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Corporations: Validity of a Contract to Issue Stock for Future Services

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It seems extremely unlikely that the legislature would recognize an enforceable right to collect inhering directly in the creditors, with no right at all in the corporation at the time. Hence this Section seems to assume an already existing liability to the corporation, as also is indicated in its language, "until the . . . captal stock, . . . shall have been paid in.", which clearly refers to payment to the corporation. Very possibly Judge Brantly's decision would have been the same had this Section been argued before him, since he stated that he would bow only before a positive provision repealing the subscriber's defense. However, to a mind not already made up, this Section seems extremely persuasive, particularly when considered cumulatively with the evidence that a corporation has a right to commence business as soon as its certificate of incorporation is issued.[25]

—Ben Berg, Jr.

CORPORATIONS: VALIDITY OF A CONTRACT TO ISSUE* STOCK FOR FUTURE SERVICES

The MONTANA CONSTITUTION Article XV, Section 10, contains a clause similar to that found in the constitutions or statutes of many other states. It provides:

> "No corporation shall issue stock or bonds, except for labor done, services performed, or money and property actually received; and all fictitious increase of stock or indebtedness shall be void. . . ."

In *Kirkup v. Anaconda Amusement Co.*[1] the Montana Supreme Court was called upon to construe the phrase "labor

[25]As always is true where presumptions are to be indulged in, they may point in both directions at once. It would be possible to say that though this Section's language is unqualified, there still is room for the operation of the implied conditions; ie., that the operation of the Section is contingent upon a liability by the defendant to the corporation so that the implied condition precedent would protect the subscriber against both the corporation and the creditor under this Section. Again, it would be possible to consider this statute as being an extremely enlightened provision seeking to more adequately protect the interests of all persons entitled to such protection, giving the corporate creditor the amount of relief that he absolutely needs, even though the stockholder may have a defense against the corporation under the impoled condition precedent. Both rationalizations are highly improbable in view of both the history of our CODE, and of the wording of the Section itself.

*The term "issue" is used herein to mean the *allotment* of stock as *fully-paid* shares—not the mere formal issuance of a share certificate.

[1](1921) 59 Mont. 469, 197 P. 1005, 17 A. L. R. 441.

done, services performed". In that case the plaintiff sued the defendant corporation for damages for breach of contract, alleging that he and one of the promoters of the defendant had before incorporation entered into an agreement by which after incorporation[3] plaintiff was to sell 4150 shares of the capital stock at par, and was to receive as his commission either the 415 shares remaining after the sale of 3735 shares, or $4150 cash, at his option. He further alleged that after defendant was incorporated, it "did agree with plaintiff to comply with the terms and conditions of said contract," and accepted the money from the sale of 770 shares, but then refused to retain plaintiff any longer or accept any more money, and refused to pay or issue stock. The lower court overruled defendant's demurrer to the complaint and gave plaintiff $4150 damages, but on appeal the Supreme Court reversed the lower court, on two grounds: first, that the complaint failed to show an assumption[4] of the contract by the corporation on any theory;[5]

[3]FREY, at page 196 in his CASES AND STATUTES ON BUSINESS ASSOCIATIONS (1935), treats the Kirkup case as one involving a question of the issuance of stock for *pre-incorporation* services, instead of *post-incorporation* services. However, the plaintiff's allegations (which we must accept as a true statement of the facts, since defendant demurred generally) show clearly that the contract contemplated services to be performed *after* incorporation.

[4]In discussing previous cases in which courts had held corporations liable on the contracts made by their promoters with third parties, the Montana court seemed unable to decide what name should be used to describe the grounds on which the corporations were held. The court considered in turn the terms *ratification*, *adoption*, *continuing offer*, and *novation*, but apparently felt that no one of them accurately fitted *all* the cases. It is submitted that instead of trying to find a term to describe *every* type of case the court should look to the peculiar facts of each case and use that term which most nearly expresses the apparent intent of the parties. *Cf.*, for the application of these terms, Fitzpatrick v. O'Neill (1911) 43 Mont. 552, 118 P. 273, Ann. Cas. 1912C, 296; Deschamps v. Loiselle (1915) 50 Mont. 565, 148 P. 335; *Words and Phrases* (Perm. ed. 1940) Vol. 2, pp. 484-485; Vol. 28, pp. 864-894; Vol. 36, pp. 118-138; BALLANTINE, CORPORATIONS (1927) §47, pp. 156-160; STEVENS, CORPORATIONS (1936) §42, pp. 187-192.

[5]Plaintiff's counsel contended that since the agreement sued on was a *promoter's* contract, it was not necessary for plaintiff to show an express novation in accordance with strict statutory provisions, but that a showing merely that the corporation accepted the benefits with knowledge of the contract would make it liable thereon. The court, after referring to the Montana statutes on novation (R. C. M. 1935, §§7460-7463), said that whenever a litigant sets out to plead a *novation* of *any* kind of contract, he must allege four essential requisites: (1) A previous valid obligation; (2) The agreement of all the parties to the new contract; (3) The extinguishment of the old contract; and (4) The validity of the new one. It then held the complaint defective in failing to allege these four things.

The court admitted that many courts have held corporations liable, even though no novation was pleaded, on the theories of *adop-*

and secondly (the point pertinent to this comment), that even if plaintiff *had* alleged the necessary facts to show such an assumption, he could not recover, for the original contract by the promoters was made in violation of the Constitutional provision above and was therefore void.

In reaching its conclusion on this second point, the court seemed confused. It started out in its interpretation of the Constitution using the term "issue" of stock, and then in the next breath switched to the phrase "contract to issue," treating them for all purposes as synonomous. This is unfortunate, for there is nothing in the language or spirit of the Constitutional provision, properly construed,[5] which forbids the making of such a contract as the one involved in the Kirkup case.[6]

To begin with, let us look at the wording of the phrase "No corporation shall issue stock . . . except for labor done, services

tion or *ratification*, but said that the facts here alleged weren't sufficient to show an assumption of the contract under either theory. The holding at this point seems questionable. Plaintiff alleged that the corporation (to quote the court) "had knowledge of said contract and did receive moneys from the said plaintiff and did issue its stock therefore under the terms of said contract, and did agree with plaintiff to comply with the terms and conditions of said contract." This ought to be sufficient to show an assumption of the contract by the corporation, whichever of the theories—*adoption* or *ratification*—is used to explain it. The A. L. R. annotation to the Kirkup case (17 A. L. R. 441) says at page 497: "If a promoter employs labor for the benefit of a corporation, to be performed either before or after its organization, with the understanding that it is to be paid for by the corporation, the corporation will become liable to pay for it, and otherwise obligated upon the contract, if after its organization, with knowledge of the facts, it acknowledges the contract and accepts the benefits of the services." (Citing cases from 13 states, and Federal and English courts).

[5] 17 A. L. R. 441, at page 464, says in criticism of the holding in the Kirkup case: "There is no question that if the contract is in fact *ultra vires* the corporation cannot be bound by it, but the Constitution permits the issuance of stock for labor performed, and it is common knowledge that a certain amount of labor is absolutely necessary for the establishment of the corporation, and other courts have held that stock may be issued in payment for such labor."

[6] It is not clear from the facts given whether plaintiff had at the time of suit elected to take *stock* or *cash* as his commission under the contract. If he had elected to take *stock*, and was suing for damages for refusal by defendant to issue it, the construction given by the court to MONT. CONST. Art. XV, §10 would clearly prevent his recovery for non-delivery. But if he had elected to take *cash*, and was suing on that theory, couldn't he contend that the invalidity of that part of the agreement giving him an option to take stock should not prejudice his right to take *cash*? Or does the presence of the option to take stock make the whole contract void? The court must have felt that it does void the whole contract, for if it had felt that only the option to take stock was void, it would surely have allowed plaintiff to amend his complaint so as to show that he was suing only on the option to take cash.

performed. . . ." The obvious import of its language is that labor or services, along with money and property, are to be deemed a valid form of consideration for the issue of corporate stock, as long as that labor has been done or those services have been performed *prior* to the time of *issuance* of the stock. The Montana Supreme Court itself, in the case of *Fitzpatrick v. O'Neill*,[7] recognized this construction of the clause, and the courts of other states have given the same interpretation to similar clauses in their constitutions or statutes.[8]

If it is true, as these courts have held, that a corporation can under this clause validly issue its stock for labor done or services performed, the next question is: Can a corporation *contract to do* the same thing at some future date; *i. e.*, does the clause authorize a corporation to *enter into an agreement* by which X is to perform labor or services for it and the corporation is then to issue stock in return? It would seem that the only logical answer to this is in the affirmative, in spite of the holding to the contrary in the *Kirkup* case. If a corporation is empowered to issue stock *today* for services X performed *yesterday,* it certainly should be able to make an agreement to issue stock *the day after tomorrow* for services X is to perform *tomorrow.* This conclusion is well-supported by the courts outside Montana, under similar statutory or constitutional provisions.[9] Even the United States Supreme Court, in the case

[7](1911) 43 Mont. 552, 118 P. 273, Ann. Cas. 1912C, 296. In that case the Montana Supreme Court upheld the issuance of corporate stock for promotion services performed before the time of issuance. No contract appears to have been made in advance of the doing of the services, though, whereas in the Kirkup case there was such a contract.

[8]Calivada Colonization Co. v. Hays (W. D. Pa. 1902) 119 F. 202; Harriage v. Daley (1915) 121 Ark. 23, 180 S. W. 333; Ellsworth v. National Home and Town Builders (1917) 33 Cal. App. 1, 164 P. 14; Wamsley v. Brothers (1922) 152 La. 148, 92 So. 766; Bryan v. Northwest Beverages, Inc. (1939) 69 N. D. 274, 285 N. W. 689. See Randall Printing Co. v. Sanitas Mineral Water Co. (1913) 120 Minn. 268, 139 N. W. 606, 608, 43 L. R. A. (N. S.) 706, 709. And for a similar holding under a Tennessee statute providing that only cash or land at a fair valuation shall be taken in payment for capital stock, see Jones v. Whitworth (1895) 94 Tenn. 622, 30 S. W. 736.

[9]Lake Street Elevated Ry. Co. v. Ziegler (C. C. A. 7th, 1900) 99 F. 114 (applying Illinois Constitution to a contract to issue stock in payment for construction of railroad lines); Turner v. Fidelity Loan Concern (1905) 2 Cal. App. 122, 83 P. 62, 70 (contract to issue stock for "good will, interest, and services in and about the management, formation, and directorship of said corporation"); Arapahoe Cattle Co. v. Stevens (1889) 13 Colo. 534, 22 P. 823 (contract to issue stock for services in procuring a loan); Morgan v. Bon Bon Co., Inc. (1917) 222 N. Y. 22, 118 N. E. 205 (contract to issue stock for services as a bookkeeper); Shannon v. Stevenson (1896) 173 Pa. 419, 34 A. 218 (contract to issue stock in consideration of defendant's leaving an-

of *Fogg v. Blair*,[10] recognized the validity of such a contract under a like provision of the Missouri Constitution. And it is interesting to note that in 1929 the Legislature of Idaho (whose Constitution contains a clause corresponding to Article XV, Section 10 above) passed a law which expressly sanctions a contract of this type.[11]

The facts in most of the cases just cited differ from those in the *Kirkup* case in two respects. Do these differences offer a grounds for reconciling the *Kirkup* case with the others?

In each of the cases cited, the contract in question was originally made by the corporation itself through its directors *after* incorporation, whereas in the *Kirkup* case the contract on which plaintiff sued was allegedly made with promoters *before* the corporation was created and then adopted by the corporation after it had come into existence. Logically this would not seem to be a justifiable basis for the difference in holding. And it is clear from the language of the *Kirkup* case that the court did not base its decision on the grounds that the contract was made

other firm to assume the corporation's presidency). For similar holdings under a Tennessee statute providing that only cash or land at a fair valuation shall be taken in payment for capital stock, see In Re Ballou (E. D. Ky., 1914) 215 F. 810, and Doak v. Stahlman (Tenn. Ch. App. 1899) 58 S. W. 741.

In Mas Patent Bottle Co. v. Cox (1932) 163 Md. 176, 161 A. 243, plaintiff alleged that defendant corporation had made a contract by which he was to sell 2000 shares of its stock, and that after he did so, defendant was to issue to him some stock as his commission. Plaintiff then alleged performance of his side of the contract and prayed for specific performance and an injunction to restrain defendant from disposing of the promised stock elsewhere. Defendant demurred on the grounds that the contract violated the following provision of the Maryland statutes: ". . . nothing in this Article shall authorize the issuance of stock or convertible securities for personal services to be rendered in the future." [CODE PUB. GEN. LAWS SUPP. 1929, Art. 23 §41 (6).] The court overruled the demurrer, saying "our construction of this provision is that it forbids stock or convertible securities to be *presently* issued for services to be performed after such issue," (Italics supplied), and held that the contract plaintiff sued on was valid because by its terms the services were to be performed *before* the issuance of the stock. It is true that the statute involved here is worded differently from the clause of the Montana Constitution in question, but its meaning is exactly the same. Each is so framed as to sanction issuance of stock for services already performed, and to prohibit issuance for services not yet performed.

[10](1891) 139 U. S. 118, 11 S. Ct. 476, 35 L. Ed. 104 (contract to issue stock for repair and construction work on railway).

[11]Ch. 262, §13 II, LAWS OF IDAHO 1929, provides: "Subscriptions for shares may be made payable . . . with cash, other property, tangible or intangible, or with necessary services actually rendered to the corporation. *This shall not prevent the corporation's contracting to pay for future services in stock and issuing the stock under such contract as the services shall be actually rendered.*" (Italics supplied).

before incorporation. For instance, at page 489 of 59 Mont., page 1011 of 197 P., the court says:

> "It is self-evident that the contract for breach of which damages are sought in this action is *ultra vires,* were it considered the obligation of the corporation on any theory. *It could neither be legally entered into by the corporation in the first instance, nor assumed by it when entered into by promoters in advance of its creation.*" (Italics supplied)

The other point at which the facts of the *Kirkup* case differ from those in each of these other cases (except *Mas Patent Bottle Co. v. Cox)*[12] is in the *type* of services called for by the contracts. Here again it is impossible to find grounds for the difference in decision. If services in procuring a loan *(Arapahoe Cattle Co. v. Stevens),*[13] and services in leaving another employment and assuming a presidency *(Shannon v. Stevenson),*[14] and services as a bookkeeper *(Morgan v. Bon Bon Co.),*[15] are valid consideration under such a provision, services in procuring stock subscriptions certainly should be. Indeed, it is difficult to imagine a type of service which is more vital to a corporation than that of selling its capital stock, for every corporation ordinarily must issue at least some of its stock before it can begin to carry on business. Furthermore, the court in the *Mas Patent* case ruled quite positively that services soliciting stock subscriptions are a valid form of consideration for the issuance of shares of stock.

The court in the *Kirkup* case cited *Webster v. Webster Co.*[16] and *Rogers v. Gladiator Gold Mining Co.*[17] in support of its contentions, but neither of these decisions is in point on the real question involved here. In the *Webster* case the services (which the plaintiff there sought to set up as consideration for the issuance of some stock to him) were shown already to have been paid for by the corporation in the form of plaintiff's yearly salary. The court was thus perfectly justified in holding that he couldn't set up those same services as consideration for the stock. And in the *Rogers* case, the court refused to recognize the services involved as consideration for stock of the corporation because they were apparently to be performed for the benefit of a *third party* and not for the corporation. Clearly

[12](1932) 163 Md. 176, 161 A. 243, *supra* note 9.
[13](1889) 13 Colo. 534, 22 P. 823, *supra* note 9.
[14](1896) 173 Pa. 419, 34 A. 218, *supra* note 9.
[15](1917) 222 N. Y. 22, 118 N. E. 205, *supra* note 9.
[16](1912) 36 Okla. 168, 128 P. 261, 47 L. R. A. (N. S.) 697.
[17](1907) 21 S. D. 412, 113 N. W. 86.

these cases don't support the holding in the *Kirkup* case, where the services were being performed for the corporation itself and had not been paid for in any other way.

It is hoped that if the Montana Supreme Court is ever again called on to determine the validity of a contract for issue of stock in return for services to be performed before the date of issue, it will overrule *Kirkup v. Anaconda Amusement Co.* and follow what seems to be the weight of authority—that such a contract is valid.[18]

—Arthur C. Mertz.

EVIDENCE: DECLARATIONS AGAINST INTEREST IN MONTANA

Much confusion still exists regarding the distinction between a declaration against interest and an admission in the Law of Evidence.[1] Under common law rules, it has long been settled that as an exception to the hearsay rule, declarations of persons

[18]There is a further ground on which the holding of the Kirkup case might be questioned: Even assuming that the contract involved *is* one looking to the issuance of stock before the services are to be performed, does it necessarily follow that the contract is utterly *void?* The wording of the constitutional provision does not lead to such a conclusion. Indeed, the fact that it refers to "all fictitious increase of stock or indebtedness" as "void", whereas in its prohibition against issuance of stock except for "labor done, services performed," it does not use the word "void", implies that a violation of this latter prohibition is not to be treated as an utterly *void* transaction. A more reasonable interpretation, and one which would better serve the interests of all the parties involved, would be a holding by which the third person (plaintiff here) would be bound as a stockholder and made to pay to the corporation the difference, if any, between the par value of the stock and value of the services performed. This approach has been followed by many courts in cases involving the so-called "trust fund doctrine" or the "fraud or holding-out theory". See Kelly v. Clark (1898) 21 Mont. 291, 53 P. 959, 69 Am. St. Rep. 668, 42 L. R. A. 621; King v. Pony Gold Mining Co. (1903) 28 Mont. 74, 72 P. 309; John W. Cooney Co. v. Arlington Hotel Co. (1917) 11 Del. Ch. 286, 101 A. 879; Meyer v. Ruby-Trust Mining and Milling Co. (1905) 192 Mo. 162, 90 S. W. 821; Corrington v. Crosby (1926) 54 N. D. 614, 210 N. W. 342, 48 A. L. R. 660; Mitchell v. Bowles (Tex. Civ. App., 1923) 248 S. W. 459; Murphy v. Panton (1917) 96 Wash. 637, 165 P. 1074. It is true that in those cases suit was by creditors of insolvent corporations to force holders of unpaid stock to pay up to par value, but the question involved was the same—namely, what effect should be given to an issue of stock for a consideration less in value than the par value of the stock.

[1]THAYER, A PRELIMINARY TREATISE ON EVIDENCE AT THE COMMON LAW (1898), p. 520. MORGAN, THE LAW OF EVIDENCE, SOME PROPOSALS FOR ITS REFORM (1927) pp. 37-49. 10 CAL. JURIS., *Evidence*, §329, p. 1097; JONES ON EVIDENCE, (4th ed. 1938) §323, p. 600.