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THE ILLEGAL ISSUE AND OVER-ISSUE OF CAPITAL STOCK OF CORPORATIONS.

THE conception of a corporation was taken from the civil law. The susceptibility of corporations to fraud and perversion was soon recognized, so that at the civil law under the empire a special permission from the State for their creation became necessary, and by the pagan emperors was granted with great reluctance: Taylor on Corp. § 4. At the common law a corporation could never be created like a partnership, merely by a contract between the individuals composing it. The right of acting in a corporate capacity is a special privilege, which may not be assumed without authority from some governing power: Morawetz on Pri. Corp. § 4; *State v. Bradford*, 32 Vt. 53. The necessity for these restrictions is occasioned principally by the limited liability of the corporators, and therefore the capital stock, the sole fund to which creditors have recourse, as well as being a favorite subject for investment, is hedged in, jealously, by statutory restrictions.

What is the effect of the illegal creation of certificates of stock by agents of a corporation, who covinously and secretly issue such certificates?

The solution of this question is dependent, in part, upon that of another, which is as to the extent of the liability of a corporation for the acts of its agents. The Maryland Court of Appeals, in *Tome v. Parkersburg Branch R. R.*, 39 Md. 71, adopt the language of Story on Agency, § 452: "It is a gen-

eral doctrine of law, that, although the principal is not ordinarily liable in a criminal suit for the acts or misdeeds of his agent, unless, indeed, he has authorized or co-operated in those acts or misdeeds; yet he is liable to third parties in a civil suit for the frauds, deceits, concealments, misrepresentations, torts, negligence, and other malfeasances or misfeasances and omissions of duty of his agent in the course of his employment, although the principal did not authorize, or justify, or participate in or indeed know of such misconduct, or even if he forbade the acts or disapproved of them. In all such cases the rule applies *respondeat superior*; and it is founded upon public policy and convenience." The Court go on and quote: "As natural persons are liable for the wrongful acts and neglects of their servants and agents, done in the course and within the scope of their employment, so are corporations, upon the same grounds, in the same manner, and to the same extent: *Ang. & Ames on Corp.* § 310; *Albert v. Savings Bank of Baltimore*, 1 Md. Ch. 407; *Thatcher v. Bank of N. Y.*, 5 Sand. 121; *Thompson v. Bell*, 10 Exch. 10; *Bargate v. Shortridge*, 5 H. of L. Cas. 297; *National Exchange Bank v. Drew*, 32 Eng. Law & Eq. 1; *Stevens v. Boston and Maine R. R.*, 1 Gray, 277; *Blackstock v. N. Y. and Erie R. R.*, 1 Bosw. 77.

In the case of the *Western Md. R. R. v. Franklin Bank*, 60 Md. 43, ALVEY, C. J., says, "Strictly speaking, corporations while acting within the scope of the powers delegated to them, cannot be guilty of wilful fraud, yet it is settled by a great number of decided cases, that corporations carrying on trade or business of any kind, are equally and to the same extent liable for the frauds and wrongs of their agents, perpetrated in the course of their employment, as individual principals would be under like circumstances: *Story*, § 452; *Grammer et al. v. Nixon*, 1 Strange, 653.

In causes of action arising out of tort, the doctrine of *ultra vires* is inapplicable. "A great distinction exists between tortious and contractual liability for acts *ultra vires*. It is no defence to legal proceedings in tort, that the torts were *ultra vires*. If the torts have been done by the corporation or by their direction, they are liable for the results, however much

in excess of their powers such torts may be:" Green's Brice's *Ultra Vires*, 265; *Sharp v. Mayor*, 40 Barb. 277; Taylor on Corp. § 338; *Alexander v. Reece*, 74 Mo. 495. This distinction, with the reason therefor, is succinctly stated in the recent case of *Salt Lake City v. Hallister*, 118 U. S. 263. "It remains to be observed that the question of the liability of corporations on contracts which the law does not authorize them to make and which are wholly beyond the scope of their powers is governed by a different principle. Here the party dealing with the corporation is under no obligation to enter into the contract. No force, or restraint, or fraud is practised on him. The powers of these corporations are matters of public policy, open to his examination, and he may and must judge for himself as to the power of the corporation to bind itself by the proposed agreement." The reports are full of cases to this effect: *Phila. Wil. and Balto. R. R. v. Quigley*, 21 How. 202; *Carter v. the Howe Machine Co.*, 51 Md. 290; *Balto. & Yorktown Turnpike Co. v. Boone*, 45 Md. 344; Cook on Laws of Stock and Stockholders, § 293; Paley on Agency, §§ 294-6. Even malice has been imputed to them and exemplary damages allowed; cases cited supra, and *Phila. Wil. etc. R. R. v. Larkin*, 47 Md. 155; *Same v. Hoeflich*, 62 Id. 300.

Attention, however, must be directed to the decision of the English Court of Appeals in the case of *British Banking Co. v. Charnwood Forest Ry, etc.*, L. R. 18 Q. B. Div. 714 (1887), overruling the decision reported in 34 Weekly Rep. 718. It was an action brought to recover damages for fraudulent misrepresentations alleged to have been made by the defendant corporation through their secretary. It appeared at the trial, that certain customers of the bank had applied to them for an advance on the security of transfers of debenture stock of the defendant company. The plaintiff's manager called upon T., the defendant's secretary, and was informed in effect that the transfers were valid, and that the stock which they purported to transfer existed. The plaintiff thereupon made the advances. It subsequently appeared that T., in conjunction with one M., had fraudulently issued certificates for debenture stock in excess of the amount which the company were authorized to issue, and the transfers concerning which

plaintiff inquired related to this over-issue. Lord ESHER, M. R., held, that although what the secretary stated related to matters about which he was authorized to speak, he did not make the statements for the defendants but for himself. And he followed the rule laid down by WILLES, J., "That the master is answerable for every such wrong of his servant or agent as is committed in the course of his service and for his master's benefit, though no express command or privity of the master be proved:" *Barwick v. Eng. Joint Stock Bank*, L. R. 2 Ex. 259. The case of the *British Banking Co. v. Charnwood, etc.*, is cited with approval by Bigelow on the Law of Frauds (1888), 225-6-7. While this preliminary and elementary proposition is well settled, still to justify a recovery, it is necessary that the certificate have all the indicia of genuineness. Thus, the agents must have apparently observed all the formalities which are required by the charter or the articles of association to be observed in the particular class of corporate transactions. It has been held that when the charter requires contracts of a particular description to be signed by corporate officers or approved in a certain manner, no agent can bind the company, unless the contract be executed in the manner prescribed: *Morawetz on Corp.* § 582; *Badger v. Am. Ins. Co.*, 103 Mass. 244; *Head v. Prov. Ins. Co.*, 2 Cranch, 127; *Henning v. U. S. Ins. Co.*, 47 Mo. 425.

"Defences by a corporation that certificates were not issued in conformity with the charter or by-laws are not considered with favor by the Courts. But where the charter provides that certificates of stock should be signed by the president, directors, and treasurer, fraudulent over-issue signed by president and treasurer alone were held not sufficient to charge the corporation:" *Holbrook v. The Fauquier & Alexandria Turnpike Co.*, 3 Cranch (C. C.), 425; *Cook on Law of Stock & Stockholders*, § 295. This principle is again enunciated in the case of *The Granger's Life Ins. Co. v. Kamper*, 73 Ala. 341.

When a corporation relies upon a grant of power from the Legislature to do an act, it is as much restricted to the mode prescribed by the statute for its exercise as it is to the particular thing allowed to be done: *Ang. & A. on Corp.* § 111;

Farmers' Loan Co. v. Carroll, 5 Barb. 613. In the case of *Bissell v. Spring Valley Township*, 110 U. S. 162, it was prescribed by statute that the bonds to be issued by a county in payment of the subscription to the stock of a railroad, if it should be determined by the electors to make such subscription, should be signed by the chairman of the board of county commissioners and attested by the clerk. Upon a suit by a holder of one of these bonds, upon which the clerk's attestation was lacking, it was held, "that the law required the bonds to be executed in a particular manner, and the signature of the clerk is essential to the valid execution of them, even though he had no discretion to withhold it. That there can be no estoppel, because they are not the bonds of the defendant:" MATTHEWS, J. To the same effect, see Taylor on Pri. Corp. § 253.

A person who deals with a corporation must, at his peril, take notice of its charter or articles of association; and this rule holds good whether the charter be contained in a public or private Act of the Legislature. It follows, therefore, that so far as the authority of an agent of a corporation is defined by its constitution the scope of the agent's powers must always be considered as disclosed: Mor. on Corp. (1st ed.) § 64. This, however, is only as to the formalities prescribed by its charter or articles of association; the by-laws of a private corporation being binding upon none but its members and officers: *Tome v. Parkersburg, etc.*, 39 Md. 75; Ang. & A. Corp. § 359; Mor. § 64.

The question which now presents itself is, when these essentials of form have apparently been complied with, what are the rights of holders of stock fraudulently issued by the company's agents, the fraud being contained in matter extrinsic to the certificate? The general proposition is well established, by the decisions, that where the authority of the officers of a corporation to bind it by their acts depends upon the performance of a condition precedent, or the existence of an extrinsic fact, and the question of compliance with the condition or the existence of the fact is to be determined by them or rests peculiarly within their knowledge, their representation, which may consist in the mere doing of the act,

that the condition has been complied with, or that the fact does exist, may be relied on by one acting in good faith, and is conclusive and binding on the corporation: *N. Y. & N. H. R. v. Schuyler*, 34 N. Y. 30; *Mer. Bank v. State Bank*, 10 Wall. 604, 644; *De Voss v. Richmond*, 18 Gratt. 338; *Orleans v. Platt*, 99 U. S. 676; *Coloma v. Eaves*, 92 Id. 484; *Henry v. Nicollay*, 95 Id. 618; *Miners' Ditch Co. v. Zellerbach*, 37 Cal. 543; *Knox v. Aspinwall*, 21 How. 539; *Ross v. Mayor & City Council*, 51 Md. 270. The case of the *B. & O. R. v. Wilkens*, 44 Md. 28-9, is distinguished from these by MILLER, J., in delivering the opinion in that case; he says, "To the general doctrines on which our decisions in these stock cases were based, there is and must be the exception of the recognized and well-settled principle of the common law in reference to bills of lading." The pole-star by which the Courts have been guided, has been the highly just principle laid down by Lord HOLT, in the case of *Hern v. Nicholls*, 1 Salk. 289: "Seeing somebody must be a loser by this deceit, it is more reasonable that he that employs and puts a confidence in the deceiver should be a loser than a stranger." The pioneer cases in this country are those of the Schuyler frauds in New York. The early New York cases are in much confusion, but the position in that State was finally established by the case of *N. Y. & N. H. R. v. Schuyler*, 34 N. Y. 30. I propose to briefly sketch the course of the New York Court. In the case of the *Mechanics' Bank v. N. Y. & N. H. R.*, 13 N. Y. 599, the by-laws passed in conformity with the charter declared that all transfers of stock should be made in the transfer-book, kept at the proper office, and where a certificate of stock had been issued, that the same should be surrendered before transfer made. It was shown that the agent of the defendant had fraudulently given to K., a *particeps criminis*, a certificate in the usual form for eighty-five shares of stock, when in fact the latter owned no stock, no certificate for such stock had been surrendered, and no stock stood in his name on the books; the plaintiff, in good faith, and in reliance upon the certificate as regularly issued and valid, made a loan to K., receiving from him the certificate, with an assignment of the stock, and a power of attorney to transfer the same.

The Court held the plaintiff not entitled to recover. This case is minutely analyzed in 34 N. Y. 30, by DAVIS, J. : "From the manner in which the decision of the Judge is stated in the *Mechanics' Bank Case*, it is difficult to tell what precise points were designed to be passed upon by the Court. It is open to conjecture that the case may have passed off on the ground of want of privity between the plaintiffs and defendants, as was intimated by SELDEN, J. (16 N. Y. 142), or on the ground as suggested in *Griswold v. Haven*, 25 N. Y. 599, that K., to whom the certificate was issued, being privy to the fraud, had of course no claim against the company, and that his assignee could have no greater rights than himself. But that it was not decided on any question of privity, we have the authority of the Judge who pronounced the opinion : 'We certainly,' he says, 'did not put our judgment upon the ground that the plaintiffs were not in privity of dealing with the defendants by reason of the non-negotiable character of the certificates, and, therefore, could not sue for fraud :'" 16 N. Y. 151 ; 34 Id. 60-1. If, however, the decision was based upon the lack of privity the New York Courts have certainly retraced their steps. In 34 N. Y. 30, the Court adopt the language of the Pennsylvania Court of Common Pleas (*Bank of Kentucky v. Schuylkill Bank*, 1 Parsons Sel. Eq. 180) : "To entitle the aggrieved party to sue in such case, no privity is necessary, except such as is created by the unlawful act and the consequential injury, because the injured party is not seeking redress upon contract, but purely for the tortious act in his commission of which the contract is an accidental incident." Likewise, in *Bruff v. Mali*, 36 N. Y. 206, "No privity is necessary except such as is created by the unlawful act and the consequential injury." Also, *Titus v. Great Wes. Turnpike*, 5 Lans. 250 ; s. c. 61 N. Y. 280. But whatever may have been the views of the other members of the Court, there is no mistaking the ground on which the Judge who pronounced the opinion intended to put the liability of a principal for the acts of an agent. It is, in brief, that a principal is bound only by the authorized acts of his agent. The Judge acts upon the impression that the case of the *North River Bank v. Aymar*, 3 Hill, 262, had been reversed by the

Court of Errors, and then lays down the proposition, that the principal is liable for the appearance of the power, but not for the appearance of the act. In 34 N. Y. the Court say: "There is an irrepressible conflict among the New York authorities as to whether a party dealing with an agent, who is within the apparent scope of his authority, must inquire into the extrinsic facts which rest peculiarly within the knowledge of the agent and which cannot be ascertained by a comparison of the power with the act done under it. The solution of it depends upon whether the decision of the *North River Bank Case*, is law." By the later cases of *The Farmers', etc. Bank v. The Butchers', etc. Bank*, 16 N. Y. 142, and *Griswold v. Haven*, 25 Id. 599, its authority is upheld; likewise by *Westfield Bank v. Cornew*, 37 N. Y. 320. The *Mechanics' Bank Case* is thus substantially overruled, and the authority of the *North River Bank Case* vindicated. The case of the *Mechanics' Bank v. N. Y. & N. H. R.*, 4 Duer, 480, is now the law.

The case of the *N. Y. & N. H. R. v. Schuyler*, 34 N. Y. 30, was one in which the secretary issued certificates of stock in his own name, fraudulently and in excess of the charter limit. The Court said: "So in this case, in the narrower view in which we are now considering it, the condition upon which the agent could issue the certificate was a transfer in the books and the surrender of a previous certificate, if any had before been issued. These facts are wholly extrinsic and peculiarly within the knowledge of the agent as part of the special duties to be attended to by him, and were represented by him to exist by the certificate itself. Where the principal has clothed his agent with power to do an act upon the existence of some extrinsic fact necessarily and peculiarly within the knowledge of the agent, and of the existence of which the act of executing the power is itself a representation, a third person dealing with such an agent in entire good faith, pursuant to the apparent power, may rely upon the representation, and the principal is estopped from denying its truth to his prejudice:" 34 N. Y. 73; s. c. 3 Hill, 262. The stock being issued beyond the charter limit, the question arose as to whether the stock purporting to be created by the

false certificates could be valid stock. "In the nature of things it is impossible. A corporation with a fixed capital divided into a fixed number of shares can have no power of its own volition, or by any acts of its officers and agents to enlarge its capital or increase the number of shares into which it is divided. The supreme legislative power of the State can alone confer that authority and remove or consent to the removal of restrictions which are part of the fundamental law of the corporate being; and hence every attempt of the corporation to exert such a power before it is conferred by any direct and express action of its officers is void; and hence every indirect and fraudulent attempt to do so is void." The *bona fide* holders of the fraudulent certificates were adjudged to be entitled to indemnity. This decision was followed in *Bruff v. Mali*, 36 N. Y. 205, which was also a case of fraudulent over-issue by the officers of a corporation. The Court say, "a joint action will lie against the principal and agent: *Phelps v. Wait*, 30 N. Y. 78; or a separate action against either: *Suydam v. Moore*, 8 Barb. 358. The wrongful act is the servant's, in fact; the principal's, by construction."

In *Titus v. Great West. Turnpike Co.*, 5 Lans, 250; s. c. 61 N. Y. 280, these cases were re-affirmed. "A corporation is liable for money advanced to the treasurer upon certificates of shares of stock of the company, signed in conformity with such resolutions, issued to the treasurer himself, although the shares were in fact spurious and fraudulently issued, it appearing that they were taken by the plaintiff in good faith." Also in *The People ex rel. Jenkins v. Parker Vein Coal Co.*, 10 How. Pr. 551.

In *Holbrook v. New Jersey Zinc Co.*, 57 N. Y. 621, the liability is based upon the doctrine of estoppel. It cannot now be denied that if a corporation, having power to issue stock certificates, does, in fact, issue such a certificate, in which it affirms that a designated person is entitled to a certain number of shares of stock, it thereby holds out to persons who may deal in good faith with the person named in the certificate that he is an owner and has capacity to transfer the shares. This does not rest on any view of the negotiability of stock, but on the general principle appertaining to the law of es-

toppel. The certificate itself must be regarded as a continuous representation of the ownership of the holder; it is equivalent to an affirmative answer to an inquiry made at the office of the company.

The recent case of *The Manhattan Beach Co. v. Harned*, in the U. S. Circ. Ct. S. Dist. N. Y., May 8, 1886, 23 Blatch. 494; s. c. 27 Fed. Rep. 484, sanctions this doctrine of estoppel. "The purchaser need not inquire to ascertain whether the person to whom a certificate has been issued has the legal title to the shares when such title is only transferable upon the books of the corporation; it is their duty toward every person who may become a purchaser upon the faith of a certificate, to exercise due diligence in his behalf. Hence it follows that if by their negligence or even by their own malfeasance a certificate has been issued by agents of the corporation whilst acting within the general scope of their powers, the purchaser has a right to rely upon the truth of the recitals and to treat them as the formal representations of the corporation made by those who are entitled to speak for it in the particular transaction." But the Court make this exception to a right of recovery, which, however, was unnecessary to a decision of the case. The certificate had been issued in the name of a fictitious person; from this fact the learned Judge reasons: "That the consequences of a purchase which could not have been consummated without the forgery or fraud of the person who prepared the spurious assignment and power of attorney, an act for which the plaintiff is not responsible, cannot be attributed to the complainant." The damage was caused by the taking of the certificate and not from its issuance. But the company was held estopped for permitting a transfer of the certificate.

There have been repeated adjudications in Pennsylvania also. The case of the *Bank of Kentucky v. Schuylkill Bank*, 1 Pars. Sel. Eq. 180, is an able presentation of the law and philosophy of the subject. The Schuylkill Bank was the Philadelphia agent of the Bank of Kentucky, to make transfers of stock and issue certificates for such stock as was originally subscribed there. The cashier of the Schuylkill Bank illegally issued certificates, under the authority con-

ferred on his bank, beyond the limit fixed by the charter. The Court of Common Pleas, KING, President, delivering the opinion, held that the obligation to surrender the old certificates was not a limitation on the power of permitting transfers so far as respected the bank, but a provision intended for the security of the bank, and that it was not true that the purchaser of the stock was under any obligation to see that such surrender was made by the seller. "The idea that the purchaser of stock is to lose the property he has honestly paid for, because the bank has not done its duty to itself, is unreasonable to the last degree." The bank was held responsible, although the stock had been issued beyond the limit fixed in the charter; *bona fide* holders were entitled to indemnity, but not to become stockholders.

The case of *Willis v. Phila. & D. R. Co.*, 13 Phila. 34; s. c. 6 W. N. C. (Pa.) 461, was likewise a case of fraudulent over-issue by the agents of the corporation. "The argument, that to hold, that the president and treasurer could by a fraudulent over-issue, bind the company to that which the company was powerless to perform, might be unanswerable if the power to give certificates was identical with the power to create stock. * * * If a certificate of stock is not a negotiable instrument, it is a written declaration that the holder has a definite share in the capital or profits of the concern, which though delivered to him is intended for circulation and virtually addressed to all the world, and third parties who are misled by such instruments may justly require that the loss shall fall on the corporation and not on them." These cases were affirmed in *People's Bank v. Kurtz*, 99 Pa. St. 346, where the facts were the same. The Maryland Court has followed these decisions to their fullest extent. In *Tome v. The Parkersburg Branch, etc.*, 39 Md. 36, the facts were these: By the by-laws of the corporation, and from matters apparent upon the face of the certificates, it was prescribed that all certificates should be signed by the president and treasurer and the corporate seal affixed. A certain C. was the transfer agent and treasurer of the company, and kept in his custody the transfer books and the corporate seal. The president, being a non-resident and absent at times, signed certain blank

certificates and intrusted them to C. C. fraudulently and for his own benefit issued certificates of stock, some with the genuine signature of the president, upon others it was alleged the signature of the president had been *forged*. The plaintiff advanced money upon certain of these certificates, issued in the name of the lender and one in the name of the broker through whom the loans were effected. The Court had no difficulty as to the genuine certificates, and ALVEY, J., in his dissenting opinion, says: "These prayers maintain that if the signature of the president to the certificates be genuine, the fraud of the transfer agent in issuing the certificate for his own benefit, and not that of the company under the facts stated, the plaintiff being innocent, does not affect the right of the holder to recover; and of this I think there should be no doubt." While the Court was unanimous upon this branch of the case, ALVEY, J., and BARTOL, C. J., dissent from the view taken by the Court, as laid down in the third prayer, which was substantially that even if the signature of the president should be found to be forged, still the plaintiff was entitled to recover if the certificates were forged by C., and were issued by him from the defendant's office, and were taken by the plaintiff in good faith. The Court say that "it is essential to public welfare, that where the acts of acknowledged agents are accompanied with all the indicia of genuineness, and are issued for a valuable consideration, the principal should be responsible, whether the indicia are true or not." They cite with approval the doctrine as to extraneous facts, laid down in *North River Bank v. Aymar*. They disclaim any intention of basing their judgment upon the negligence displayed by the corporate officers, and say that independently of that aspect of the case, there was enough in the facts mentioned in the prayers, to have entitled the plaintiff to recover: Id. 85-6. ALVEY, J., in dissenting, says, "that if the representation of the transfer agent in respect to the signature of the president, is to conclude the corporation, then his representation as to the genuineness of the seal and every other act of authentication must equally conclude; thus rendering nugatory all the checks that corporations may have devised." By reference to the opinion of the same Judge, delivered in the

case of the *Western Md. R. v. Franklin Bank*, 60 Md. 36, it will be seen that he recognizes the wisdom and authority of the decision of *Tome v. Parkersburg, etc.*

In the case of the *Western Md. R. v. Franklin Bank*, the signatures of the president and treasurer were left with a clerk, a son of the treasurer, during the enforced absence of these officials. The clerk forged the name of the treasurer of the Safe Deposit Company to the receipt for coupons which was attached to the funding certificate issued by the company and negotiated them with persons aware of the fact that he held the position of clerk. The Court say: "It may be conceded, and was doubtless the case, that the agent had no authority in fact to issue such certificates; he had no real authority as between himself and his principal, or other parties conusant of the facts, for doing the particular acts complained of. But the company, by its own act, and as it turned out, misplaced confidence, placed the agent in a position to do, and procure to be done, that class and description of acts to which the particular acts in question belong; and in such case, where the particular acts in question are done in the name of and apparently on behalf of the principal, the latter must be answerable to innocent parties for the manner in which the agent has conducted himself in doing the business confided to him. Upon no other principle could the public venture to deal with an agent. In such case the apparent authority must stand as and for the real authority." They held further, "that no distinction should be made where parties deal in such certificates in the regular course of business, without ground of suspicion, because they happen to be in the hands of a party who is an agent of the company, or because they happen to represent on their face that the coupons had been deposited by such person."

The same question which was involved in the case of *Tome v. Parkersburg Branch R. R., etc.*, arose recently in England and received a like adjudication. This was the case of *Shaw v. Port Philip and Colonial Gold Mining Co.*, L. R. 13 Q. B. Div. 103. The secretary of the company, without any authority, affixed the seal of the company, which was in his custody, to certificates of stock, and either himself forged the

signature of a director, or procured it to be forged, and issued it. STEPHEN, J., said, "It is admitted on behalf of the defendant that, if there had been merely a false issue of the certificates in the absence of the directors, it would have bound the company. But it is contended that the present case differs from these because the director's name was forged, and that the secretary carried out his fraud by means of forgery. How does this make any difference? It is said that it does so because no decision has ever yet given validity to a forged document. It is asserted that there is a distinction between forgery and other fraud, but I fail to see that it is so. A director is to sign every certificate and certain other formalities are to be observed. These formalities had in the present case apparently been observed. The person who receives the certificate knows whether he received it from the secretary, but he cannot verify the due observance of the other formalities. I think therefore that the company has made it part of the duty of the secretary and within the scope of his authority to warrant the genuineness of each certificate he issues, and that the plaintiff in this case is entitled to our judgment." This case is also cited with extended comments in 24 AMERICAN LAW REGISTER, 90. The Supreme Court of the United States has laid itself open to criticism, which has not been long in forthcoming, by its decision of the case of *Moore v. Citizens' National Bank of Piqua*, 111 U. S. 156. The cashier of the bank obtained a loan of money from the plaintiff upon the faith of a certificate of stock duly signed by the president and cashier of the bank and issued in the name of the plaintiff. The certificate contained the usual provision that the stock was transferable only on the books of the bank, in person or by attorney, on the surrender of this certificate. The Court, by most refined reasoning, concluded that the case was distinguishable from such cases as that of *Titus v. Great West. Turnpike Road*, 61 N. Y. 237, by the circumstance that in that case "the certificate was issued in the name of the person who as officer of the corporation had issued them and not in the name of the person to whom they were transferred. That having distinct notice that the surrender and transfer of a former certificate were pre-requisite to the lawful issue of a new one, and having

accepted a certificate that she owned stock without taking any steps to assure herself that the legal pre-requisites to the validity of her certificate, which were to be fulfilled by the former owner and not by the bank, had been complied with, she does not, as against the bank, stand in the position of one who receives a certificate of stock from the proper officers without notice of any facts impairing its validity." This case has been severely criticised, and, it seems, with much reason, that the provision in the by-laws and upon the face of the certificates provided solely that that certificate could only be transferred upon a surrender of the certificate, and did not refer to prior certificates: Lowell on the Transfer of Stocks, § 112 (note). In this connection may also be cited the case of *West. Md. R. v. Franklin Bank*, *supra*, and the language of TANEY, C. J., in the case of *Lowry v. Commercial and Farmers' Bank*: Taney's Decisions, 316. "In general, a party must be presumed to have notice of everything that appears upon the face of the instrument under which he claims title. But a transfer of stock cannot in this respect be likened to an ordinary conveyance of real or personal property. The instrument transferring the title is not delivered to the party; the laws require it to be written on the books of the bank in which the stock is held; the party to whom it is transferred rarely, if ever, sees the entry and relies altogether upon the certificate of the proper officer of the bank, stating that he is entitled to so many shares. And that the purchaser need not look beyond the certificate, or examine the books of the corporation to ascertain the validity of the transfer." See also *Salisbury Mills v. Townsend*, 109 Mass. 115; Taylor on Corp. § 598.

The text-writers have formulated the principles deducible from these cases substantially as laid down in 2 Mor. on Corp. § 761. "A *bona fide* purchaser of certificates for shares in a corporation, issued in due form by agents of the company having authority to issue such certificates under ordinary circumstances, can compel the corporation to recognize the certificate as valid and accord to him the rights of a shareholder, unless the creation of new shares is prevented by some legal prohibition; and if the shares which the certificate purports to represent cannot legally be created, by reason of some legal

prohibition, the purchaser is entitled to recover his damages from the corporation for the false representation contained in the certificate:" Taylor, § 591; Cook, Law of Stocks, § 293; Pollock on Contracts, § 94. Redfield in his work on Railways maintains the contrary doctrine and follows *Mechanics' Bank v. N. Y. & N. H. R.*, 13 N. Y. 599, as does Field on Corp. § 144.

It is a general rule that where the whole amount of the corporate stock has been issued and the corporation becomes liable, either to issue certain certificates to a wronged person or pay him damages, that the Court having no authority to direct such an issue, can only give judgment that the corporation pay damages: Cook on Law of Stocks, etc. § 284; *People ex rel. Jenkins v. Parker Vein, etc. Co.*, 10 How. Pr. 551; *Finley Shoe Co. v. Kurtz*, 34 Mich. 89. Courts have no power, by mandate or decree, or in any other manner, to effect an increase or reduction of the capital stock: Cook, § 284; *Williams v. Savage Mfg Co.*, 3 Md. Ch. 418; *Baker v. Wasson*, 59 Tex. 140; *Smith et al. v. N. Am. M. Co.*, 1 Nev. 423; 2 Mor. § 683. But in Massachusetts a rule prevails to the effect that the corporation in such a case may be compelled to issue the stock, and to prevent an illegal over-issue it must purchase an equal amount of shares in the market: *Boston, etc. Co. v. Richardson*, 135 Mass. 473; *Machinists' National Bank v. Field et al.*, 126 Id. 345; *Pratt v. Taunton C. M. Co. et al.*, 123 Id. 110; Lowell on Transfer of Stocks, § 116.

The injured party can sue the directors in a separate action, if they knowingly pledge over-issued stock: *National Exchange Bank v. Sibley*, 71 Ga. 726; *Ashbury v. Watson*, 54 Law T. Rep. 30; *Bruff v. Mali*, 36 N. Y. 200; *Cazeaux v. Mali*, 25 Barb. 578; or jointly with the corporation, or the corporation in a separate action: Cook, § 295.

The vendor of a share of stock impliedly warrants that the same is issued by the duly constituted officers of the company, and is sealed with the genuine seal of the corporation; but he does not impliedly warrant that such shares have not been fraudulently issued by the officers in excess of the charter limit. If this prove to be the case, the vendee has no recourse

against him : *People's Bank v. Kurtz*, 99 Pa. St. 346 ; Cook, § 296 ; Mor. § 761 ; *State v. North La. R.*, 34 La. An. 947 ; *Seitzer v. Mali*, 41 N. Y. 619.

The measure of damages is the market value of the stock at the date of demand by the holder for a transfer, or if no demand were made, at the date of filing the bill, subject to such lien as would properly have attached to genuine stock under similar conditions : *In re Bahia & San Francisco R.*, L. R. 3 Q. B. 595 ; *The Phila. & Darby R. Cases*, 13 Phila. 44 ; 99 Pa. St. 344, 513. Consequently, when certificates of stock contain apparently all the essentials of genuineness, a *bona fide* holder of such certificates has a claim to recognition as a stockholder, if such stock can legally be issued, or to indemnity if this cannot be done ; the fact of forgery does not extinguish such right when it has been perpetrated by or at the instance of the officer placed in authority by the corporation and intrusted with the custody of its stock-books and held out by the company, in the language of the Court, in the case of *B. & O. R. R. v. Wilkens*, 44 Md. 28-9, "as the source of information on the subject." But there may be two exceptions to this general proposition : (1) The dictum of WALLACE, J., in *Manhattan Beach Co. v. Harned*, U. S. Cir. Ct. S. Dist. N. Y., May 10, 1886, 23 Blatch. 494, that where a certificate is issued in the name of a fictitious person there can be no recovery, unless a transfer has been effected upon the company's books ; (2) That laid down by the Supreme Court in *Moore v. The Citizens' Bank, etc.*, 111 U. S. 156, that one dealing with the transfer agent of the company and receiving a certificate in his (the transferee's) name, does not stand in the position of a *bona fide* holder without notice.

What are the consequences of the increase of capital stock by a corporation acting directly as a body or through its agents, who openly and under color of authority make such increase ; such issuance being in excess of the corporate powers or in an unauthorized manner.

There is a well-defined distinction drawn by the Courts and text-writers between an irregular increase and the over-issue of capital stock. Cook, in his recent work on the Law of Stocks and Stockholders, lays down the proposition that "where

the full capital stock of a corporation has been issued and there is no charter, or statutory provision authorizing an increase of the stock, it is clear that any issue of stock in excess of the capital is not a legitimate increase of the capital stock. It is unauthorized and illegal, and it is termed in law an over-issue of stock. There is a clear distinction between over-issued stock and an irregular increase of stock. The former exists when it is made, although no increase of the stock is authorized by the charter or by statute. The latter occurs when there is a statutory or charter provision authorizing an increase of the stock, but the formalities prescribed for making the increase have not been strictly complied with. Over-issued stock is void, while an irregular increase of stock is merely voidable." Cook, § 291.

In the following section the same author says that over-issued stock is wholly void, whether it be the result of accident, mistake, or want of knowledge, or it be due to fraud and substantial wrongdoing. The animus or intent of the parties is not material. So rigid and well established is this rule that not even a *bona fide* holder of such stock can give to it any validity or vitality. It is void: § 292.

Morawetz, against his inclination, is forced to acknowledge this distinction; he regrets that a distinction should be made between *de facto* corporations and shares issued *de facto* without authority. "Two rules, however, seem to be well established in the United States by force of the actual decisions: (1) If a corporation has no legal right to increase the amount of its capital stock upon any terms, shares created in excess of the amount authorized by the charter or law under which the corporation was organized will be treated by the Courts as null and void. (2) If a corporation is authorized by law to increase its capital stock upon complying with certain prescribed forms and conditions, and the corporation or its agents appear to have endeavored to comply with the prescribed forms or conditions, and have in fact increased the company's capital stock by issuing new shares on the assumption that the legal right to increase the capital stock had been acquired, and if the holder of such new shares has acted as a shareholder and enjoyed the rights of a shareholder, then the crea-

tion of such new shares will be recognized by the Courts and given effect according to the intention of the parties, although the statutory forms or conditions were not complied with, and no legal rights to create the new shares were in fact obtained:" 2 Mor. § 763. To the same effect, Taylor, § 541; Boone, § 114; Waterman (1888), §§ 190, 208.

The first of these rules rests upon the ground that the creation of shares in a corporation without legislative authority is prohibited by the common law, and that the contracts of membership represented by shares created in violation of the common-law prohibition will not be recognized and enforced by the Courts: 2 Mor. § 764. Over-issued stock is void by reason of its being *ultra vires*, the corporation being prohibited by the common law, and contrary to public policy. "The term *ultra vires*, whether with strict propriety or not, is used in different senses. An Act is said to be *ultra vires* when it is not within the scope of the corporation to perform it under any circumstances, or for any purpose. An Act is also sometimes said to be *ultra vires* with reference to the rights of certain parties, when the corporation is not authorized to perform it without their consent; or with reference to some specific purpose, when it is not authorized to perform it for that purpose, although fully within the scope of the general powers of the corporation, with the consent of the parties interested, for some other purpose. And the rights of strangers dealing with the corporation may vary according as the act is *ultra vires* in one or the other of these senses. When an Act is *ultra vires* in the first sense mentioned, it is generally, if not always, void *in toto*, and the corporation may avail itself of the plea. But when it is *ultra vires* in the second sense, the right of the corporation to avail itself of the plea will depend upon the circumstances of the case:" *Bissell v. Mich. & Southern R.*, 22 N. Y. 262-289; *Miners' Ditch Co. v. Zellerbach*, 37 Cal. 578.

In this connection it may be stated, that when the company is organized under a general incorporation law, the act itself generally provides that the amount of the capital stock be fixed and specified in the articles of association. This pre-

scribes and limits the amount of stock as fully as though it had been fixed by a special charter: Cook, § 279.

A corporation has no implied power to vary the amount of its capital stock as originally fixed; and every attempt of the corporation to exert such power before it is conferred, by any direct or express act of its officers, is void: Boone, § 114; *N. Y. & N. H. R. v. Schuyler*, 34 N. Y. 30; *Curry v. Scott*, 54 Pa. St. 270; *Wood v. Dummer*, 3 Mason, 308; *Railway v. Allerton*, 18 Wall. 233; *Salem, etc. v. Ropes*, 6 Pick. 23; 2 Mor. § 434; Taylor, § 133; *Smith v. Goldsworthy*, 4 Q. B. 430; *Smith v. Am. Co.*, 1 Nev. 428.

That corporations have not an implied power to effect changes in the amount and number of capital stock seems to be settled law: Green's Brice (2d ed.), 158; Thompson on Liab. of Stockholders, § 115; *Lathrop v. Kneeland*, 46 Barb. 432; *Mutual Life Ins. v. McKelway*, 12 N. J. Eq. 133.

In the case of *Seignouret v. Home Ins. Co.*, U. S. Circ. Ct. E. Dist. La., July 2, 1885, 24 Fed. Rep. 332, which was a suit to restrain the company from reducing its capital stock, it was held that a provision, for the better conduct and management of the affairs of the company, for a special general meeting called for the purpose from time to time to amend, alter or annul, either wholly or in part, all or any clauses of said deed, or of the existing regulations and provisions of the company, did not authorize a reduction of the number and value of the shares of the company. The power to dissolve does not carry with it the power to change the capital stock, which was substantially forming a new corporation. Also, *Droitwich Co. v. Curzon*, L. R. 3 Ex. 35; *In re Ebbw. etc. Co.*, L. R. 4 Ch. Div. 827; *In re Financial Co.*, L. R. 2 Ch. App. 714; *Society v. Abbott*, 2 Beav. 559. If a corporation is created with a fund limited by the Act, it cannot enlarge or diminish that fund, but by license from the Legislature, and if the capital stock is parcelled out into a fixed number of shares, this number cannot be changed by the corporation itself: *Salem, etc. v. Ropes*, 6 Pick. 32; *Oldtown Road v. Veazie*, 39 Me. 521; 1 Dane's Abr. C. 22, A. 1.

A number of cases representing the different phases of this question have been before the Supreme Court of the United

States, for adjudication. In the case of *Chubb v. Upton*, 95 U. S. 667-8, upon the trial Chubb had objected to the production in evidence of the proceedings by which the company increased its stock, upon the ground of their alleged irregularities, and of informalities in the papers filed in the public offices. The Court said, "It is settled by the decisions of the Courts of the United States and by the decisions of many of the State Courts, that one who contracts with an acting corporation cannot defend himself against a claim on such contract, in a suit by the corporation, by alleging the irregularity of its organization. The same principle applies to the case of a subscription to the capital stock, in an organization which has attempted irregularly to create itself into a corporation, and has acted as such. The rule applies to increasing the stock of the corporation, when the question arises upon paying a subscription for stock forming a part of such increase. The duty and necessity of performing the contract of subscription are the same as in the case of an original stockholder. The statute of Illinois authorizing an increase of the capital stock, papers were filed under the law for that purpose, which were examined by the Attorney-General, and certified to be in due form; and the company proceeded to issue its stock upon that theory. The defendant became a subscriber and attended meetings. It is idle to deny that this was the case of an organization which claimed to have taken and apparently supposed it had taken, the measures required by law to complete its increase of capital. It acted as such, and the defendant, by receiving his certificate of stock, entered into engagements with it as such. If it be conceded that its increased stock be but *de facto*, and that it could have been annulled or suppressed by the action of the Attorney-General as acting under an irregular organization, the defendant derives no aid from the admission. The cases cited are clear to the point that he cannot make the objection, but must perform the engagements he has made." In the case of *Pullman v. Upton*, 96 U. S. 328, the Court say, "whether the corporate stock had been properly increased, was a question the State only could raise." To the same effect see *Upton v. Hansbrough*, 3 Biss. 421; *Upton v. Hamborn*, Id. 417; *Upton*

v. *Jackson*, 1 Flippin, 413; *Upton v. Tribilcock*, 91 U. S. 45; Thompson on Liab. of Stockholders, § 410.

The case of *Scovill v. Thayer*, 105 U. S. 143, contains a review of the law on this subject. The Fort Scott Co. was organized under the general incorporation law of Kansas, which, therefore, with its articles of incorporation, constituted its charter. By these articles the original stock of the company was fixed at \$100,000; ch. 23, § 14, of the statutes of Kansas provides "that any corporation may increase its capital stock to any amount not exceeding double the amount of its authorized capital." "The second issue increased the stock to \$200,000, which was the limit prescribed by the charter. The question, therefore, is whether the stock of the third and fourth issues, by which the aggregate amount was raised to \$400,000, is or is not void. To decide that the holders of stock issued *ultra vires* have the same rights as the holders of authorized stock is to ignore and override the limitations and prohibitions of the charter. We think it follows that if the holders of such spurious stock have none of the rights, they can be subjected to none of the liabilities of a holder of genuine stock. His contract to pay for spurious stock is without consideration and cannot be enforced. It is insisted that the defendants, having attended, by proxy, the meetings at which the increase of the stock beyond the limit imposed by law was voted for, and having received the certificates for the stock thus voted for, and after such increase the company by its agents having held itself out as possessing a capital of \$400,000 and invited and obtained credit on the faith of such representation, he is now estopped from denying the validity of the stock and his obligation to pay for it in full. We think that he is not estopped to set up the nullity of the unauthorized stock. It is true that it has been held by this Court that a stockholder cannot set up informalities in the issue of the stock which the corporation had the power to create. But these were cases where the increase of the stock was authorized by law. The increase itself was legal and within the power of the corporation, but these were simply informalities in the steps taken to effect the increase. A distinction must be made between shares which the company had no power to issue and shares which the company had power

to issue, although not in the manner in which or upon the terms upon which they have been issued. The holders of the shares which the company had no power to issue in truth had nothing at all, and are not contributors" (citing 2 Lindley on Part. 138). The case of *Stace and Worth* is cited with approval; that was a case of illegal consolidation of two corporations; two holders of stock of the consolidated company applied to have their names taken from the list of contributors upon the winding up of the company. The Vice-Chancellor said this was a void agreement with a void acting upon it, a void recognition and a void ratification by the acts which have been mentioned. It comes to an aggregate of nothings, and that aggregate of nothings is all that there is to fix those gentlemen on the list of stockholders. Upon the principles stated in these authorities we are of opinion that the defendant is not estopped by any acts of his to assert the invalidity of the stock issued in excess of the limit authorized by the charter and to deny his liability thereon. Nor is he estopped by the acts of the agents of the company. The officers of the company had no authority to make these representations, and the public has no right to trust them. Persons dealing with the managers of a corporation must take notice of the limitations imposed upon their authority by the act of incorporation. The laws secured to the public and the creditors an infallible mode of ascertaining the real capital of the company. They were bound to know that the law permitted no such increase of its capital stock as the company had attempted to make, and that any representation that it had been made was false. A creditor who has been defrauded by misrepresentations of the real capital of the company has his remedy in an action of tort against all who participated in the fraud. GRAY and FIELD, JJ., dissented.

These cases are contrasted in the case of *Veeder v. Mudgett*, 95 N. Y. 310. In this case the meeting at which the stock was increased was not formally called, nor was the certificate of the increase of capital made and filed as prescribed by statute. The stock was all issued to stockholders who had voted for the increase and who subsequently received dividends thereon. The Court held them estopped, citing *Eaton v. Aspinwall*, 19 N. Y. 119; *Aspinwall v. Sacchi*, 57 Id. 331; *Buffalo &*

Albany R. v. Cary, 26 Id. 75 ; *Kent v. Quicksilver, etc. Co.*, 78 Id. 159, and *Shelton v. Eickenmyer*, 90 Id. 613, in support. Distinguishing this case from that of *Scovill v. Thayer*, they say, "But where, as in the present case, the abstract power did exist, and there was a way in which the increase could lawfully be made, and the creditors could without fault believe that this increase had been lawfully effected and the necessary steps had been taken, then the doctrine of estoppel may apply and the increased stock be deemed valid as against the creditors who have acted upon the faith of such increase. We must therefore treat the increase as lawful and precisely as if the needed preliminary steps had in truth been taken."

In the case of *The Grangers' Life Ins. Co. v. Kamper*, 73 Ala. 325, the Court say that "this case, like that of *Scovill v. Thayer*, the attempt to increase the stock of the company beyond the limit fixed by its charter was *ultra vires*. The stock itself was therefore void. It conferred on the holder no rights, and subjected them to no liability."

Again, in the recent case of *Pool v. The West Print Butter, etc. Assn.*, U. S. Circ. Ct. Dist. Neb., March 28, 1887, 30 Fed. Rep. 513, the formalities required by the statutes of Nebraska, with respect to an increase of the capital stock, were not complied with. The Court say: "One other matter is suggested, and that is, the illegality of the increase of stock from \$25,000 to \$250,000, and the limitations, both in the charter of the company and the statutes of Nebraska, against the amount of the indebtedness. The complainants hold only stock which was thus irregularly issued, and I do not think it lies in their mouth—or, indeed, in the mouth of any of the original stockholders, cognizant of the fact and assenting thereto—to question the liability of the corporation for the entire debt created in favor of the Middleton Bank. No man can plead his own wrong to defeat an honest debt: *Kansas City Hotel v. Harris*, 51 Mo. 464; *Clark v. Thomas*, 34 Ohio St. 46; *Kent v. Quicksilver, etc. Co.*, 78 N. Y. 180; Story's Eq. Jur. § 1539, are authorities also sustaining the liability of holders of irregularly increased stock: *Pullman v. Upton*, 96 U. S. 328, that of a transferee of such stock, although he may have taken such shares as collateral; and *Kansas City Hotel v. Hunt*, 57 Mo. 126, that of a subscriber subsequent to the

issue of the stock ; but the Court say that the mere subscription, without any payment thereon, or any other act of recognition, will not bind the defendant. When a subscriber has done nothing by which he may be held estopped, he may decline to receive stock improperly issued, and may be in a position to defend in a suit brought to enforce his subscription to it: *Sturges v. Stetson*, U. S. Circ. Ct. S. Dist. Ohio, 1858, 1 Biss. 246 ; Taylor, § 541. Assent may be shown as conclusively by acquiescence as by a formal vote; *Lawe's Case*, 1 DeG., J. & S. 504 ; *Payson v. Stoeve*, 2 Dill. 428 ; Cook, § 285.

Morawetz, on the other hand, denies that it is founded upon estoppel. In most of the cases in which the rule was applied, the failure to comply with the statutory condition, precedent to the right of issuing the shares, was a matter of public record of which the parties were bound to take notice. Moreover, the rule has been applied in favor of the corporation and of the parties who participated in the violation of the law: 2 Mor. § 764.

When the power is given to increase or decrease the capital stock or the number of shares into which it is divided, the mode of proceeding indicated by the statute or articles of association must be substantially adhered to: Taylor, § 133 ; *Spring Co. v. Knowlton*, 103 U. S. 49 ; *Knowlton v. Congress Spring Co.*, 57 N. Y. 518.

Over-issued stock may, however, it seems, be legalized by a subsequent legal increase of the capital stock: *Sewell's Case*, L. R. 3 Ch. Ap. 131 ; *N. Y. & N. H. R. R. Co. v. Schuyler*, 34 N. Y. 56-7 ; Cook, § 292. In *Oler v. Balto. & Randallstown R.*, 41 Md. 583, this state of facts was presented to the Court. The company had obtained subscriptions for stock beyond the limit fixed by its charter, and upon suit, to recover Oler's subscription, it was met with the defence that the taking of subscriptions beyond the prescribed amount released him. The Court held, "that if he had been a subscriber for the additional unauthorized shares, there could be no recovery against him ; but that being one of the earliest subscribers, and there being stock not issued, he was liable."

In *Merrill v. Reaver*, 50 Ia. 404, it was decided, that the corporation has illegally increased its stock, is no defence to

a note given for a subscription, when it is not alleged that the illegal cannot be distinguished from the legal stock.

Upon investigation, it is apparent that the validity of irregularly issued stock is based upon its analogy to the case of a *de facto* corporation: *Chubb v. Upton*, 95 U. S. 667-8; *Scovell v. Thayer*, 105 Id. 143. The question of irregularly issued stock has not yet been presented to the Maryland Courts, and their decision cannot be anticipated with any degree of confidence. Maryland reports almost alone present cases where defects of incorporation apparent upon the face of the certificate of incorporation have prevented the recognition of bodies so organized as corporations *de facto*. The case of *Boyce v. Trustees, etc. of the M. E. Church*, 46 Md. 359, was a suit against the church, to which it set up its own incapacity as a defence: the Court say, "The statute law of the State expressly requiring certain prescribed acts to be done to constitute a corporation, to permit parties indirectly, or upon the principle of estoppel, virtually to create a corporation for any purpose, or to have acts so construed, would be in manifest opposition to the statute law, and clearly against its policy, and justified upon no sound principle in the administration of justice," and held the church not to be estopped. That the weight of authority is overwhelmingly the other way, see *Taylor on Corp.* § 146 *et seq.*; *Thompson*, § 410 *et seq.*; *Mor.* §§ 736-761. The Maryland Court applied the same rule in the case of *Franklin Fire Ins. Co. v. Hart*, 31 Md. 59; *Grape Sugar, etc. Co. v. Small*, 40 Id. 395. The Courts have based their decisions as to the validity of stock irregularly increased, upon the responsibility of *de facto* corporations, and whether the Maryland Court will follow the analogy set by its own judgments cannot be forecast. The statutes as clearly provide in this case, as in the case of the original incorporation of a company, that the capital stock may be increased or diminished by complying with the provisions of the following sections, which prescribe the nature of the notice and the character and form of the certificate to be recorded.

LEWIS PUTZEL.

Baltimore.