132 (1909).

[12] See notes, 34 West Virginia Law Review, *op. cit.*; FLETCHER, *op. cit.*; sec. 1425; STEVENS, *op. cit.*, pp. 333-334; BALLANTINE, MANUAL OF CORPORATION LAW AND PRACTICE, 1936, p. 117; Schwenk, *op. cit.*

would simply be to deprive the subscriber of his right to withdraw but not also of his power to do so. For in the event of withdrawal, the corporation cannot enforce specific performance, although the other subscribers may claim damages for breach of contract.[13] This is small comfort for those who are earnestly organizing a corporation, since the measure of damages, if recoverable, must necessarily be speculative and difficult.

Under the "offer" theory, in case there is no withdrawal, a further consideration arises as to when the subscription is considered accepted. Is the subscription accepted *ipso facto* by the mere fact of the corporation coming into existence or must there be acceptance, express or implied by the corporation? Dicta are abundant that the fact of legal existence, without more, is sufficient acceptance and the subscriber may not thereafter withdraw.[14] Some authorities, on the other hand, indicate that acceptance is necessary,[15] although this may be express or implied. On the bases of both policy and reason, acceptance should be required; reason, because an offer results in a contract only when accepted; and policy, because when the corporation sues on the subscription courts invariably find acceptance, while if the subscriber sues to enforce his rights it is usually difficult to show that there is. Frey, although arguing that there must be acceptance, justifies the rule that incorporation alone should mean acceptance in:

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[13] In *Deschamps v. Loiselle*, 50 Mont. 565, 145 Pac. 344, recovery of damages was, however, denied. In *Eden v. Miller* (1930, C. C. A. 2d) 37 F. (2d) 8, the subscribers were allowed to sue for such damages as they could prove. This case is noted in 44 Harvard Law Review, 126. See also Schwenk, *op. cit.*, *Osborn v. Crosby* (1885) 63 N. H. 583, 3 Atl. 429; *Philadelphia Medical Publishing Co. v. Wolfenden* (1915) 248 Pa. 450, 94 Atl. 138.

[14] *Balfour v. Baker City Gas Co.* (1895), 27 Ore. 300, 41 Pac. 164; *Auburn Bolt Works v. Shultz* (1891), 143 Pa. 256, 22 Atl. 904; *Muncy Traction Engine Co. v. De la Green* (1888), 143 Pa. 259, 13 Atl. 747; *Bole v. Fulton* (1912), 233 Pa. 609, 82 Atl. 947; *Jeannette v. Bottle Works v. Schall* (1900), 13 Pa. Super. 96; *Kramer v. Hamsher* (1916), 63 Pa. Super, 311; *San Joaquin Co. v. Beecher*, (1894), 101 Cal. 70, 35 Pac. 349; *Twin Creek Co. v. Lancaster* (1881), 79 Ky. 552; *Bullock v. Falmouth Co.* (1887), 85 Ky. 184, 3 S. W. 129; *Cartwright v. Dickinson*, 88 Tenn. 476, 12 S. W. 1030.

[15] *Steely v. Texas Improvement Co.* (1909), 55 Tex. Civ. App. 463; 119 S. W. 319; *Martin v. Rothwell* (1918), 81 W. Va. 681, 95 S. E. 189; *Buffalo & Jamestown R. Co. v. Gifford* (1882), 87 N. Y. 294; *Yonkers Gazette Co. v. Taylor* (1898), 30 App. Div. 334, 51 N. Y. Supp. 969; *Martin v. Cushwa* (1920), 86 W. Va. 615, 104 S. E. 97; *Red Wing Co. v. Friedrich* (1879), 26 Minn. 112, 1 N. W. 827; *Collins v. Morgan Grain Co.* (1926), 16 F. (2d) 253 (C. C. 9th); *McCormick v. Great Bend Co.* (1892) 48 Kan. 614, 29 Pac. 1147; *Penobscot R. Co. v. Dummer* (1855), 40 Me. 172; *Stone v. Walker* (1917), 201 Ala. 130, 77 So. 554; *U. S. Pump Co. v. Davis* (1895), 2 Kan. App. 611, 42 Pac. 590.

> ". . . (1) that capital is the most desperate need of a newly formed corporation, and technicalities of 'acceptance,' etc. must not be permitted to hinder its acquisition, and (2) that when a new enterprise has progressed to the point of formation of the corporation, so many persons might be adversely affected in such various ways by the failure of a subscriber to make his agreed contribution to the common fund that the most feasible procedure is to accord the corporation a right to the subscription price." [16]

In refutation, it may be argued that, if the need for capital were as urgent, as well it may be, acceptance should not be difficult to make. Again, since the corporation is privileged to choose its stockholders and can, therefore, reject some subscriptions, acceptance should be as clear as rejection.[17]

The "Contract" Theory.

Under the "contract" theory, followed in only a few jurisdictions,[18] a subscription agreement among several persons to take shares in a proposed corporation becomes a binding contract and is irrevocable from the time of subscription unless cancelled by all the parties before acceptance by the corporation. This is generally known as the minority rule.

The subscription is treated as a contract among the subscribers to pay for stock in a proposed corporation on the one hand and as an offer to subscribe on the other.[19] In *Coleman Hotel Co. v. Craw-*

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[16] *Op. cit.*, note 6, pp. 1019-1020.

[17] See Notes, 8 Columbia Law Review, 47, 48. It is said that "in view of the tendency to make subscriptions binding as soon as possible it (acceptance by mere incorporation) is likely to prevail." See also BALLANTINE ON CORPORATIONS, 1946, sec. 190a.

[18] FLETCHER, *op. cit.*, secs. 1419 and 1426; BALLANTINE, *supra*, sec. 75. See also *Linkart v. Heelan* (1939), 136 Neb. 492, 286 N. W. 780; *Nebraska v. Lednicky*, 79 Neb. 587, 113 N. Y. 245, noted in 8 Columbia Law Review, 47; *Coleman Hotel Co. v. Crawford* (1928: Tex. Comm. App.), 3 S. W. 2d 1109, reversing (1927: Tex. Civ. App.), 290 S. W. 810. The Coleman case is noted in 7 Texas Law Review, 312 and 27 Michigan Law Review, 467. See also *Chicago Bldg. & Manufacturing Co. v. Lyon*, 10 Okla. 704, 64 Pac. 6; *Hughes v. Antietam Manufacturing Co.* (1871), 34 Md. 316; *Glenn v. Busey*, 5 Mackey (D. C. 233); *Utah Hotel Co. v. Madsen* (1913), 43 Utah 285, 134 Pac. 577; *Lake Ontario, A. & N. Y. R. Co. v. Mason* (1857), 16 N. Y. 451; *Johnson v. Wabash & Mt. V. Pl. Road Co.* (1861), 16 Ind. 389. It is said that although many cases contain dicta on the contract theory, only the Coleman case is direct authority. 61 A. L. R. 1481.

[19] In an *obiter dictum* in *Minneapolis Threshing Co. v. Davis* (1889), 40 Minn. 110, 3 L. R. A. 796, 12 Am. St. Rep. 701, 41 N. W. 1026, the court said: "A subscription by a number of persons to the stock of a corporation to be thereafter formed by them has in law a double character: First. It is a contract between the subscribers themselves to become stockholders without further act on their part, immediately upon the formation of the corporation. As such a contract, it is a binding contract and

ford,[20] the Texas Commission of Appeals held the subscription irrevocable as a contract among the subscribers supported by good consideration. The Court said:

> "The mutual promises of the subscribers to the agreement in question, whereby each subscriber would, if the promises made therein should be carried out, obtain the advantage of pecuniary benefits resulting from the operation of the enterprise contemplated by the proposed corporation, is amply sufficient as a consideration to constitute a valid and enforceable contract."

It will thus be seen that the "offer" phase of the subscription referred to in other cases is omitted. It should, however, be observed that even under the Coleman case it is difficult to imagine how the corporation may enforce the contract, since the subscription agreement was entered into by the subscribers, the corporation not being a party to it.[21] It would be more reasonable to authorize the other subscribers to sue for damages rather than have the corporation enforce a subscription that is withdrawn.[22] The right of the corporation to enforce the subscription agreement may only be sustained under the theory that the corporation was a third party beneficiary under an agreement *pour autrui*. This would be an extension of the subscription agreement, not express but assumed.[23] The basis on which the third party beneficiary rule rests is that the agreement to subscribe for stock is for the sole benefit of the corporation. Two important objections to the third party beneficiary theory become clear, at

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irrevocable from the date of the subscription (at least in the absence of fraud or mistake), unless cancelled by consent of all the subscribers before acceptance by the corporation. Second. It is also in the nature of a continuing offer to the proposed corporation, which, upon acceptance by it after its formation, becomes as to each subscriber a contract between him and the corporation." The decision was based on the second proposition. See also FLETCHER, *op. cit.*, sec. 1426; and BALLANTINE, *op. cit.*, sec. 190.

[20] *Op. cit.*, note 18, *supra*.

[21] See COOK, CORPORATIONS, 8th ed., sec. 167; FLETCHER, *op. cit.*, sec. 523.

[22] See *Planter's and Merchant's Independent Packet Co. v. Webb* (1908), 156 Ala. 551, 46 So. 977, 16 Ann. Cas. 529; *Hudson Real Estate Co. v. Tower* (1892), 156 Mass. 82, 32 Am. St. Rep. 434, 30 N. E. 465 (later appeal in 161 Mass. 10, 42 Am. St. Rep. 379, 36 N. E. 680).

[23] In *Windsor Hotel Co. v. Schenk* (1915), 76 W. Va. 1, 84 S. E. 911, the court said: "If it is a contract among the subscribers, each subscription being founded upon the others as consideration therefore, a contract is thus made for the sole benefit of the corporation. 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." See also Notes, 8 Columbia Law Review, 47.

least, under our law: First, Under our law,[24] a *pour autrui* contract must contain a clear or express intention to benefit a third party.[25] This is much to be desired in subscription agreements. Second. If the stipulation *pour autrui* is a donation, then the subscription must be accepted by the corporation in form as provided for donations.[26] The "contract" theory, however, requires no acceptance by the corporation because the contract becomes effective upon subscription and although the corporation has not yet been organized. In fact the legal character of the subscription derives force not from acceptance by the corporation but from the contract of the subscribers among themselves.

Frey, analyzing the theory, enumerates the following conflicting results:

> "Under the 'contract' theory either of these conflicting results would seem analytically possible: (1) that by virtue of his subscription the subscriber at once becomes a member of an 'association' and that when this association is transformed into the contemplated corporation, he automatically becomes a shareholder in such corporation of the shares designated in his subscription; (2) that the subscription is an offer which the subscriber has no power to revoke without the consent of the other parties to the contract; (3) that the subscription is an offer which the subscriber has the power to revoke without the consent of the other parties to the contract, but the subscriber is under a duty to such other parties not to exercise this power of revocation without their consent." [27]

The conclusion from above analysis is, of course, that the "contract" theory is miserably inadequate to explain the modern development of the law governing formative subscriptions.

Assertion is made [28] that the Supreme Court of the Philippines, in *Velasco v. Poizat*,[29] decided that a "stock subscription is a contract between the corporation on one side and the subscriber on the other." It may well be under the facts of the case, which bear no relation at all to the point under discussion. Jean M. Poizat, de-

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[24] *Uy Tam and Uy Yet v. Leonard*, 30 Phil. 471. This case contains an exhaustive review of the law on *pour autrui* contracts.

[25] ". . . First, that a stipulation *pour autrui* must be clearly expressed; . . ." *Ibid.*, p. 488.

[26] "Manresa says that the second paragraph of this article corresponds almost always to the juridical conception of a gift, it being necessary in such case to apply the rules relating to gifts in so far as the form of acceptance is concerned. This is true where the stipulation is for the sole benefit of the third person." *Ibid.*, pp. 474-475.

[27] *Op. cit.*, note 6, p. 1006. See also Lukens, *op cit.*, note 10, *supra;* and Morris, *op. cit.*, note 10, *supra.*

[28] FISHER, THE PHILIPPINE LAW OF STOCK CORPORATIONS, 1929, p. 83.

[29] 37 Phil. 802, 805.

fendant in this case, was a subscriber to the stock of the Philippine Chemical Product Company, together with several others. He paid twenty-five per centum of his subscription, leaving the balance unpaid at the time of suit. The corporation was organized, Poizat acting for some time as treasurer and manager. When the corporation failed and went into bankruptcy, Poizat claimed exemption from payment of his unpaid subscription claiming the same privilege of another stockholder, whose remaining unpaid subscription was assumed by other shareholders upon forfeiture of some fully paid stocks. This being a suit by the assignee in insolvency, no other conclusion was possible except that a contract bound Poizat to the corporation to pay the unpaid subscription. The conclusion could have been premised on either the "offer" or "contract" theory and the result would be the same. Had Poizat withdrawn from his subscription before the Company came into existence a different case, material to us, would have been presented.

One serious objection to the "contract" theory remains. If the corporation is not organized within a reasonable time, the subscriber is tied up for a long time to a project which, after all, may not come through. This may equally impair the economic welfare of society.[30]

From a consideration of the two theories on formative subscriptions, it may be concluded that they are vain justifications of varying policies. They both seek to extend their roots into contract law, although they are not even remote relations of the latter. When one is determined to reach a conclusion, I suppose he will get there irrespective of valid premises. But since premises are necessary to give force to the conclusion, they may be supplied from other areas of the law no matter whether they be specious adoptions. The law developed by courts on formative subscriptions is peculiar to corporate law and is quite apart from the law of contracts.

Subscription as Requisite to Incorporation.

Subscriptions appearing on the articles of incorporation, when such subscriptions are required by statute as preliminary to incorporation, have been held binding and irrevocable from the time the articles are drawn, irrespective of the fact that incorporation has not then resulted.[31] This rule seems true, however, only in respect

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[30] See Little, The Illinois Business Corporation Law, 28 Illinois Law Review, 997, 1004.

[31] *Hughes v. Antietam Mfg. Co.*, (1871) 34 Md. 316; *Lake Ontario, A. & N.Y.R. Co. v. Mason*, (1857) 16 N.Y. 451; *Johnson v. The Wabash & Mt. Vernon Plank-Road Co.*, (1861) 16 Ind. 389; *Jones v. Milton & R. Turn. Co.*, (1856) 7 Ind. 547; *Poughkeepsie & S. P. Pl. Road Co. v. Griffin*, (1861) 24 N. Y. 150; *Sodus Bay & C. R. Co. v. Hamlin*, (1881) 24 Hun (N. Y.) 390; *Seacoast Packing*

to those subscribers who sign the articles of incorporation. Under our law, however, only the incorporators, the number of whom is limited, need sign the articles, it being evident that many subscribers do not sign the articles. The rule cannot be brought into operation by the mere expedient of having the subscribers' names appear in the articles without their signatures. There are cases which even hold that the rule does not apply where preliminary articles are signed but the subscriber does not sign the articles as filed.[32] Consequently, those who do not sign the articles of incorporation may withdraw, under the "offer" theory, before the corporation comes into existence.

It may, of course, be said, for the purpose merely of bringing about corporate existence, that not much paid in capital is necessary. Since the law requires subscription of only twenty per centum of the entire number of "authorized shares" and payment of twenty-five per centum of the subscription, the shares may be so classified that the subscribers under the articles can subscribe for shares having the least value. This will not, however, solve in any manner the pressing need of a new corporation for operating capital nor will this afford protection to creditors.

Recent American Legislation.

To do away with all the difficulties set forth above and to do justice, at the same time, to subscribers, the Uniform Business Corporation Act recommended a provision as follows:

> "SECTION 6. *Subscriptions for Shares Before Incorporation.*—
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> "I. Subscriptions for shares of a corporation to be formed shall be in writing. Unless otherwise provided in the writing, the subscription shall be
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> "(a) irrevocable for a period of one year from the date of signing, except as provided in subdivision II of this section;
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> "(b) revocable after a period of one year from the date of signing, unless prior to such revocation a certificate of incorporation has been issued as provided in Section 5.
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> "II. Subscriptions for shares may be revoked at any time by either party upon such grounds as exist at law or in equity for the rescission of any contract.
>
> "III. Upon the issue of the certificate of incorporation, subscriptions for shares may be enforced by the corporation according to their terms unless revoked as provided in this section.

Co. v. Long, 116 S. C. 406; *Lowville & B. R. R. Co. v. Elliot*, 101 N. Y. Supp. 328; *Anderson v. The Newcastle and Richmond Rail-road Co.*, (1859) 12 Ind. 376; *Rehbein v. Rahr*, (1901) 109 Wis. 136; *Campbell v. Raven*, (1913) 176 Mich. 208.

[32] *Poughkeepsie & S. P. Pl. Road Co. v. Griffin, supra; Shiffer v. Akenbrook*, (1921) 75 Ind. 149.

> "IV. When no provision as to the time of payment is made in the contract of subscription, shares shall be paid for on the call of the board of directors."

The drafters, commenting on above provision, said:

> ". . . It is to the interest of each subscriber that the others shall be bound, and it accords with public policy that the new corporation should have, as resources, enforceable subscriptions if fairly obtained. Seldom do the incorporators subscribe for all the shares. It would be inconvenient, and it would seem to be unnecessary, to require every subscriber to sign the articles. Accordingly, the effect . . . is to put incorporators and subscribers before incorporation on the same footing: the subscriptions are irrevocable, and upon incorporation, both incorporators and subscribers automatically become shareholders." [33]

It may be said, in passing, that the recommended provision does not infringe upon the freedom of the parties to contract as they will. They may still provide for the revocability of their subscriptions, irrevocability only resulting from failure to provide anything in the writing. Neither does the provision bind the subscriber indefinitely, for the period of irrevocability is limited.

Washington,[34] Idaho,[35] Kentucky,[36] and Louisiana [37] adopted the provision without change. Illinois,[38] Oklahoma,[39] and Minnesota [40] adopted the same provision with slight modifications. California [41] and Michigan,[42] although not adopting the Uniform Business Corporation Act provision, have solved the confusion by enacting express provisions in their laws.

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[33] The drafters patterned the provision after secs. 14 and 24 of the English Companies Act of 1908. On the Cohen Report, No. 20, see Freund, Company Law Reform, 9 Modern Law Review, 235, 243.

[34] Sec. 3806-6, Remington's Revised Statutes, 1931, as amended and supplemented.

[35] Sec. 30-108, tit. 30, ch. 1, Idaho Code.

[36] Sec. 271.075, Revised Statutes, 1948.

[37] Sec. 1086, General Statutes, 1939.

[38] Sec. 16, Business Corporation Act, 1933.

[39] Sec. 31, Business Corporation Act, L. 1947.

[40] Sec. 301.17, Business Corporation Act, 1933.

[41] "Every subscriber to shares and every person to whom shares are originally issued is liable to the corporation for the full consideration agreed to be paid for the shares." Sec. 1300, California Corporations Code. This solution is timid and leaves many of the problems for judicial decision. See BALLANTINE, STERLING AND BUHLER, CALIFORNIA CORPORATION LAWS, 1949, p. 162.

[42] "Upon the filing of the articles in the office of the secretary of state the corporate existence shall begin and those persons who subscribed to shares prior to the filing of the articles, whether by signing the articles or otherwise, or their assigns shall be shareholders in the corporation." Sec. 450.5, par. 2, General Corporation Act, Public Acts, 1931—No. 327. It is apparent from this provision that it does not resolve as much as the Uniform Business Corporation Act.

We are not aware that the policies apparent from a reading of the quoted proposal have been disputed at all. There is a general feeling that disputes arising from differing views of the nature of formative subscriptions should be concluded. This can be done effectively only by legislation. It is important that the liberty to contract be preserved and this, the proposal has done. It is also important that subscribers should not be allowed to speculate on the stocks of the corporate venture. This is accomplished if no revocation clause is provided in the contract of subscription. And if a revocation clause is provided, the promoters of the business venture are at once put on notice of what they may be up to. The time within which the subscription contract shall be irrevocable may be shortened or extended, as suits our convenience, but the idea is to make private capital as liquid as possible and as the prevailing business conditions justify. And not the least important, the law on the point is rendered comparatively certain. Business ventures, for obvious reasons, are afraid of uncertain laws that require needless expenditures to settle through the process of litigation.

THE CORPORATION AS AN INCORPORATOR

There is, perhaps, no principle of corporation law better settled than that without express statutory authorization a corporation may not be an incorporator.[43] This is so to the extent that it is taken for granted and becomes sometimes a point of illustration by which a court reaches a decision. Our Supreme Court used it in this fashion. We quote:

> "In section 173 of the Corporation Law it is declared that 'any person' may become a stockholder in building and loan associations. The word 'person' appears to be here used in its general sense, and there is nothing in the context to indicate that the expression is used in the restricted sense of 'natural person.' It should therefore be taken to include both natural and artificial persons, as indicated in section 2 of the Administrative Code. We would not say that the word 'person,' or 'persons,' is to be taken in this broad sense in every part of the Corporation Law. For instance, it would seem reasonable to say that the incorporators of a corporation ought to be natural persons, although in section 6 it is said that five or more 'persons,' not exceeding fifteen, may form a private corporation. But the context there, as well as the common sense of the situation, suggests that natural persons are meant." [44]

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[43] 1 FLETCHER, CYCLOPEDIA OF CORPORATIONS, Permanent edition, sec. 85, p. 287; CLARK, CORPORATIONS, 1916, p. 67; 1 MORAWETZ, PRIVATE CORPORATIONS, 1886, sec. 433, p. 408.

[44] *Government of the Philippine Islands v. El Hogar Filipino*, 50 Phil. 399, 460-461.

The statement is obviously an *obiter dictum* but is one backed by authorities from which we find no dissent.[45] It would be foolhardy, indeed, to expect a different statement of the law in a case directly presenting the question. So in Alabama,[46] Arizona,[47] California,[48] Colorado,[49] Connecticutt,[50] Delaware,[51] District of Columbia,[52] Florida,[53] Georgia,[54] Hawaii,[55] Iowa,[56] Maine,[57] Massachusetts,[58] Mississippi,[59] Montana,[60] Nebraska,[61] Nevada,[62] New Mexico,[63] New Jersey,[64] New York,[65] North Carolina,[66] North Dakota,[67] Oklahoma,[68] Oregon,[69] South Carolina,[70] South Dakota,[71] Texas,[72] Virginia,[73] and

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[45] *Knowles v. Sandercock*, 107 Cal. 629; *Denny Hotel Co. v. Schram*, 6 Wash. 131, 137; *State ex. rel. v. Vanderbilt University*, 129 Tenn. 279, 327; *Herman v. Brooklyn Sav. Bank*, 187 N. Y. 738, 739; *Schwab v. Potter Co.*, 194 N. Y. 409, 416; *Converse v. Emerson & Co.*, 242 Ill. 619, 626.

[46] Sec. 1, Tit. 10, Code of Alabama, 1940.

[47] Sec. 53-203, Arizona Code Annotated, 1939, ch. 53.

[48] Sec. 300, Tit. 1, California Corporations Code.

[49] Sec. 2, Colorado Statutes Annotated, 1935, ch. 41.

[50] Sec. 5151, General Statutes, Revision of 1949.

[51] Sec. 1, Revised Code of Delaware, 1935, ch. 65.

[52] Sec. 29-201, District of Columbia Code, 1940.

[53] Sec. 612.03, General Corporation Law.

[54] Sec. 22-1801, General Corporation Law.

[55] Sec. 8305. Tit. 21, Revised Laws of Hawaii, 1945.

[56] Sec. 491.1, General Corporation Law, Iowa Code, 1946, ch. 491.

[57] Sec. 8, General Corporation Law, Revised Statutes, 1944.

[58] Sec. 6, ch. 156, General Corporation Law, General Laws of Massachusetts, Tercentenary Edition, 1932.

[59] Sec. 5310, Mississippi Code, 1942, ch. 100.

[60] Secs. 5902 and 5908, General Corporation Law, Revised Codes of Montana, 1935, vol. 3, Civil Code.

[61] Sec. 21-102, General Corporation Law, Revised Statutes, 1943, ch. 21.

[62] Sec. 1602, General Corporation Law, Compiled Laws, 1929.

[63] Sec. 54-206, General Corporation Law, Statutes Annotated, 1941.

[64] Sec. 14:2-1, General Corporation Law, Revised Statutes, 1937. DILLON, CORPORATIONS, 1902, p. 23; *Central R. R. Co. v. Penn. R. R. Co.*, 31 N. J. Eq. 475, 494-495.

[65] Sec. 5, Stock Corporation Law.

[66] Sec. 55-2, General Corporation Law, North Carolina Code, 1943.

[67] Sec. 10-0201, General Corporation Law, Revised Statutes, 1943.

[68] Sec. 10, Business Corporation Act, 1947.

[69] Sec. 77-201, General Corporation Law, Compiled Laws Annotated, 1940, Tit. 77.

[70] Sec. 7726, General Corporation Law Code of Laws of South Carolina, 1942, ch. 153.

[71] Sec. 11.0201, General Corporation Law, South Dakota Code, 1939.

[72] Art. 1303, General Corporation Law, Revised Civil Statutes, 1925, Tit. 32.

[73] Sec. 3849, General Corporation Law, Tit. 35.

West Virginia,[74] where, like our law, the word "person" alone is used in the statutes, we may expect the law to be the same as ours. Some statutes, to remove all doubt, as those of Arkansas,[75] Maryland,[76] New Hampshire,[77] Rhode Island,[78] Tennessee,[79] Vermont,[80] and Wisconsin,[81] use "persons of full age," "adult persons," "persons of lawful age," "persons over the age of twenty-one years," or "adult residents." And as if these were not enough, Idaho,[82] Illinois,[83] Indiana,[84] Kansas,[85] Kentucky,[86] Louisiana,[87] Minnesota,[88] Missouri,[89] again New York,[90] Ohio,[91] Pennsylvania,[92] Washington,[93] and Wyoming[94] expressly require incorporators to be natural persons.

But, paraphrasing our Supreme Court, what is there in the "context of the law" saying incorporators shall be "persons," as well as "the common sense of the situation," which compels a conclusion that incorporators must be natural persons? Why may not corporations do as well? The "context of the law" expounds nothing and "the common sense of the situation" may point the other way. Again, what need is there for legislating that incorporators must be natural persons? Is there anything particularly important about incorporating a corporation so that only natural persons are qualified to do so?

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[74] Sec. 3016, General Corporation Law, West Virginia Code, 1943, ch. 31.

[75] Sec. 64-101, General Corporation Act.

[76] Sec. 3, General Corporation Law, The Annotated Code of the Public General Laws of Maryland, 1929, art. 23.

[77] Sec. 2, General Corporation Law, Revised Laws of New Hampshire, 1942.

[78] Sec. 6, General Corporation Law, Rhode Island General Laws, 1938, Tit. 15,

[79] Sec. 3714, General Corporation Law, Annotated Code, 1934, Tit. 9.

[80] Sec. 5754, General Corporation Law, Revised Statutes, 1947.

[81] Sec. 180.01, General Corporation Law, Wisconsin Statutes, 1933.

[82] Sec. 30-102, Idaho Code, Tit. 30.

[83] Sec. 46, The Business Corporation Act; 1 The Chicago Bar Association, *Illinois Business Corporation Act Annotated,* 1947, p. 218.

[84] Sec. 25-213, Burns Annotated Statutes, 1933, art. 2.

[85] Sec. 17-2701, General Corporation Code, General Statutes, 1939.

[86] Sec. 271.025, Revised Statutes, 1948, ch. 271.

[87] Sec. 1081, Business Corporation Act, General Statutes, 1939.

[88] Sec. 301.03, Business Corporation Act, 1933.

[89] Sec. 49, General and Business Corporation Act, 1943; Pearcy, Missouri Corporation Law, 1948, p. 310.

[90] Sec. 7, General Corporation Law.

[91] Sec. 8623-4, General Corporation Act, 1927; TOWNSEND, OHIO CORPORATION LAW, 1940, Permanent Revised Edition, p. 28; 1 DAVIES, OHIO CORPORATION LAW, 1942, pp. 142-143.

[92] Sec. 201, Business Corporation Law, Act No. 106, L. 1933.

[93] Sec. 3803-2, Washington Corporation Act, Tit. 15, Remington Revised Statutes of Washington, 1931, as amended and supplemented.

[94] Sec. 44-101, General Corporation Law, Wyoming Compiled Statutes, 1945.

Not much light is shed by writers and court decisions on the policy of the doctrine as stated in the beginning. Historically, if credence be given to Kyd,[95] the spectacle of one corporation being inside another would be nothing new. So, proceeding upon the suggestion of this author, the court, in *Regents v. Williams*,[96] elaborated as follows:

> ". . . It is sufficient to say of a corporation aggregate, of which various definitions are to be found in the books, some fanciful and metaphysical, that it is an artificial intellectual being, the mere creature of the law, composed generally of natural persons in their natural capacity; but may also be composed of persons in their political capacity of members of other corporations, as in the case of *Christ's Hospital of Bridewell*, chartered by Edward VI of which the mayor, citizens, and commonalty of London, are made the governors, and incorporated by the name of the governors, etc., of the hospital of Edward VI of England, of Christ Bridewell—so in the cases of the Universities of Oxford and Cambridge, of which the many colleges (distinct and separate corporations), within those universities, form component parts of those larger corporation."

But then neither Kyd nor above case said a corporation may be an incorporator of another. And, indeed, so well established is the general proposition that these statements are considered no authority to overthrow it. Said Fletcher of the Regents case:

> ". . . But this case either on its facts or in its dicta is not authority for the proposition that corporations may act as incorporators unless the law expressly allows it and if there is no private act of the legislature incorporating them. Clearly other corporations are not within the meaning of the word 'persons,' 'incorporators,' 'commissioners,' and the like, as used in modern statutes within the meaning of this chapter and it has been many times so decided."[97]

In the light of the settled doctrine, we can pick up no quarrel with Fletcher; Morawetz[98] did mention Kyd but then opined that a corporation may not be an incorporator.[99]

On examination of the early cases in the United States, we find some reasons which may no longer satisfy our cravings for the practical. On the whole, they reduce themselves to the question of authority. So, in *Nebraska Shirt Co. v. Horton*,[100] in denying suit by a receiver in bankruptcy of a corporation to enforce a subscrip-

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[95] TREATIES ON THE LAW OF CORPORATIONS, 1793, pp. 32-37.
[96] 31 Am. Dec. (1838) 72, 83.
[97] 1 FLETCHER, *supra*, sec. 85, note 36, p. 288.
[98] 1 MORAWETZ, PRIVATE CORPORATIONS, 1886, sec. 35, p. 35.
[99] *Ibid.*, sec. 433, p. 408.
[100] 93 N. W. 225.

tion contract by another corporation,[101] the court said: "Corporations have quite enough power without allowing them to incorporate themselves in new companies." With the same end in view, but disclosing the premise of the conclusion, some courts examine the nature of a corporation. Thus, it is said that "It is elementary that corporation are the creatures of the law, either by special and express legislation, or under general and formal statute authorizing their formations. In either case, they have only such powers or rights and incur only such obligations, as are conferred or imposed, expressly or impliedly, and as are necessary, and inherent to their existence." [102] From this premise, it was easy to give vitality to the ancestral abhorrence of corporations. Judges could not imagine why a corporation which "has no soul to be damned, and no body to be kicked" should be empowered to incorporate other corporation. The strongest statement of this fear is found in *Schwab v. Potter Co.*[103] as follows: " 'Artificial persons,' without brain or body, existing only on paper through legislative command and incapable of thought or action except through natural persons, can not create other 'artificial persons,' and those, others still, until the line is so extended and the capital stock so duplicated and reduplicated, as to result in confusion and fraud." The logic is unassailable once the premise is accepted. The "fiction" theory of corporate personality invades this area of the law. This is hardly the occasion to discuss a subject that has engaged the attention of scholars and philosophers for many centuries now. It is sufficient at this time to remark that the judges have done a good job of confusing the means with the ends. The problems of business life are better solved by pragmatism or empiricism than by slavish loyalty to concept formulations. Once we are cognizant that behind the premise was the policy of inhibiting corporations, now gone or nearly so, we shall no longer hesitate to substitute a different premise and thus arrive at a contrary conclusion.

What we have said in the foregoing paragraph is, however, incomplete without an additional consideration. Stock ownership by a corporation in another was, for the first time, authorized by a gen-

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[101] Subscription and incorporation, as corporate powers, belong ot the same category and are so treated, though not always. See, for instance, PEARCY, MISSOURI CORPORATION LAW, 1948, p. 30.

[102] *Insurance Company v. Harbor Protection Company*, 37 La. 233, 237. See also *Converse v. Emerson & Co., supra; Schwab v. Potter Co., supra*, 416.

[103] *Ibid.*

eral law in New Jersey in 1888.[104] Before that time special charters granted the power sparingly and courts were not inclined to favor such power in the absence of express grant. Reviewing the public prejudice against corporations, Justice Brandeis, in his dissent, said: "The power to hold stock in other corporations was not conferred or implied. The holding company was impossible." [105] It was against this background that courts also held that corporations could not themselves be incorporators. And although corporations are now generally empowered by general laws to own stocks in other corporations, we still carry to this day a relic of the past. The principle we are discussing, thus, draws support exclusively from the "fiction" theory of corporate personality.

As the rule rests on a very insubstantial ground, we find exceptions now and then. So in *Kardo Co. v. Adams,*[106] the court found no fault in a corporation using dummies who organized another corporation.[107] The same holding was arrived at in *Durham v. Firestone Tire Etc. Co.*[108] In this last case, the court also held "that under the law of Arizona a corporation is not prohibited from subscribing to or holding the stock of a new corporation whose purpose is naturally subsidiary to, and in aid of, the business of the old corporation." [109] It would be interesting to speculate whether Arizona would allow a corporation to be an incorporator itself.[110] There is no sense in the law denying to a principal an act that it allows to be done by his agent. Besides, the use of dummy incorporators is quite general, for the law attaches little or no importance to incorporators. Their function is extremely ceremonial. As Fletcher says: "Corporators are mere instruments of the law for purposes of preliminary organization. The moment that is accomplished, the amount required as capital paid in, the necessary certificate signed, and the charter granted, they are *functi officio,* or, more accurately, they may then become stockholders. They exist before stockholders, and do not exist with them, for it is said that 'when stockholders come in, corporators cease to be.' " [111] And if a corporation, under certain

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[104] Compton, "Early History of Stock Ownership by Corporations," 9 George Washington Law Review, 125. See Public Laws of New Jersey, ch. 259, p. 385.

[105] *Louis K. Ligget Co. et al v. Lee et al.,* 288 U. S. 517, 541.

[106] 231 Fed. 950.

[107] See 1 DAVIES, OHIO CORPORATION LAW, 1942, 142.

[108] 47 Ariz. 280.

[109] *Ibid.,* pp. 288-289.

[110] The same is not possible in the case of Ohio, under whose jurisdiction the Kardo case was decided.

[111] FLETCHER, *supra,* sec. 81, p. 279.

limitations, are allowed to invest in other corporations,[112] why not empower it to incorporate these other corporations? A well known writer sees no reason why corporations should not be allowed to become incorporators, in proper cases, of new corporations.[113]

Realizing that there is possibly no hope of reversing the judicial attitude, Michigan expressly empowers a corporation to incorporate other corporations. It goes further by authorizing partnerships, which are not even juridical entities under its law, to act as incorporators. The Michigan law provides:

> "'Incorporator' shall be a *natural person who, or a corporation or a partnership which,* signs the articles." [114]

It is submitted that this indicates the proper direction towards which the law should grow, especially as an erring corporation may be subject to question by the State.[115] Indeed, under the Corporation Law the Securities and Exchange Commissioner may refuse to register the articles of incorporation where a corporation appears as an incorporator, unless there are a sufficient number of natural persons to meet the legal requirement.

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[112] This is generally recognized now and is so by the Corporation Law. Sec. 13, par. 10, Act No. 1459, as amended by Act No. 3518.

[113] "It would therefore seem wiser to permit corporations, for proper purposes, to be incorporators of a new company. Qualified statutory authority for this is found in some states, where permission is given a corporation to reincorporate or reorganize, or, with other corporations, to consolidate into a new corporation." STEVENS ON CORPORATIONS, 1949, pp. 266-267, citing for the last statement section 7 of the New York General Corporation Law, amended in 1929 so as to confine it to instances of consolidation.

[114] Sec. 450.2, General Corporation Act, Public Acts, 1931, No. 327.

[115] *Vinegar Co. v. Foehrenbach,* 148 N. Y. 59, 66.