THE WITHDRAWAL AND ACCEPTANCE OF PRE-INCORPORATION SUBSCRIPTIONS TO STOCK.

EDWARD CLARK LUKENS

A good deal of litigation has arisen regarding subscriptions to stock made prior to the formation of the corporation. It is well settled that in general such subscriptions may be enforced by the corporation after it is formed.[1] That is, if a subscription [2] is made and is not withdrawn, and the corporation is properly formed [3] and notifies the subscriber of its acceptance of the

[1] Collins v. Morgan Grain Co., 16 F.(2d) 253 (C. C. A. 9th, 1926); Planters Co. v. Webb, 156 Ala. 551, 46 So. 977 (1908); Scott v. Houpt, 73 Ark. 78, 83 S. W. 1057 (1904); Kohler v. Agassiz, 99 Cal. 9, 33 Pac. 741 (1893); Danbury R. Co. v. Wilson, 22 Conn. 435 (1853); National Bank v. Amoss, 144 Ga. 425, 87 S. E. 406 (1915); Stone v. Great Western Co., 41 Ill. 85 (1866); McCormick v. Great Bend Co., 48 Kan. 614, 29 Pac. 1147 (1892); Bullock v. Falmouth Co., 85 Ky. 184, 3 S. W. 129 (1887); Bryant's Pond Co. v. Felt, 87 Me. 234, 32 Atl. 888 (1895); Athol Music Hall Co. v. Carey, 116 Mass. 471 (1875); Minneapolis Co. v. Davis, 40 Minn. 110, 41 N. W. 1026 (1889); State v. Reynolds, 268 Mo. 210, 186 S. W. 1057 (1916); Deschamps v. Loiselle, 50 Mont. 565, 148 Pac. 335 (1915); Nebraska Chicory Co. v. Lednicky, 79 Neb. 587, 113 N. W. 245 (1907); Ashuelot Boot & Shoe Co. v. Hoit, 56 N. H. 548 (1876); Buffalo & N. Y. C. R. Co. v. Dudley, 14 N. Y. 336 (1856); Boushall v. Stronach, 172 N. C. 273, 90 S. E. 198 (1916); King v. Howeth & Co., 42 Okla. 178, 140 Pac. 1182 (1914); Balfour v. Baker City Gas Co., 27 Ore. 300, 41 Pac. 164 (1895); Jeannette Bottle Works v. Schall, 13 Pa. Super. 96 (1900); Seacoast Packing Co. v. Long, 116 S. C. 406, 108 S. E. 159 (1921); Cartwright v. Dickenson, 88 Tenn. 476, 12 S. W. 1030 (1890); McCord v. Southwestern Sundries Co., 158 S. W. 226 (Texas 1913); Utah Hotel Co. v. Madsen, 43 Utah 285, 134 Pac. 577 (1913); Lewis' Adm'r v. Glenn, 84 Va. 947, 6 S. E. 866 (1888); Martin v. Rothwell, 81 W. Va. 681, 95 S. E. 189 (1918). As this fundamental proposition is undisputed and practically all the cases cited in this article support it, it seems unnecessary at this point to cite more than one case in any jurisdiction.

[2] A distinction is sometimes made between a real subscription and a mere promise to subscribe, or some other kind of pre-incorporation promise which is not an actual subscription. See Avon Springs Sanitarium Co. v. Weed, 104 N. Y. Supp. 58, *rev'd* on other grounds, 189 N. Y. 557, 82 N. E. 1123 (1907); Sanders v. Barnaby, 166 App. Div. 274, 151 N. Y. Supp. 580 (1915); Lake Ontario Shore R. Co. v. Curtiss, 80 N. Y. 219 (1880); Yonkers Gazette Co. v. Taylor, 30 App. Div. 334, 51 N. Y. Supp. 969 (1898); Woods Motor Vehicle Co. v. Brady, 181 N. Y. 153, 73 N. E. 674 (1905); Strassburg R. C. Co. v. Echternacht, 21 Pa. 220 (1853); Phila. Medical Publishing Co. v. Wolfenden, 248 Pa. 450, 94 Atl. 138 (1915). As to the validity of such a distinction, see MORAWITZ, CORPORATIONS (2d ed. 1886) § 49, and 1 COOK, CORPORATIONS (8th ed., 1923) 383.

[3] A defect in the corporate organization is held to be a defense to a suit to enforce a subscription made prior to incorporation in Schloss & Kahn v. Montgomery Trade Co., 87 Ala. 411, 6 So. 360 (1889); Clark v. Barnes, 58 Mo.

subscription, it can enforce the subscription even though it was made before the corporation was in existence.

The validity of pre-incorporation subscriptions is generally based upon one of two theories, that the subscription is a continuing offer to the prospective corporation which is accepted by the corporation when or after it comes into existence, or that it is a contract with the other subscribers as well as an offer to the corporation. Where a corporation after it is formed sues to enforce such a subscription which remains unrevoked, the subscription is binding under either theory, and it makes no practical difference which the court relies upon.

It is in the case of an attempted withdrawal of the subscription before organization is completed that the difference becomes important. If the subscription is only an offer to the corporation it must be unaccepted as long as the corporation is not yet in existence, and can therefore be withdrawn. If on the other hand it is a contract between the subscribers it is binding as soon as it is made, and there can be no withdrawal. There is a distinct division of authority on this, a large majority of the cases holding that a subscription can be withdrawn at any time before the corporation is formed,[4] while the view that it is a contract

App. 667 (1894); Capps & McCreary v. Hastings Prospecting Co., 40 Neb. 470, 58 N. W. 956 (1894); Dorris v. Sweeney, 60 N. Y. 463 (1875); Bywaters v. P. & G. N. Ry. Co., 73 Tex. 624, 11 S. W. 856 (1889). This defense is denied in Allen v. Rhodes, 230 Fed. 321 (C. C. A. 8th, 1916); Selma R. Co. v. Lipton, 5 Ala. 787 (1843); Planters Co. v. Webb, 144 Ala. 666, 39 So. 562 (1905); Mississippi & O. R. R. Co. v. Cross, 20 Ark. 443 (1859); Jones v. Dodge, 97 Ark. 248, 133 S. W. 828 (1911); Canfield v. Gregory, 66 Conn. 933, 33 Atl. 536 (1895); State Building Co. v. Pierce, 92 Iowa 668, 61 N. W. 426 (1894); Ramsey v. Peoria Marine & Fire Ins. Co., 55 Ill. 311 (1870); McCarthy v. Lavasche, 89 Ill. 270 (1878); Gill's Adm'x v. Ky. & Colo. Gold & Silver Mining Co., 70 Ky. 635 (1870); Swartwout v. Michigan Air Line R. Co., 24 Mich. 389 (1872); Central Plank Road Co. v. Clemens, 16 Mo. 359 (1852); Haskell v. Worthington, 94 Mo. 560, 7 S. W. 481 (1888); Phoenix Warehousing Co. v. Badger, 67 N. Y. 294 (1876); Lydell Ave. Lumber Co. v. Lighthouse, 137 App. Div. 422, 121 N. Y. Supp. 802 (1910); Wadesboro Cotton Mills Co. v. Burns, 114 N. C. 353, 19 S. E. 238 (1894); Nickum v. Burckhardt, 30 Or. 464, 47 Pac. 788, 48 Pac. 475 (1897); McHose & Co. v. Wheeler, 45 Pa. 32 (1863); Francis Marion Hotel Co. v. Chicco, 131 S. C. 344, 127 S. E. 436 (1925); Panhandle Packing Co. v. Stringfellow, 180 S. W. 145 (Texas, 1915). It will be observed, however, that most of these cases depended upon estoppel.

[4] Collins v. Morgan Grain Co., Planters Co. v. Webb, both *supra* note 1; Snodgrass v. Zander, 106 Ark. 462, 154 S. W. 212 (1913); San Joaquin Co. v. Beecher, 101 Cal. 70, 35 Pac. 349 (1894); National Bank v. Amoss, *supra* note 1; Macon Assn. v. Chance, 31 Ga. App. 636, 122 S. E. 66 (1924); Mc-

between subscribers is the minority rule.[5] In some cases there are special circumstances showing that the agreement in the particular case involved a contract with other persons as well as an offer to the corporation, or was solely a contract between individuals.[6]

It will be observed that both of these theories rest upon the law of contracts. In each case the effort is to describe the situation in terms of offer and acceptance. The subscription is the offer to enter into a contract, and the theories differ only in their conception of who is the offeree. The view that the subscription is a continuing offer to the prospective corporation seems to overlook the point that in ordinary contract law there must not only be an offer but someone to whom the offer is made. The use of the word "continuing" must mean not merely that the offer has not been withdrawn, but that it is as though the offer had been made at the instant the offeree came into existence. The transaction is forced into the molds of contract law by assuming that an offer, made when there was no offeree, was made when there was an offeree, by simply designating the offer as "continuing." The situation is helped but little by saying that the offer is made to someone who acts as agent for the proposed

Cormick v. Great Bend Co., *supra* note 1; U. S. Pump Co. v. Davis, 2 Kan. App. 611, 42 Pac. 590 (1895); Bryant's Pond Co. v. Felt, Athol Music Hall Co. v. Carey, both *supra* note 1; Hudson Co. v. Tower, 156 Mass. 82, 30 N. E. 465 (1892); Intermountain Co. v. Jack, 5 Mont. 568, 6 Pac. 20 (1885); Deschamps v. Loiselle, *supra* note 1; Jermyn v. Searing & Co., 225 N. Y. 525, 122 N. E. 706 (1919); Yonkers Gazette Co. v. Taylor, *supra* note 2; Auburn Bolt Works v. Shultz, 143 Pa. 256, 22 Atl. 904 (1891); Muncy Traction Engine Co. v. De La Green, 143 Pa. 269, 13 Atl. 747 (1888); Jeannette Bottle Works v. Schall, 13 Pa. Super. 96 (1900); Hawthorn Bottle Co. v. Cribbs, 51 Pa. Super. 555 (1912); Kramer v. Hamsher, 63 Pa. Super. 211 (1916); Donaldson v. Rollman, 23 Pa. D. R. 802 (1914); Gleaves v. Brick Church Turnpike Co., 1 Sneed 491 (Tenn. 1853); Lewis v. Hillsboro Roller Mill Co., 23 S. W. 338 (Texas 1893); Elliott v. Ashby, 104 Va. 716, 52 S. E. 383 (1905); Greenbrier Industrial Exposition v. Rodes, 37 W. Va. 738, 17 S. E. 305 (1893).

[5] Glenn v. Busey, 5 Mackey 223 (D. C. 1886); Hughes v. Antietam Co., 34 Md. 316 (1871); Minneapolis Threshing Machine Co. v. Davis, *supra* note 1; Lake Ontario, Auburn & N. Y. R. Co. v. Mason, 16 N. Y. 451 (1857); Non-Electric Fibre Mfg. Co. v. Peabody, 21 App. Div. 247, 47 N. Y. Supp. 677 (1897); Clapp v. Gilt Edge Consolidated Mines Co., 33 S. D. 123, 144 N. W. 721 (1913); Windsor Hotel Co. v. Schenk, 76 W. Va. 1, 84 S. E. 911 (1915).

[6] Ada Dairy Assn. v. Mears, 123 Mich. 470, 82 N. W. 258 (1900); Osburn v. Crosby, 63 N. H. 583, 3 Atl. 429 (1886); Sanders v. Barnaby, Phila. Medical Publishing Co. v. Wolfenden, both *supra* note 2; Garrett v. Phila. Lawn Mower Co., 39 Pa. Super. 78 (1909).

corporation, as we would then have the anomaly of an agent for a non-existent principal.

On the other hand, the view that the subscription is a contract with the other subscribers meets with some difficulties. This theory in its essence is that the subscriber adds to his express offer to the proposed corporation an implied promise to the other subscribers that he will not withdraw that offer, and that this implied part of the transaction is binding at once. The trouble is that in none of these cases are the other subscribers the plaintiffs, nor does it appear from the language of the opinions upholding the minority rule that an action could be maintained by the other subscribers. This view appears to confuse the case of a simple subscription with the less frequent case of an agreement between persons in which they promise each other that they will form a corporation, which agreement may of course include a subscription to stock.

It may not be impossible to work out either or both of these theories on the basis of implied assignments, third party beneficiary rule, or some similar bit of ingenuity, so that they will do no violence to the law of contracts and of agency. It is clear, however, that no useful purpose would be served by so doing, as the courts do not decide between the majority and the minority rules on this basis. The real issue is not which theory can be brought into closer harmony with contract law rules, but whether as a matter of policy subscriptions should be revocable until the corporation is formed or not. A suggestion of this appears in *Bryant's Pond Steam Mill Co. v. Felt*,[7] in which after discussing the contract situation the court adds:

> "And in view of the fact that such subscriptions are often obtained by over persuasion, and upon sudden and hasty impulses, we are not prepared to say that the rule of law which allows such a revocation is not founded in wisdom. We think it is."

It might be said in fairness to the policy of the opposite view that the court's remarks as to over persuasion and hasty

[7] 87 Me. 234, 32 Atl. 888 (1895), quoted with approval in Collins v. Morgan Grain Co., *infra* note 11.

impulses might just as well apply to stock subscriptions made after incorporation, or indeed to any kind of promises to pay.

The question of the acceptance of the subscription can arise only under the so-called majority rule. Under the other view the subscriber cannot withdraw even before the formation of the corporation, so it makes no difference whether the subscription is accepted after incorporation or not. Assuming the majority rule to be the law, the right to withdraw exists at least until the offeree corporation comes into existence. The question then arises whether that right is terminated *ipso facto* the moment the corporation comes into being, or whether it remains until and unless there is an actual acceptance of the subscription by the corporation. On this question authority is less abundant.

Among the cases following the majority rule, there are some dicta stating or implying that the subscription becomes binding as soon as the corporation is formed,[8] and some indicating that an actual acceptance after formation is necessary.[9] In none of these cases was the question directly at issue in the sense that a withdrawal had been attempted after the corporation was formed but before an actual acceptance was made. The defense in no case depended solely on a lack of acceptance, and the courts were consequently under no necessity of defining the precise moment at which the subscriptions became fully-formed contracts. The divergence of opinion shown in these cases therefore indicates that the rule on this point is still not definitely fixed, rather than that there is a conscious division of authority.

[8] San Joaquin Co. v. Beecher, *supra* note 4; Twin Creek Co. v. Lancaster, 79 Ky. 552 (1881); Bullock v. Falmouth Co., *supra* note 1; Balfour v. Baker City Gas Co., *infra* note 12; Auburn Bolt Works v. Shultz, 143 Pa. 256, 22 Atl. 904 (1891); Muncy Traction Engine Co. v. De La Green, 143 Pa. 269, 13 Atl. 747 (1888); Bole v. Fulton, 233 Pa. 609, 82 Atl. 947 (1912); Jeannette Bottle Works v. Schall, 13 Pa. Super. 96 (1900); Kramer v. Hamsher, 63 Pa. Super. 211 (1916); Cartwright v. Dickenson, 88 Tenn. 476, 12 S. W. 1030 (1890).

[9] Collins v. Morgan Grain Co., *infra* note 11; Stone v. Walker, 201 Ala. 130, 77 So. 554 (1917); McCormick v. Great Bend Co., *supra* note 1; U. S. Pump Co. v. Davis, *supra* note 4; Penobscot R. Co. v. Dummer, 40 Me. 172 (1855); Bryant's Pond Co. v. Felt, *supra* note 1; Red Wing Co. v. Friedrich, 26 Minn. 112, 1 N. W. 827 (1879); Buffalo & Jamestown R. Co. v. Gifford, 87 N. Y. 294 (1882); Yonkers Gazette Co. v. Taylor, 30 App. Div. 334, 51 N. Y. Supp. 969 (1898); Steely v. Texas Improvement Co., 55 Tex. Civ. App. 463, 119 S. W. 319 (1909); Martin v. Rothwell, *supra* note 1; Martin v. Cushwa, 86 W. Va. 615, 104 S. E. 97 (1920).

The Pennsylvania courts have laid down the definite rule that the subscription can be withdrawn up to the time when the certificate or application for charter is filed in the office of the Secretary of the Commonwealth, and that at the moment of filing the obligation of the subscriber becomes final.[10] It is difficult to see its justification other than as a rule of convenience. The corporation has not come into existence when the application has been filed in the office of the Secretary of the Commonwealth. The Governor may refuse to grant the charter, and if he does grant it, the corporate existence does not date back to the time the Secretary received the application. There are not two contracting parties in existence any more than there were at the time the subscription was made. Not only is there no actual acceptance; even the existence of the promisee is still lacking.

Taking one of the best considered and most recent cases on the other side, we find in *Collins v. Morgan Grain Co.*,[11] first, a definite recognition, which is lacking in most of the cases, of the fact that there is a division of authority on the question of withdrawal prior to incorporation, with a positive adoption of the so-called majority rule; and second, a declaration that the subscriptions are not binding until "the corporations have been organized, and the subscriptions accepted."

If the law of contracts is applicable, and the majority rule as to the subscriptions is adopted, it would seem that there should be an actual acceptance. When the corporation is formed, we have two potential contracting parties, plus an outstanding offer made by one of them to the other. To constitute a contract there must also be some kind of an acceptance, express or implied. If the formation of the corporation, without more, makes the subscription binding, it must be on the ground that the forma-

[10] Auburn Bolt Works v. Shultz, 143 Pa. 256, 22 Atl. 904 (1891); Muncy Traction Engine Co. v. De La Green, 143 Pa. 269, 13 Atl. 747 (1888); Jeannette Bottle Works v. Schall, 13 Pa. Super. 96 (1900); Kramer v. Hamsher, 63 Pa. Super. 211 (1916). These cases speak indiscriminately of the time of filing the certificate, and of the time when the incorporators are ready to file it. It is submitted that they cannot literally mean the latter, as it is too indefinite; and that the court has merely overlooked the fact that the two expressions are not synonymous.

[11] 16 F.(2d) 253 (C. C. A. 9th, 1926).

tion itself constitutes an implied acceptance. But how can the mere coming into existence of a potential contracting party imply an acceptance of offers made in anticipation of its existence? The act of being born, in the case of a natural person, does not involve the implied acceptance of any offers. No other kind of an offer made to a prospective corporation is regarded as accepted by the mere fact of its coming into being. Why should it be implied that the new-born corporation desires to accept such offers rather than to reject them, when it has as yet had no opportunity to do either?

In some cases facts appear which are clearly sufficient to constitute an implied acceptance without doing violence to the rules of contract law. Thus in *Balfour v. Baker City Gas Co.*,[12] while there was no express acceptance of the subscription, the subscriber consented to the holding of the organization meeting, and a stock certificate was made out in his name. Similarly, in *Cartwright v. Dickenson*,[13] the subscriber was not only present at the organization meeting but had paid part of the subscription and had served as a director, enough to show that both he and the corporation were treating the subscription as an existing contract. Such cases of acceptance by conduct are clearly distinguishable from cases of unaccepted subscriptions, and yet the court in the latter case says that "at the moment when the conditions required by law as preliminary to the granting of a charter were complied with the subscribers became shareholders." If all the cases containing dicta of this kind showed such instances of implied acceptance, the theory that acceptance is unnecessary would quickly disappear. In some of the cases, however, there is no such distinction on the facts, and the statements of the courts cannot be so easily disposed of.

The chief cause of the confusion regarding the necessity for acceptance appears to be a failure in many of the cases openly to recognize, as is done in *Collins v. Morgan Grain Co.*,[14] the division of authority and the divergent theories on the question

[12] 27 Or. 300, 41 Pac. 164 (1895).
[13] 88 Tenn. 476, 12 S. W. 1030 (1890).
[14] *Supra* note 11.

of withdrawal. Thus in the Pennsylvania cases,[15] the court follows the majority rule in permitting subscriptions to be withdrawn prior to incorporation, on the ground that they are "mere proposals," but holds them to be binding the moment the application for charter is filed, asserting that "each subscriber contracts with his associates . . . and these mutual promises form a valid and sufficient consideration." [16]

The trouble here is that if the subscriptions are contracts between the subscribers they are not "mere proposals," but are binding at once. If they are mere proposals they are not contracts with the other subscribers, and their consideration is to be found not in the other proposals, but in the undertaking of the corporation, after it has accepted the subscription, to issue the stock. The same paragraph contains language consistent with both doctrines, which are not consistent with each other.

A court which adopts the rule that subscriptions can be withdrawn prior to incorporation, must recognize that this rule can only be based on the theory that the subscriptions are "mere proposals" and are not already contracts. It should then adhere to the reasoning of the rule and require the proposals to be accepted by the offeree as in the case of ordinary offers to contract, expressly or by actual implication. A court which prefers to regard the subscription as a trilateral agreement, binding as between the subscribers when made, should permit no withdrawal at any time. Under neither view is there any justification for the middle ground that the subscription is a mere offer when made but becomes a contract without being accepted.

Pursuing the application of the law of contracts one step further, the question arises whether, if actual acceptance of the

[15] Jeannette Bottle Works v. Schall, 13 Pa. Super. 96 (1900), and other Pennsylvania cases cited *supra* note 10.

[16] Also in several Pennsylvania cases not involving the question of withdrawal, the court utters the dictum that stock subscriptions are trilateral contracts, the other subscribers being party to them. If these dicta really represented Pennsylvania law, these cases would conflict with the withdrawal cases given in note 10, which they do not purport to do. See Groff v. Pittsburgh R. Co., 31 Pa. 489 (1858); Phila. & Del. Co. R. Co. v. Conway, 177 Pa. 364, 35 Atl. 716 (1896); Marles Moulding Co. v. Stulb, 215 Pa. 91, 64 Atl. 431 (1906); Wolf v. Excelsior Automatic Scale & Supply Co., 270 Pa. 547, 113 Atl. 569 (1921); Altoona Milk Co. v. Armstrong, 38 Pa. Super. 350 (1909); Garrett v. Phila. Lawn Mower Co., *supra* note 6.

subscriptions is necessary, notice of the acceptance must be given to the subscriber. In *Richelieu Hotel Company v. International Company,*[17] it is held that such notice is unnecessary. It is difficult to see why the ordinary rules regarding offer and acceptance should be abandoned at this final stage. The acceptance of the offer must ordinarily be communicated to the offeror, and no logical reason appears for making an exception in this case.

The question remains whether any necessity exists for determining these questions of corporation law by the application of the law of contracts. "Rules derived by a process of logical deduction from pre-established conceptions of contract and obligation have broken down before the slow and steady and erosive action of utility and justice." [18] It makes little practical difference which of the theories as to pre-incorporation subscriptions is the more logical deduction from the law of contracts. It is an important question in the law of corporations whether a subscriber may cancel his subscription at any time before the corporation is formed or not, and many questions of utility and justice are involved, which are doubtless the factors of real weight in the courts' decisions. It makes little difference that it is out of harmony with contract law if the just and practical rule is that subscriptions are binding immediately upon the formation of a corporation without the necessity of actual acceptance.

The opinions in such corporation cases still pay homage to the law of contracts, but the frequent subordination of contract logic to corporation utility and justice indicates that this is a situation to which Judge Cardozo's statement applies. The law would be greatly clarified if the courts would, in cases of necessity, depart frankly from the contractual and agency bases, and develop rules peculiar to the law of corporations.

---

[17] 140 Ill. 248, at 266, 29 N. E. 1044 (1890).

[18] CARDOZO, "THE NATURE OF THE JUDICIAL PROCESS," 99-100.