POST-INCORPORATION SUBSCRIPTIONS AND OTHER CONTRACTS TO CREATE* SHARES AT A FUTURE TIME

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The general subject of "subscriptions" to corporate shares has received little or no adequate analysis either by courts or text writers in this country. The term "subscription" (or "subscription contract" or "subscription agreement") is employed by both courts and commentators in a variety of senses of which the following are the more frequent examples:

1. Agreements between a number of persons contemplating the future formation of a corporation, each one of whom designates the number of shares in the proposed corporation which he will take upon its organization.

2. Agreements between promoters of corporations and an individual whereby the individual promises the promoters to become the holder of a designated number of shares in a corporation to be formed by them. Here the contract differs from that set out in class one, in that the agreement is not between those who contemplate shareholdership in the corporation to be organized, but between one such person and the promoters.

*Shares are units of *existing* legal relations. When new shares come into existence new units of the totality of legal relations constituting corporate "membership" are created. A corporation is never in any useful sense a shareholder with respect to its own shares. The term "issue" when applied to shares imports a transfer from the corporation to someone of something already in existence. This implication of the term has resulted in much confusion of thought, especially with respect to so-called "treasury shares." Consequently, throughout this paper, the present writer will employ the word "create" rather than "issue" with reference to transactions purporting to result in a change in the number or character of shares outstanding, and the term "issue" will be used only in connection with "shares certificates," the tangible evidence of "shares." The practitioner frequently uses the expression "create shares" to describe an increase in the corporation's authorized capital stock, but until further acts occur this merely results in the corporation having additional *power* to create ("issue") shares, and this capacity of the corporation obviously ought to be distinguished sharply from the aggregate of rights, duties, etc., which constitutes one the holder of a share.

3. Transactions between an existing corporation and an individual whereby shares of that corporation of a designated class and number are *immediately* created as to such individual, especially if the duty to deliver a share certificate to the other party¹ is contingent upon certain agreed payments being made by him.

4. Contracts between a corporation and an individual for the creation *at a future date* of shares of the corporation of a designated class and number as to the individual. Here, as in the case of pre-incorporation subscriptions, the transaction may be merely between one individual and the corporation or it may involve a number of individuals and the corporation, as where a so-called subscription list is circulated and signed by those desiring to have shares or additional shares created as to them at a future date.

Since it would be impossible within the compass of a single paper to deal adequately with all four of these types of "subscriptions," this article will be limited to contracts between an existing corporation and a person for the creation of shares in the future. This includes the fourth type of "subscriptions" enumerated above as well as other transactions not usually labelled "subscriptions" but involving the creation of shares in the future, such as convertible securities, stock purchase warrants and so-called pledges of unissued shares. All forms of pre-incorporation subscription agreements, however, and all transactions between an existing corporation and a person contemplating the creation of shares immediately at the time of the transaction are expressly excluded from the scope of this paper. But before proceeding along the narrow path selected, a brief explanation would seem desirable of the difficulty of determining whether a given transaction resulted in shareholdership being at once created as to a particular person, or constituted only a contract to create such shares in the future.

¹ Throughout this paper "the other party" refers to the person dealing with the corporation for the creation of shares as to him, whether he be a "subscriber," convertible security holder, "pledgee of unissued shares," holder of a stock purchase warrant, etc.

HOW ARE SHARES CREATED?

Although there is still a widespread tendency in practice to confuse share certificates with the shares they evidence, it is today generally conceded that the issuance of a share certificate is not essential to the creation of shares.² Moreover, the authorities agree that even payment is not a pre-requisite to the creation of shares.³ What, then, are the acts which must occur in order that new shares may come into existence? Assuming that a corporation has power to create shares of a given class and number (*i. e.*, that such shares are part of the authorized but unissued capital stock), if a transaction occurs between the corporation and a person whereby the corporation and the person mutually manifest consent to the *immediate* creation of such shares as to such person, he becomes at once the holder of the shares, provided the creation of such shares as to such person or upon the agreed terms is not rendered impossible by some controlling law. For example, although the contemplated shares might be part of the corporation's authorized but unissued capital stock, the transaction might contravene a rule of law not merely forbidding but making impossible the creation of shares as to an enemy alien, or prior to the actual receipt by the corporation of the full par value thereof. But if no such special obstacle frustrates the desire of the parties, the common law would appear to require, for the immediate creation of shares which the corporation is then empowered to create, nothing more than the aforesaid mutual manifestations of consent thereto.⁴

Perhaps it will be objected that the situation posited is highly academic in that normally such a transaction either would be accompanied by the issuance to the other party of a share certi-

² 5 THOMPSON, CORPORATIONS (3d ed. 1927) § 3512; 1 COOK, CORPORATIONS (8th ed. 1923) § 80; 1 MACHEN, CORPORATIONS (1908) § 171.

³ 5 THOMPSON, *loc. cit. supra* note 2; 1 COOK, *loc. cit. supra* note 2; 1 MACHEN, *op. cit. supra* note 2, § 174.

⁴ Cf. 1 MACHEN, *op. cit. supra* note 2, § 173, saying: "According to this (most American courts') view of the common law, all that is necessary to constitute a person a shareholder is a present intention on his part and on the part of the company that the relation of shareholder and corporation subsist between them. When once that intention exists, the relationship is *eodem instanti* established without the necessity of any formality whatsoever."

cate or would clearly indicate the mutual intention that the other party was not to become the holder of the shares in question until a future date upon which a share certificate or an equivalent instrument would be tendered or at least made available to him. Unfortunately, such a simple presentation of the situation fails to reveal two major difficulties inherent in many of the cases involving transactions for the creation of shares. In the first place, it assumes (as I have thus far appeared to do) that shareholdership is a definite status and that therefore the other party at a specified time either is or is not the holder of the designated shares, whereas an examination of the cases justifies only a very limited assent to such a view;⁵ and in the second place, it assumes not only that the parties had a definite and reciprocal under-

⁵ The difficulty of categorically determining shareholdership is well illustrated by cases in a single jurisdiction arising out of transactions in violation of a constitutional provision that "no corporation shall issue stock except for money paid, labor done, or property actually received, and all fictitious increase of stock or indebtedness shall be void." For example, in Texas, where art. 12, § 6 of the constitution so provides, if corporation *C* issues to *S* certificates for common shares and *S* pays the corporation nothing in return therefor, or merely gives his note, and the certificates state they are full-paid and non-assessable (or at least fail to state that they are not full-paid) does *S* become a shareholder? *S* is responsible to *creditors* of corporation *C* for his proportion of unsecured debts up to the par value of his shares. *Rowan v. Texas Orchard Development Co.*, 181 S. W. 871 (Tex. Civ. App. 1916); *McWhirter v. First State Bank of Amarillo*, 182 S. W. 682 (Tex. Civ. App. 1916). Corporation *C* can maintain an action against *S* (or even an innocent transferee) for surrender and cancellation of the certificates. *Walker Caldwell Producing Co. v. Meneffee*, 240 S. W. 1023 (Tex. Civ. App. 1922). *S* can maintain an action for recovery and cancellation of a note and a deed in trust securing the note given to the corporation in return for the certificates. *Prudential Life Ins. Co. of Texas v. Pearson*, 188 S. W. 513 (Tex. Civ. App. 1916), *rev'd*, 222 S. W. 967 (Tex. Comm. App. 1920) (on the ground that the constitution had not been violated). Is *S* a shareholder?

In California under a similar constitutional provision (art. XII, § 11) would *S* become a shareholder as a result of such a transaction? *S* is responsible to *creditors* of corporation *C* for the difference between the amount paid and par, but not exceeding the amount of the creditors' claims. *Herron Co. v. Shaw*, 165 Cal. 668, 133 Pac. 488 (1913). Innocent donee transferees of *S* are not responsible to *C*'s creditors for the amount unpaid on such shares. *Rhode v. Dock-Hop Co.*, 184 Cal. 367, 194 Pac. 11 (1920). Shareholders of corporation *C* can maintain a representative suit against *S* for surrender and cancellation of the certificates. *James v. Steifer Mining Co.*, 35 Cal. App. 778, 171 Pac. 117 (1918); *cf. Domenigoni v. Imperial Live Stock & Mortgage Co.*, 189 Cal. 467, 209 Pac. 36 (1922) (in which *S*, to whom certificates had been issued for notes instead of for the percentage of cash required by the Blue Sky Commission, was held not entitled to a recovery and cancellation of the notes).

standing of the legal relations implied by their use of the term "shares" in their transaction, but also that the intent of the parties as to the time when these legal relations are to come into existence is clearly evidenced.

WHEN ARE SHARES CREATED?

A study of the "nature" of a share is beyond the purport of this paper, but inasmuch as I find it convenient to use the term herein and deplore the vague sense in which it is usually employed, possibly I shall be excused for emphasizing that the term "share" is but a symbol for an aggregate of legal relations. If this be agreed, obviously the term has little or no utility unless the legal relations which it connotes are mutually understood. A specific person may, moreover, have some, but not necessarily all, of these legal relations with a corporation,⁶ and the conception of "shareholdership" as a status becomes comprehensible only if the legal relations normally embraced by that term are enumerated. I therefore venture to indicate the principal legal relations which I find it convenient to describe, perhaps arbitrarily, by my conception of the norm of a "corporate share": (1) right to vote; (2) right to participate in "net earnings" or "surplus"; (3) right to participate in "capital distributions"; (4) right to examine the corporate books; (5) right to maintain a representative suit; (6) duty to pay "calls" or "assessments"; (7) responsibility to corporate creditors to the extent of "capital contributions"; (8) further responsibility to corporate creditors where imposed by statute. Of course these legal incidents will vary with the particular class of shares concerned; and therefore the present emphasis is not upon the specific incidents but upon recognition that "share" is not a unified relationship but a complex concept implying a number of separable legal relations.

Assuming a general understanding of the precise legal incidents attaching to shares of a given class, our initial problem is to determine when that *totality* of legal relations, and in that

⁶ Cf. Comment, *Effects of Irregular Attempts to Create Corporate Shares* (1927) 37 YALE L. J. 362.

sense "shareholdership," has resulted from a particular transaction. In other words, what acts of the corporation and of the other party shall we interpret as constituting manifestations of consent to the *present* creation of shares of a designated class and number, and what acts shall we construe as contemplating the *future* creation of such shares, that is, as forming contracts to create shares at a future time? Normally, the tender by the corporation of a share certificate and the acceptance of it by the other party would be unequivocal manifestations of consent to the immediate creation of such shares as to such person, and, if the shares described in the certificate were part of the corporation's authorized but unissued capital stock, "shareholdership" would usually result. Obviously, however, this ought not to be the sole test, for if a corporation, regretting its bargain, refuses a share certificate for the immediate delivery of which it has accepted payment, this ought not to postpone the rights of the other party as a shareholder until such time as he could obtain appropriate judicial relief, especially if he cannot readily acquire similar shares on the market.

In a carefully drafted written contract the intention of the parties as to the time when the other party is to become a shareholder will be clearly indicated.⁷ But not infrequently such transactions are exceedingly vague as to this time element,⁸ although it may be of considerable importance to the other party whether he is to participate in the benefits and burdens of the corporate enterprise at once or not until some later date. Consider, for example, some typical cases. Corporation *C* presents to *S* and he signs the following instrument:

⁷ Examples: In the subscription receipts for common stock issued by the Mohawk Hudson Power Corporation it is specifically provided: "For the purpose of voting and of receiving dividends, and for such purposes only, the registered holder hereof shall be deemed a registered holder of one share of the common stock of the Company for each \$20.00 which shall have been actually paid to the Company hereunder at the time and in the manner herein provided for."

Subscription warrants recently issued by the Detroit Edison Company expressly state: "To those making payments of the subscription in instalments, transferable purchase certificates, acknowledging receipt of the first instalment payment, will be issued. . . . *The purchase certificates shall not entitle the holders thereof to voting or any other rights of a stockholder.*"

⁸ See examples *infra* p. 756.

"I hereby subscribe for fifty shares of the common stock of corporation *C* of the par value of \$100.00 each, for which I agree to pay \$1000.00 upon the signing of this subscription and \$4000.00 in such manner and at such times as the board of directors of the corporation may direct." ⁹

Upon payment of the \$1000.00 does *S* become at once a shareholder, or is this a contract for the future creation as to *S* of fifty shares upon payment of the last "call" of the board? Or corporation *C* presents to *S* and he signs the following instrument:

"I hereby subscribe for fifty shares of the common stock of corporation *C* of the par value of \$100.00 each, provided subscriptions totalling \$50,000 are obtained." ¹⁰

Assuming that corporation *C* is then in existence and that this is not a pre-incorporation subscription, does *S* automatically become a shareholder upon the fulfillment of the condition by *C* obtaining *bona fide* subscriptions totalling \$50,000, or does *S* become a shareholder only at such future time as *C* may unequivocally recognize him as a shareholder either by tendering him a certificate or by entering his name upon the register of shareholders, etc.? Again, corporation *C* presents to *S* and he signs the following instrument:

"I hereby *purchase* fifty shares of the common stock of corporation *C* at \$100.00 per share. It is understood and agreed that the certificate will be issued as soon as available provided the purchase price as aforementioned has been paid in full." ¹¹

Does *S* become a shareholder immediately upon signing the instrument, or upon payment in full, or not until the corporation thereafter has done some act such as tendering him a share certificate whereby it then manifests its consent to his becoming the holder of the shares in question?

⁹ Cf. *In re Hall*, 206 Fed. 850 (N. D. Iowa 1913).

¹⁰ Cf. *St. Paul, etc., R. R. v. Robbins*, 23 Minn. 439 (1877).

¹¹ Cf. *Crichfield-Loeffler, Inc. v. Taverna*, 4 N. J. Misc. 310, 132 Atl. 494 (1926).

GUIDES TO THE DETERMINATION OF WHETHER A TRANSACTION
IS AN IMMEDIATE CREATION OF SHARES OR A
CONTRACT FOR THEIR FUTURE CREATION

Whether the acts of the parties in a given transaction should be interpreted as manifestations of consent to the immediate creation of shares or not will depend primarily upon the particular circumstances in each case. A few rules may, however, be suggested as tentative guides to the intention of the parties, but in no sense as absolute indications. If the agreement includes a promise by the corporation to permit the other party to participate in dividend payments from the time the agreement was entered into, this is strong evidence that the transaction was intended as an immediate creation of shares.¹² Similarly, if the corporation with the consent of the other party represents to third persons that payments made by the other party prior to the delivery of a share certificate to him are accretions to "capital," this suggests that the other party was regarded as at once becoming a shareholder at the time the transaction was entered into.¹³ On the other hand, if the corporation undertakes to pay interest to the other party on payments made by him prior to the delivery of a share certificate, this indicates an intention that the other party is not at once to be regarded as the holder of the shares.¹⁴ If the agreement provides for forfeiture of advance payments as the exclusive remedy of the corporation in the event of the other party's failure to pay a stipulated instalment when due, this also

¹² When the North American Company offered to its shareholders of record on *August 7, 1924*, the opportunity to acquire additional preferred shares, the subscription agreements provided in part as follows: \$20.00 per share is to be remitted by the subscriber with his subscription. . . . The balance, or \$30.00 per share allotted, will be advanced to the North American Company (hereinafter called the Company), for account and at the request of the subscriber hereby made, and the subscriber is required and hereby undertakes to repay the same in deferred instalments as follows: \$10.00 per share on January 2, 1925; \$10.00 per share on April 1, 1925; \$10.00 per share on July 1, 1925. . . . Preferred stock issued against this subscription is to bear 6% cumulative dividends from *July 1, 1924*. Upon completing the above deferred payments, . . . the subscriber or his assignee shall be entitled to receive . . . a certificate or certificates in transferable form representing the number of shares of preferred stock subscribed and paid for. Cf. *Sarback v. Kansas Fiscal Agency Co.*, 86 Kan. 734, 122 Pac. 113 (1912).

¹³ *Ross v. Bank of Gold Hill*, 20 Nev. 191, 19 Pac. 243 (1888).

¹⁴ *Stern v. Mayer*, 166 Minn. 346, 207 N. W. 737 (1926).

indicates that the other party is not regarded as the holder of the shares until he has made the final payment.¹⁵ An "acceleration clause," on the other hand, might imply the forfeiture of presently-existing shares.¹⁶

In the remainder of the paper I shall hurdle this difficulty of interpretation by assuming that the original transaction between the parties was unquestionably a contract for the future creation of shares, and shall attempt to examine into those legal consequences of such a transaction which vary according to the presence or absence of other typical facts.

SUBDIVISIONS

The subject has three distinct subdivisions: (1) contracts to create shares which the corporation has the power to create; (2) contracts to create shares which the corporation has no power to create, and which disability is not overcome prior to the contract date for the creation of the shares; (3) contracts to create shares which the corporation has no power to create, but which disability is overcome prior to the contract date for the creation of the shares. This paper is limited to the first of these subdivisions; the legal relations arising out of contracts to create shares which the corporation has no power to create will be dealt with in a subsequent article.

¹⁵ The stock purchase certificates recently issued by the International Nickel Company contained this typical clause: "Failure to pay any instalment within the time limits above fixed and as above set forth, shall operate as a forfeiture of all rights in respect of the subscription and the instalments previously paid thereon. . . ."

¹⁶ An excellent example is to be found in the 1924 subscription agreements of the North American Company: "In the event that the subscriber shall default in paying any instalment when due as above specified (and time shall be of the essence) all future instalments shall at once become due and the said Trust Company, without notice or advertisement and at public or private sale and at the cost of the subscriber, may at any time thereafter sell all or any part of the stock represented by the certificates so delivered to it as security for account of the subscriber and may apply the net proceeds, together with any dividends theretofore received by it upon the stock in question, to the satisfaction of the indebtedness of the subscriber. The surplus, if any, and any stock not so sold, shall, upon satisfaction of the subscriber's indebtedness, be delivered to the subscriber or his assignee against surrender of the initial payment receipt."

“POWER TO CREATE SHARES”

Inasmuch as the term “power to create shares” (or an equivalent short-hand expression) is an extremely useful tool in the presentation of this subject, an explanation of the sense in which it is herein used seems desirable. Corporation *C* needs more capital. The directors resolve to create additional shares. The president of corporation *C*, having been authorized by the board, thereafter says to *S*, a prospective shareholder:

“We are willing to let you have at once 100 of our non-voting 6 per cent. preferred shares of \$100 par value at a total price of \$75 per share to be paid upon call during the next three months.”

S responds, “I accept the offer.” Does *S* thereby become the holder of 100 non-voting 6 per cent. preferred shares of corporation *C*, assuming that such was the intention of the parties? This is said to depend upon whether or not the corporation had at the time of the transaction power to create as to *S* shares of the class and number in question.

But what does the term “power to create shares” mean, and how is the existence or non-existence of the power to be determined? Of primary importance in answering these questions are the language and judicial interpretation of applicable statutes. Of the diverse statutory prohibitions relating to the creation of shares, the following are the principal types: (1) a statutory prohibition against the creation of a particular class of shares, for example, non-voting shares;¹⁷ (2) a statutory prohibition against creating shares of a particular class beyond a certain number, for example, limiting the number of preferred shares to two-thirds in par value of the outstanding common shares;¹⁸ (3) a statutory prohibition against creating shares for a particular kind

¹⁷ In *People ex rel. Watseka Telephone Co. v. Emmerson*, 302 Ill. 300, 134 N. E. 707 (1922), art. XI, § 3 of the Illinois Constitution was construed to secure to each shareholder the right to vote for directors.

¹⁸ IDAHO COMP. STAT. (1919) § 4752 (9): “. . . at no time shall the total amount of the preferred stock, issued and outstanding, exceed two-thirds of the capital stock paid in cash or property.”

of consideration, for example, labor or services;¹⁹ (4) a statutory prohibition against creating shares for less than a certain minimum amount of consideration, for example, par value;²⁰ (5) a statutory prohibition against creating shares as to certain persons, for example, enemy aliens or infants or other corporations;²¹ (6) a statutory prohibition against creating shares without the antecedent consent of a stipulated percentage of the shareholders;²² (7) a statutory prohibition against creating shares without the antecedent consent of a public body such as the Blue Sky Commission;²³ (8) a statutory prohibition against creating shares without first filing certain required papers or statements in a designated public office.²⁴

¹⁹ MD. ANN. CODE (Bagby, 1924) § 41 (6): "Nothing in this Article shall authorize the issuance of stock or personal securities for personal services to be rendered in the future."

²⁰ Section 69 of the NEW YORK STOCK CORPORATION LAW (1909) provides *inter alia*: "No shares of stock having par value shall be issued for money in an amount less than the par value of such shares."

²¹ The General Corporation Act of Illinois, ILL. REV. STAT. (Cahill, 1927) c. 32, § 8, provides: "No corporation shall purchase, acquire or hold, directly or indirectly, the stock of a building corporation or of an agency and loan corporation." In a number of states, including Illinois, there are statutory provisions prohibiting one corporation from holding shares in another if the effect may be substantially to lessen competition.

²² The Alabama Constitution, ALA. CIV. CODE (1923) § 237, provides that: "No corporation shall issue preferred stock without the consent of the owners of two-thirds of the stock of said corporation."

²³ Cal. Laws 1917, c. 532, as amended by Laws 1919, c. 148: "Sec. 3. No company shall sell . . . or offer for sale, negotiate for the sale of, or take subscriptions for any security of its own issue until it shall have first applied for and secured from the commissioner a permit authorizing it so to do. . . . Sec. 4. . . . If he finds that the proposed plan of business of the applicant is not unfair, unjust or unequitable, that it intends to fairly and honestly transact its business, and that the securities that it proposes to issue and the methods to be used by it in issuing and disposing of them are not such as, in his opinion, will work a fraud upon the purchaser thereof, the commissioner shall issue to the applicant a permit authorizing it to issue and dispose of securities, as therein provided, in this state, in such amounts and for such considerations and upon such terms and conditions as the commissioner may in said permit provide. . . . Sec. 12. Every security issued by any company, without a permit of the commissioner authorizing the same then in effect, shall be void. . . ."

²⁴ For example: "The whole or any part of any unissued balance of the authorized capital stock may be issued, subsequent to the issue of stock certified by the articles of organization, by vote of the directors, under authority of the by-laws or of a general or special vote of the incorporators at the first meeting or of the stockholders at a subsequent meeting, if, within thirty days after such vote of the directors, a certificate signed and sworn to by the president, treasurer and a majority of the directors is submitted to the commissioner, setting forth— (a) the total amount of capital stock authorized; (b) the amount of stock already issued for cash payable by instalments and the amount paid thereon; also

Stipulations corresponding to the first six of the foregoing prohibitions may also be found in the articles of association of various corporations. Furthermore, certain prohibitions may be regarded as a matter of common law, such as the creation of shares of no par value, or, under certain circumstances, the creation of shares in another corporation, without express statutory authorization.²⁵

Let us return, then, to the transaction between *S* and corporation *C*. Will the transaction result in the immediate creation as to *S* of shares of a given class and number, as the parties intended? The answer depends upon three considerations: (1) does the transaction constitute a violation of one or more of the foregoing prohibitions; (2) what is the legal effect of non-compliance with such a prohibition; (3) what is the meaning of the term "share"? The first of these considerations is primarily a matter of fact, and it is upon the latter two that the question of the feasibility of stating that the corporation has "power to create shares" depends. It resolves itself into an analysis of the legal relations resulting from the transaction despite non-compliance with the prohibition, and secondly, a determination of whether or not those legal relations are accurately (in the sense of most conveniently) described by the term "shares."

If the statutes, or the provisions of the articles of association containing the prohibitions as to the creation of shares heretofore enumerated, always specifically stated that no attempted violation of the prohibition could result in the creation of shares, and if the legal relations connoted by the term "shares" were ex-

the amount of full paid stock already issued for cash, property, services or expenses; (c) the amount of additional stock to be issued for cash, property, services or expenses, respectively; (d) a description of said property and a statement of the nature of said services or expenses, in the manner required by Section 10. The commissioner shall examine such certificate in the same manner as the original articles of organization. If he finds that it conforms to the requirements of the law, he shall endorse his approval thereon, and it shall thereupon be filed in the office of the state secretary, who, upon payment of the fee provided in Section 55, shall cause it and the endorsement thereon to be recorded. *No issue of stock subsequent to that certified by the articles of organization shall be lawful until said certificate is filed with the secretary as aforesaid. . . .*" MASS. GEN. LAWS (1921) c. 156, § 16. The italics are the writer's.

²⁵ Cf. MACHEN, *op. cit. supra* note 2, at 77: "Probably, all authorities agree that a corporation cannot engage in speculation in stocks, unless such speculation is one of the expressed objects for which the company is incorporated."

pressly set forth or uniformly understood, then the legal consequences of the abortive attempt to violate the regulation would be relatively simple. One could readily predict at least what legal relations would *not* result from the transaction, and the generalization "no power to create shares" would have a clear meaning.

But unfortunately the sources of these prohibitions are not thus precise. To be sure, statutes of this character frequently state that all "increases of stock or indebtedness" in violation of the statute "shall be void."²⁶ But "void" is not a self-explanatory word, and courts differ as to its interpretation and application.²⁷ In practically every instance such transactions will have *some* legal consequences. These can be adequately described, when dealing with a single transaction, without the use of an expression such as "power to create shares," but when a correlation of the legal consequences of many varying fact situations is attempted, some such general term becomes essential. Whether the legal consequences of a given attempt to create shares in violation of a prohibition shall be described by the term "shares" is thus a query which demands an answer.

In a future article the present writer will present an analysis of the legal relations resulting from attempts to create shares in violation of each of the above-mentioned prohibitions. For the purposes of this paper it will be assumed that the precise legal consequences of such transactions are predictable. If no prohibition be violated, or if the legal consequences of the transac-

²⁶ State constitutions or statutes very commonly provide that "no corporation shall issue stock except for money paid, labor done, or property actually received, and all fictitious increase of stock or indebtedness shall be *void*."

²⁷ Compare, for example, *Sherman v. Smith*, 185 Iowa 654, 169 N. W. 216 (1919), with *Lee v. Cameron*, 67 Okla. 80, 169 Pac. 17 (1917). In the Iowa case there was a statute requiring permission from the executive council if it were proposed to create shares for something other than cash, and providing that "shares" created in violation of the statute should be "void." In an action to enforce promissory notes given in return for "shares" falsely certified to the council as created for money, the court held that consideration for the notes was not lacking, although no permission had been obtained to create shares for anything but money. In the Oklahoma case there was a constitutional provision that "no corporation shall issue stock except for money, labor done, or property actually received to the amount of the par value thereof, and all fictitious increases of stock or indebtedness shall be void." In an action to cancel "shares" purported to have been created as to *D* by the *P* corporation for 40 per cent. of par, it was held that neither *D* nor an innocent transferee for value from *D* became a shareholder by virtue of either transaction.

tion, even though in violation of the prohibition, are no different, at least in the particulars heretofore set forth in defining the norm of a "share,"²⁸ than if the prohibition had not been violated, then the transaction will herein be described as within the corporation's "power to create shares." But if the legal consequences of the transaction, in any of the respects enumerated in the foregoing definition of "shares," will be different than if the prohibition had been complied with, then the corporation will be said to have "no power to create shares" by such a transaction.

CONTRACTS TO CREATE SHARES WHICH THE CORPORATION HAS THE POWER TO CREATE

Cases involving this type of contract are almost uniformly concerned with some phase of this question: what are the legal relations between the parties when the time for performance has arrived? Especially when confronted with an action by the corporation to obtain the contract price of the shares, courts tend to resolve their doubts as to the "nature" of the transaction by characterizing it under some circumstances as a "subscription" and under others as a "purchase and sale" of property.²⁹ Such verbiage, however, merely serves to becloud three important and inseparable problems.

In the first place, when the stipulated date for performance of the contract has arrived (or if no specific date is set, when a reasonable time has elapsed), does the other party automatically become the holder of the shares contracted for, or is some further act, either on his part or on the part of the corporation or

²⁸ See *supra* p. 754.

²⁹ In *Marson v. Deither*, 49 Minn. 423, 52 N. W. 38 (1892), after holding that non-tender of a certificate is no defense to payment of a 40 per cent. "call" on a "subscription" made by the assignee of an insolvent corporation for the benefit of its creditors, the court added, at 427, 52 N. W. at 39: "The rule, of course, has no application to the case of a sale of stock, which stands on the same footing as any other contract of purchase of property." This distinction was quoted with approval in *Barnard v. Tidrick*, 35 S. D. 403, 152 N. W. 690 (1915). In *Crichfield-Loeffler, Inc. v. Taverna*, *supra* note 11, in limiting the corporation to damages rather than the full contract price, the court said, at 312, 132 Atl. at 495: "Upon an examination of the contract we have reached the conclusion that it is not a subscription agreement, but a contract for the sale of stock controlled by the law appertaining to the sale of goods."

both, a pre-requisite to the existence of such shareholdership?³⁰ This may be regarded as analogous to those oftentimes fruitless inquiries in sales cases as to whether or not the "property" or the "title" has passed to the buyer.³¹ The theory behind this question is, of course, that one cannot be made a shareholder in a corporation without his consent, nor can he become a shareholder without the consent of the corporation,³² and that consequently such acts of consent are essential to the creation of the shares on the agreed date, unless the mere acts of the parties in entering into the contract may be regarded as continuing manifestations of consent to the creation of the shares, culminating in shareholdership on the date for performance. A carefully drawn contract will, to be sure, explicitly provide the legal relations of the parties when the contract date for the creation of the shares arrives,³³ and in the absence of such stipulations the only feasible course is neither to affirm nor to deny that a status of

³⁰ Happily, some few courts have clearly recognized the confusion latent in the term "subscription." Examine, for example, the case of *Kruse v. Hudson County Brewing Co.*, 79 N. J. Eq. 392, 82 Atl. 104 (1911), in which Vice Chancellor Garrison said, at 404, 82 Atl. at 109: "What the rights are of one who subscribes to capital stock must, in each instance, be determined by the contract between him and the company; and the words 'subscriber to capital stock' cannot be held to have a fixed, definite and unchangeable meaning. In one case, by the terms of the contract, the so-called 'subscriber' may have immediately become a stockholder; in another case, he might not become a stockholder until he had paid certain sums of money; and so through all the variations that contractual relations are subject to as regulated by their terms."

³¹ Cf. *UNIFORM SALES ACT*, § 63 (1): "Where, under a contract to sell or a sale, the 'property' in the goods has passed to the buyer, and the buyer wrongfully neglects or refuses to pay for the goods according to the terms of the contract or the sale, the seller may maintain an action against him *for the price of the goods*"; with § 64 (1): "Where the buyer wrongfully neglects or refuses to 'accept' and pay for the goods, the seller may maintain an action against him *for damages for non-acceptance*." The quotation marks and italics are those of the writer.

³² Cf. *Foote v. Anderson*, 123 Fed. 659 (C. C. A. 3d, 1903). In holding that the mere fact that a certain bank's stock-book set forth that the defendant owned 135 shares was not sufficient evidence to subject him to a shareholder's statutory responsibility to creditors of the bank, the court said, at 661: "It is clear that a corporation by its own act cannot make one its shareholder, nor can one make himself a shareholder without the consent of the corporation. The corporation may evidence its assent to the creation of the relation by placing on its books the name of one as a shareholder, and that act may evidence, as against the company, the contract, and a person, by knowledge of and acquiescence in such act, may be held a stockholder; but it is equally clear that, this relation being one based on mutual consent, neither party by its or his own separate act can create it. It requires assent of both to bind."

³³ See *supra* note 7.

shareholdership has resulted without a detailed examination into the respective legal consequences of the transaction on or after the contract date for performance.³⁴

The second major problem inherent in every contract for the future creation of shares is: what acts did the parties respectively undertake to perform, or in other words, what acts by each constitute performance or at least "substantial" performance of the bargain. If we assume that shareholdership does not *ipso facto* result as to the other party upon the arrival of the contract date for the creation of the shares, and that the contract therefore contemplates further action on the part of the corporation, what are the acts which performance of the contract requires of the corporation? Is any unequivocal recognition of the other party as the holder of the shares contracted for sufficient, such as entering him as a shareholder on the books of the corporation, sending him notices of shareholders' meetings, etc., or is the tender of a share certificate or an equivalent instrument to the other party in every case an essential element of substantial performance by the corporation, unless the contract specifically provides otherwise? Even if we assume that shareholdership does automatically result on the contract date for the creation of the shares, the question still remains as to whether the mere existence of this status constitutes corporate performance of the bargain, or whether the corporation is in default until it has at least made a share certificate or equivalent instrument available to the other party. In many cases arising out of contracts for the future creation of shares much perplexing debate might be avoided by a clear-cut recognition that the ultimate issue is solely what constitutes performance of the agreement. As will be hereafter developed, in the last analysis the determination of this question depends not upon the "intention" of the parties, where no specific intention is clearly manifested, but upon the customs of the particular economic "institution" involved, *i. e.*, upon the typical reactions of those engaged in marketing and investing in corporate shares.

³⁴ See *supra* notes 5 and 6.

The foregoing consideration of what acts constitute performance of the contract leads inevitably to the third problem latent, but seldom articulate, in cases arising out of these contracts. Are the promises of the parties independent or mutually dependent? If the corporation has promised to deliver a share certificate to the other party on a certain date, and he has promised to pay the agreed price on a certain date (not necessarily the same date), under what circumstances if any will the corporation have a right to the price without first tendering the certificate; or, conversely, under what circumstances if any will the other party have a right to the certificate without first tendering the price? A study of the rules for determining whether contractual promises are independent or mutually dependent is beyond the scope of this paper,³⁵ and the question is here emphasized merely because many of the controversies resulting from contracts for the future creation of shares might have been avoided had the draftsmen of such contracts been conscious of this problem.³⁶

³⁵ For the classical exposition of the rules for determining whether the duties of the parties to a bi-lateral contract are independent or mutually conditional, see the footnote by the reporter, Sergeant Williams, to the case of *Pordage v. Cole*, 1 Wms. Saunders 319 (1669), CORBIN, CASES ON CONTRACTS (1921) 508. For modern applications examine *Noyes v. Brown*, 142 Minn. 211, 171 N. W. 803 (1919), CORBIN, 522; *International Text-Book Co. v. Martin*, 221 Mass. 1, 108 N. E. 469 (1915), CORBIN, 529. For a detailed study of the problem see 2 WILLISTON, CONTRACTS (1920) § 816, *et seq.*

³⁶ An apparent conflict of decisions in a given jurisdiction may be merely an implicit judicial recognition that in one transaction for the creation of shares mutually dependent duties resulted, while in another the duties of the corporation and of the other party were independent. For example, in *St. Paul, etc., R. R. v. Robbins*, *supra* note 10, the defendant signed the "stock-subscription book" of the plaintiff and promised to pay for the number of shares set opposite his name. In an action to recover the amount of the "subscription" non-tender of a certificate was allowed as a defense on the express grounds (at 442) that the two promises were "concurrent and dependent." In *Columbia Electric Co. v. Dixon*, 46 Minn. 463, 49 N. W. 244 (1891), the defendant "subscribed" for certain shares in the plaintiff corporation and gave his promissory note therefor to the plaintiff. In an action to enforce payment of the note, non-tender of a certificate was not allowed as a defense. This illustrates the English view approved by Professor Langdell in his *SUMMARY OF CONTRACTS* (2d ed. 1880) 150, but by the weight of authority in this country the promise in a promissory note is treated as conditional upon the performance of a promise given in a separate instrument in exchange for the note. See 2 WILLISTON, *op. cit. supra* note 35, § 840. In Indiana, for example, this view was adopted at an early date by *McCulloch v. Dawson*, 1 Ind. 413 (1849); hence, in that state, failure of the plaintiff corporation to allege affirmatively tender of a certificate was allowed as

UPON THE ARRIVAL OF THE CONTRACT DATE FOR PERFORMANCE
IS TENDER TO THE OTHER PARTY OF A CERTIFICATE FOR
THE SHARES CONTRACTED FOR A CONDITION TO
THE CORPORATION'S RIGHT TO THE
PURCHASE PRICE?

The courts and text-writers almost universally agree that in the case of a "subscription" to shares tender of a share certificate is not pre-requisite to a right in the corporation to the contract price, whereas in the case of a "purchase" of shares from the corporation, the duty of the other party to pay the contract price is contingent upon the tender to him of a certificate.³⁷ Unfortunately, however, the authorities fail to indicate in what way a "subscription" is to be distinguished from a "purchase" or the reasons for this distinction.

a defense to an action to enforce payment of a promissory note given by the defendant to the plaintiff pursuant to his "subscription." *Summers v. Sleeth*, 45 Ind. 598 (1874).

Furthermore, a duty to make a partial payment of a "subscription" may be regarded as independent of performance by the corporation as in *Marson v. Deither*, *supra* note 29, whereas the duty to pay in full or to pay a final instalment may be regarded as dependent upon corporate performance, including tender of a certificate.

Cf. Walter A. Wood Harvester Co. v. Robbins, 56 Minn. 48, 50, 57 N. W. 317, 318 (1893), which held that "a tender of the certificate of stock is not a condition precedent to a right of action to recover an *instalment* of the stock subscription," with *Walter A. Wood Harvester Co. v. Jefferson*, 57 Minn. 456, 460, 59 N. W. 532, 533 (1894), which held that "a readiness and willingness, however, to deliver the certificate must be alleged in the complaint in actions for the *whole amount subscribed*, or to enforce payment of the final instalment of the amount subscribed." The italics are the writer's.

³⁷ See Note, *Necessity of Issuance or Tender of Stock Certificate to Render Subscriber Liable as a Stockholder* (1915) L. R. A. 1915A 465, 468: "The doctrine that a tender of a stock certificate is not a condition precedent to an action by the corporation to recover the subscription, or to the liability of the subscriber on his subscription, is expressly limited, in some cases, to subscriptions as distinguished from sales. . . . When there is a sale of corporate stock as distinguished from a subscription, the corporation cannot maintain an action on the contract without offering to deliver, or having ready for delivery, the stock. . . ." See also BALLANTINE, *PRIVATE CORPORATIONS* (1927) 108: "In case of a *contract to purchase* shares the delivery of the certificates and the payment of the price are usually intended by the parties to be concurrent acts. Neither party can ordinarily sue the other without a tender of performance, and the purchaser will not become a shareholder until the certificates have been indorsed and delivered. But in case of a *subscription* it is not ordinarily necessary either that the certificates be tendered or that the subscription price be paid. It is well settled that the issue or tender of a certificate of stock is not a condition precedent to the right of a corporation to make calls or maintain an action on a *subscription* for stock. . . ." The italics are the writer's. See 5 THOMPSON, *op. cit. supra* note 2, § 3808.

One possible difference between these two types of transactions suggested by the cases and texts is solely as to the facts involved. In the case of a "subscription" the very word "subscribe" is used, or the other party signs an instrument headed "subscription list," and the transaction between the other party and the corporation is part of a campaign by the corporation to market a block of shares and is merely one of a number of similar transactions between the corporation and other persons, whereas in the case of a "purchase" the term "subscribe" or "subscription" does not appear and the transaction between the other party and the corporation is an isolated one and unconnected with any general offering of shares by the corporation to the public or to its shareholders. But there would appear to be nothing inherent in such a factual difference between the two types of transactions which would justify dispensing with tender of a certificate in the one case as a pre-requisite to a right to payment, and requiring it in the other.

A more plausible distinction suggested by a careful examination of the cases is that the courts use the term "subscription" to describe a transaction whereby the other party is regarded as having at once become a shareholder, even prior to payment or tender of a certificate,³⁸ and the term "purchase" to designate a

³⁸ *E. g.*, a careful study of the cases cited in the L. R. A. note, *supra* note 37, for the proposition that "tender of a stock certificate is not a condition precedent . . . to the liability of the subscriber on his subscription" reveals that in every such case the court regarded the other party as having become a shareholder and frequently expressly emphasized that fact. Examine: *Chandler v. Northern Cross R. R.*, 18 Ill. 190 (1856); *New Albany & Salem R. R. v. McCormick*, 10 Ind. 499 (1858); *Slipher v. Earhart*, 83 Ind. 173 (1882); *Waukon & Mississippi R. R. v. Dwyer*, 49 Iowa 121, 125 (1878) ("a subscriber to stock becomes a stockholder by virtue of the subscription in the absence of a provision requiring payment as a condition of membership; and that, too, without the receiving of any certificate of stock"); *Smith & Davis v. Gower*, 2 Duv. 17 (Ky. 1865); *Glenn v. Rosborough*, 48 S. C. 272, 26 S. E. 611 (1896); *Astoria, etc., Ry. v. Hill*, 20 Ore. 177, 181, 25 Pac. 379, 380 (1890) ("The effect of the ordinary subscription to the capital stock of a corporation is to constitute the subscriber a shareholder immediately, with the right to vote at meetings and share in the dividends, and subject him to a liability to contribute to the amount of his subscription when called upon in a legal manner. . . . It has been repeatedly held that the tender of a certificate for shares is never a condition precedent to the liability of a *shareholder* to contribute the amount of his share after a proper call." The italics are the writer's.) See *Delaware R. R. v. Thorp*, 1 Houst. 149, 155 (Del. 1855), where the court said: "We think there is no substantial distinction in the charter between the meaning of the terms subscriber and stockholder as indifferently employed in it, and that a subscriber may

transaction in which the vesting of shareholdership in the other party is regarded by the courts as being postponed until the happening of a future event, normally payment of the agreed price.³⁹ As a basis for determining whether tender of a share certificate is a pre-requisite to the corporation's right to the price, this distinction between a "subscription" and a "purchase" is as untenable as the factual differentiation indicated above.

Such emphasis upon the status of the other party is misplaced. The real issue is: (1) whether the bargain is to be construed as requiring payment by the other party on a given date independently of any question of "performance" by the corporation; ⁴⁰ or (2) whether, if the bargain be construed as making

be sued even under this charter for arrears due from him on his subscription without proof that certificates of stock had been issued or tendered to him." *Kennebec & Portland R. R. v. Jarvis*, 34 Me. 360 (1852); see *Robson v. Fenniman Co.*, 83 N. J. L. 453, 457, 85 Atl. 356, 358 (1912) ("The subscription of the plaintiff, and its acceptance by the corporation, were considered by both parties as constituting the plaintiff a stockholder of the company. . . .").

The following recent cases also support the conclusion that if the other party is regarded by the court as having become a shareholder, tender to him of a share certificate is not a prerequisite to his duty to pay the agreed price: *Eastern States, etc., Exposition v. Vail's Estate*, 96 Vt. 517, 121 Atl. 415 (1923); *Preston v. Jeffers*, 179 Ky. 384, 200 S. W. 654 (1918); *Skluzacek v. Forsum*, 139 Minn. 498, 166 N. W. 124 (1918); *Doyon v. Fogleson*, 46 S. D. 290, 192 N. W. 752 (1923); *Majors v. Girdner*, 31 Cal. App. 47, 159 Pac. 826 (1916); *Gallatin County Farmers' Alliance v. Flannery*, 59 Mont. 534, 197 Pac. 996 (1921); *Kennebec Housing Co. v. Barton*, 123 Me. 293, 122 Atl. 852 (1923); *First Caldwell Oil Co. v. Hunt*, 100 N. J. L. 308, 101 N. J. L. 240, 127 Atl. 209 (1925).

³⁹ In each of the following cases in which tender of a share certificate to the other party was held to be a condition precedent to a right in the corporation to recover the agreed price from him, the court apparently regarded the other party as not having become a shareholder: *Baird v. Kiline*, 53 N. D. 244, 205 N. W. 681 (1925); *Phillips v. Matthews*, 205 Ala. 480, 88 So. 641 (1921); *In re Hall*, *supra* note 9; *Summers v. Sleeth*, *supra* note 36; *St. Paul, etc., R. R. v. Robbins*, *supra* note 10; *Considerant v. Brisbane*, 14 How. 487 (N. Y. 1857); *Barnard v. Tidrick*, *supra* note 29; *cf. Lincoln Shoe Mfg. Co. v. Sheldon*, 44 Neb. 279, 62 N. W. 480 (1895); see *Marlatt v. Coutoure*, 41 N. D. 127, 132, 169 N. W. 582, 584 (1918). In *St. Paul, etc., R. R. v. Robbins*, *supra*, the court said, at 441: "It appears from the complaint that, at the time of this subscription, the company was fully organized, so that it does not stand upon precisely the same footing as a subscription made prior to, and for the purpose of effecting, the organization. Such a subscription gives to the subscriber an interest in the corporation, and the right to take part in organizing it, and this interest and right are a sufficient consideration to support his promise. But the subscription in this case does not appear to have been to the original stock. . . . The mere subscription to this stock, while it constitutes a valid contract on the part of the company to issue the stock to defendant upon his paying for it, and, on his part, to receive and pay for it, does not give him an interest in the company, nor vest in him the title to the stock."

⁴⁰ See *supra* note 35.

the right to payment and the right to "performance" by the corporation mutually dependent, the corporation should be regarded as having sufficiently performed in the absence of a tender of a certificate.

In many contracts for the future creation of shares payment in full by the other party antedates any duty of the corporation to tender a certificate, as, for example, in the case of convertible bonds, loans secured by a pledge of "unissued shares," and stock dividend warrants. Although many problems involving the status of the other party may arise out of such transactions, their facts exclude the question now under consideration, namely, the duty of the corporation to tender a certificate as a condition precedent to a right to the agreed price.

The modern tendency is so strongly opposed to construing duties in bi-lateral contracts as mutually independent that, in the absence of an express contrary intention of the parties, the duties of the corporation and of the other party will normally be held to be mutually and concurrently conditional.⁴¹ Moreover, if in some few instances the right of the corporation to the contract price of the shares be regarded as totally independent of any performance on its part, the question as to what constitutes performance on the part of the corporation and the related question as to whether or not the other party has acquired the status of a holder of the shares contracted for are, of course, immaterial. Where, however, the duties arising out of a contract for the future creation of shares are mutually dependent, most courts seem to regard the status of the other party at the time of the suit for the contract price as decisive of his duty to pay: if he is then a holder of the shares contracted for he must pay the agreed price; if he is not, he has a defense.⁴²

Upon the arrival of the contract date for the creation of the shares the other party may automatically become a holder of the

⁴¹ See 2 WILLISTON, *op. cit. supra* note 35, § 835: "Since concurrent conditions protect both parties, courts endeavor, so far as is not inconsistent with the expressed intention of the parties, to construe performances of mutual promises as concurrent conditions." *Courtright v. Deeds*, 37 Iowa 503 (1873). But *cf. Farmers' Mutual Telephone Co. v. Howell*, 132 Iowa 22, 109 N. W. 294 (1906).

⁴² See *supra* notes 38 and 39.

shares contracted for even though no certificate has as yet been tendered him. If he does not, then further action is necessary. This will usually be some form of recognition of him as a shareholder by the corporation, such as tendering him a share certificate, entering him on the register of shareholders, sending him notice of shareholders' meetings, etc. If such shareholdership could result only by tender to him of a share certificate, then, of course, a rule requiring shareholdership as the condition precedent to his duty to pay would be identical with a rule requiring a tender of a certificate as a condition precedent. But tender of a certificate is not essential to the creation of shares. Consequently, courts which allow non-tender of a certificate as the sole defense to the payment of the purchase price must do so not because the other party is regarded as not having become a holder of the shares contracted for, but because they regard tender of a certificate as an essential element in performance by the corporation of its part of the bargain, regardless of whether or not the shares contracted for have been created as to the other party at the time of the suit.

Throughout this discussion it is assumed that the contract does not expressly or by reasonable implication indicate the intention of the parties as to whether the duty to pay the agreed price is to be contingent on tender of an appropriate certificate or not. Under what circumstances, then, should performance by the corporation of the conditions precedent to its right to the price be construed to include tender to the other party of the certificate? The question can be answered only by determining the degree of importance in the commercial world of possession of such a certificate. In the case of a small, closed corporation, possession of a share certificate may be of relatively slight importance to the other party once he has acquired the shareholdership contracted for. But where the transaction involves a large corporation whose shares are listed on a recognized exchange and are actively dealt in, the commercial correlation between a share certificate and the shares it evidences may be so great that without a certificate the other party would be seriously handicapped in the enjoyment of that which he sought by the contract, even though technically he

had acquired the contemplated shareholdership.⁴³ Under these latter circumstances the courts might well deem the corporation's performance as not substantially complete until it had tendered to the other party a share certificate or an instrument which those dealing therein would regard as its equivalent.⁴⁴

WHAT IS THE MEASURE OF THE CORPORATION'S CLAIM AGAINST THE OTHER PARTY?

Where the corporation has performed all conditions precedent to its right to payment and the other party is in default, can it recover from him the full contract price or only damages measured by the excess of the contract price over the market value of the shares? The authorities approach this problem too by inquiring whether the transaction was a "subscription" or a "sale."⁴⁵ In the case of a "subscription," particularly a pre-incorporation subscription, the right of the corporation to recover the full contract price is unquestioned.⁴⁶ But if the transaction be regarded

⁴³ An analogous situation is presented by a "sale c. i. f." where delivery of "shipping documents" (*i. e.* bill of lading, invoice, insurance policy) by the seller to the buyer may be a prerequisite to the seller's right to the purchase price, even though the goods have arrived safely, been delivered to the buyer, and the "property" therein is regarded by the court as having passed to the buyer. *Mitsubishi Goshi Kaisha v. J. Aron & Co., Inc.*, 16 F. (2d) 185 (C. C. A. 2d, 1926); *Orient Co. Ltd. v. Brekke & Howlid*, [1913] 1 K. B. 531; *Harper v. Hockstim*, 278 Fed. 102 (C. C. A. 2d, 1921), 20 A. L. R. 1232 (1922); *cf.* *Lundy v. S. Pfeifer & Co.*, 162 La. 355, 110 So. 556 (1926).

⁴⁴ The importance of possession of a share certificate has been enhanced by the provision of the Uniform Stock Transfer Act, § 1, that title to a certificate and to the shares represented thereby can be transferred only by delivery of the certificate.

⁴⁵ See *Crichfield-Loeffler, Inc. v. Taverna*, *supra* note 11, in which the defendant signed an agreement as follows: "The undersigned hereby purchases fifty shares of the C corporation at \$10.00 per share." In construing the agreement the court said, at 312, 132 Atl. at 495: "Upon an examination of the contract we have reached the conclusion that it is not a subscription agreement, but a contract for the sale of stock controlled by the law appertaining to the sale of goods." *Cf.* *Lincoln Shoe Mfg. Co. v. Sheldon*, *supra* note 39, in which the defendant signed the following agreement: "For value received we, the undersigned subscribers, hereby bind ourselves to purchase the number of shares of stock set opposite our names in the L company at \$50.00 per share." In construing this agreement the court said, at 288, 62 N. W. at 482: "While it is true that the word 'purchase' is in the contract, yet we are unable to construe this contract as a contract of sale of stock."

⁴⁶ In some jurisdictions, especially in the New England states, the right of the corporation against the subscriber is held to exist only if he expressly promised to pay, the remedy of the corporation in the absence of such an express promise being limited to a forfeiture. See 1 COOK, *op. cit. supra* note 2, § 74; 5 THOMPSON, *op. cit. supra* note 2, § 3764.

as analogous to a "contract to sell," there is no uniform rule as to the amount of the corporation's recovery.⁴⁷

Prior to the *Sales Act* there were three lines of cases dealing with the amount the seller might recover if the buyer breached his contract: (1) the "English" view, followed by nearly half the states, that the difference between the contract price and the market value of the goods was always the measure of the seller's recovery;⁴⁸ (2) the "New York" view, accepted in a number of states, that the seller, by not only tendering the goods to the buyer but also setting them aside for him, may always recover the full price;⁴⁹ (3) a middle view, held in New Hampshire and a few other states, accepting the New York rule where the goods were not readily marketable at a fair price but adopting the English rule in all other cases.⁵⁰ The *Sales Act*, enacted in twenty-

⁴⁷ The cases which, in considering the amount of the corporation's recovery against the other party, suggest a distinction between a subscription to shares and a sale of shares apparently use the term "sale" to refer to a transaction for "treasury shares," but even as to such "sale" there is no uniform rule as to the amount of the corporation's recovery. In the case of *Crichfield-Loeffler, Inc. v. Taverna*, *supra* note 11, the court emphasized the fact that the agreement might have been for "treasury shares" (although the agreement expressed no such intent, nor did the evidence reveal that the corporation had any "treasury shares"), and on this basis limited the corporation's recovery to the difference between the contract price and the market price at the time the other party refused to perform. In *Lincoln Shoe Mfg. Co. v. Sheldon*, *supra* note 39, on the other hand, the court expressly refused to construe the agreement as referring to "treasury shares" and gave judgment for the full contract price. Furthermore, in the case of *Button v. Cities Fuel & Power Co.*, 300 Fed. 280 (C. C. A. 4th, 1924), 266 U. S. 619, 45 Sup. Ct. 98 (1924), the court granted a recovery against the other party of the full contract price, although the agreement clearly involved "treasury shares."

Although a detailed analysis of "treasury shares" is beyond the scope of this paper, some confusion might be avoided by reiterating that a corporation is never in any useful sense a shareholder with respect to its own shares; the term "treasury shares" merely refers to a power in the corporation to create certain shares, which power it acquired in a particular way, to wit, by the surrender or cancellation of shares formerly outstanding, in contradistinction to power to create shares resulting from the corporation's original authority not as yet exercised. Although for other purposes there may be justifiable distinctions between "treasury shares" and "authorized but unissued capital stock," for the purpose of determining the amount of the corporation's recovery upon a contract to create shares the source of its present power to create shares of the class and number contracted for would appear to be immaterial. Indeed, if the corporation tenders "treasury shares" to the other party, he will normally be benefited by the fact that fewer shares of that class will be outstanding than if the corporation had tendered him part of its "authorized but unissued capital stock."

⁴⁸ 2 WILLISTON, SALES (2d ed. 1924) § 562.

⁴⁹ *Ibid.*

⁵⁰ *Ibid.* § 564.

nine jurisdictions, including all of the important commercial states, adopts the third view.⁵¹

But the *Sales Act* does not apply to contracts for the creation of shares; nor is there sufficient analogy between a sale of tangible personal property and a creation of shares to compel an application of the sales rules to the latter situation. The amount which the corporation should be permitted to recover is a *sui generis* proposition as to which there is little direct authority. Cases involving a transfer of shares by one shareholder to another present quite different considerations.

In the case of a sale of goods, if the "property" has passed to the buyer and the seller is not in default the seller may always enforce payment of the contract price.⁵² Similarly, as has been noted, if the shareholdership contracted for has resulted and the corporation is not in default it has a right to the full contract price. In the case of a contract to sell goods, the "property" not having passed to the buyer, many writers believe that to give the seller who still has "title" an action for the full contract price is anomalous.⁵³ However justified such an attitude may be with respect to contracts to sell goods, it finds no parallel in contracts to create shares. The unpaid seller of the goods still has the goods; his damage is the temporary loss of the advantage of a sale. The unpaid corporation has nothing, since it is never in any useful sense a holder of its own shares. It can acquire substance only by the receipt of capital pursuant to contracts to create shares, and not to entitle the corporation to enforce payment in full of such contracts is to withhold from it its life-blood.

In modern corporate financing the initial working capital of newly organized corporations is frequently obtained, not as a result of pre-incorporation subscriptions (unquestionably enforceable in full), but through the medium of contracts to create shares entered into by the corporation shortly after the formalities of incorporating have been complied with. Moreover, even where corporations have long been in existence, plans for expansion or re-organization frequently involve complicated and delicately bal-

⁵¹ UNIFORM SALES ACT, § 63 (3).

⁵² 2 WILLISTON, *op. cit. supra* note 48, § 561.

⁵³ 2 WILLISTON, *op. cit. supra* note 48, § 565.

anced financial arrangements that would be defeated or seriously hampered with no proportionate gain to anyone, if those who had agreed to contribute definite sums to the corporation's capital could not be made to pay the full amount. Furthermore, the difficulty heretofore emphasized of determining whether or not one is a shareholder and of differentiating, factually or logically, between pre-incorporation and post-incorporation agreements to become a shareholder renders desirable a uniform rule in all such cases as to the amount of the corporation's recovery upon breach by the other party. These reasons, combined with a moralistic sympathy toward any extension of the doctrine of specific performance, recommend that if payment of the contract price be past due and the corporation itself be not in default it should be granted a recovery of the full amount, regardless of whether or not the other party has become the holder of the shares contracted for, and without reference to whether the transaction was entered into prior to incorporation or thereafter.⁵⁴

If the other party is compelled to pay the contract price for the shares, it would seem beyond question that following the enforced payment he should be entitled to recognition as a shareholder whether or not he was prior thereto.⁵⁵ Consequently, the corporation should have the election either of rescinding the transaction and making the other party pay damages, measured by the excess of the contract price over the reasonable sale value of the shares, or of affirming the transaction and compelling payment of the full contract price. The further problem presents itself, however, as to whether or not the other party can, at his election, refuse to become a shareholder despite such enforced performance of his contract. For instance, corporation *C* contracts with *S* to create ten common shares as to him on May 1, and in return

⁵⁴ Accord: *Smith v. General Motors Corp.*, 280 Fed. 205 (C. C. A. 6th, 1923); *Scranton Axle & Spring Co. v. Scranton Board of Trade*, 271 Pa. 6, 113 Atl. 838 (1921); *Button v. Cities Fuel & Power Co.*, *supra* note 47; *Provident Gold Mining Co. v. Security Co.*, 168 Cal. 304, 142 Pac. 884 (1914); *Lincoln Shoe Mfg. Co. v. Sheldon*, *supra* note 39. *Contra*: *Crichfield-Loeffler, Inc. v. Taverna*, *supra* note 11.

⁵⁵ In *Button v. Cities Fuel & Power Co.*, *supra* note 47, after decreeing payment of the full contract price, the lower court said, at 298: "It follows, of course, that Doherty, when these payments have been properly made, will be entitled to the 20,000 shares of stock."

S agrees to pay \$1000.00 on that date. On May 1, corporation *C* tenders *S* a certificate for ten shares which he refuses to accept. Corporation *C* thereafter obtains a judgment against *S* for \$1000.00. *S* pays \$1000.00 to *C* but notifies the corporation that he does not want to be registered as a shareholder or to receive a certificate or to have anything to do with the corporation. Would *S* thereafter be a shareholder? For example, if a statute imposed upon *shareholders* a responsibility to corporate creditors, would *S* be subject to such responsibility? If the suit by corporation *C* against *S* be regarded as in the nature of a bill for specific performance, then *S* would probably be held to such a statutory responsibility, for one of the benefits to the shareholders of corporation *C* (the real parties in interest behind the corporate entity) of performance of the contract is the acquisition by *S* of this statutory duty.

DOES BANKRUPTCY OF THE CORPORATION UPON THE CONTRACT
DATE FOR THE CREATION OF THE SHARES TERMINATE
ITS CLAIM AGAINST THE OTHER
PARTY FOR THE CONTRACT PRICE?

Minnesota appears to be the only state which has thus far decided this question. In the case of *Stern v. Mayer*⁵⁶ the defendant signed an instrument whereby he purported to "subscribe" for five shares in corporation *C*, and agreed "to take the same when issued and to pay for the same \$800.00" in yearly instalments of seventy-two dollars. The corporation agreed "to issue and deliver the stock when the amount paid with interest thereon at 6 per cent. per annum from the date of each payment shall equal the subscription price of the stock." The instrument also contained a forfeiture clause. Subsequent to the execution of this agreement corporation *C* was adjudged a bankrupt and the plaintiff, as trustee, sought to recover from the defendant an alleged balance unpaid on the agreement. The court sustained a demurrer to the complaint on the ground that the writing constituted a "sale" of shares and not a "subscription," that the de-

⁵⁶ *Supra* note 14, at 347, 207 N. W. at 737; Note (1927) 46 A. L. R. 1172.

fendant did not thereby become a shareholder, and that the bankruptcy of the corporation resulted in a "complete destruction of the subject matter which makes performance impossible."

In the decision of such a case the interpretation of the agreement is obviously of extreme importance. If the defendant were unquestionably a shareholder (for example, if he had been the transferee with notice of an existing shareholder and had been registered on the corporate books as such), the bankruptcy of the corporation would clearly not exonerate him from the payment of any balance due on the shares for the benefit of the corporation's creditors. Where, however, as in the instant case, the defendant has dealt directly with the corporation and has neither claimed nor received any benefits of shareholdership, it may be practically impossible to determine categorically whether or not he became a shareholder by virtue of the transaction, if the intention of the parties with respect thereto is not clearly manifested. Under such circumstances, in the absence of other facts creating equities in favor of the corporation's creditors against the defendant, it would seem proper to regard the intervening bankruptcy of the corporation as a defense to further payments on the agreement. But the question of the defendant's status is not necessarily decisive, for even though the agreement evidenced a clear intent that the defendant was not to become a shareholder until the final payment agreed upon, if the defendant had been held out to corporate creditors with his consent as a shareholder (for example, by the publication of a statement by the corporation with the knowledge of the defendant that his advance payments had been credited to the "capital" of the corporation), the trustee in bankruptcy, on behalf of the corporation's creditors, might reasonably be accorded a claim against the defendant for the unpaid balance of the agreed price.

HAS THE OTHER PARTY A RIGHT TO SPECIFIC PERFORMANCE BY THE CORPORATION?

Thus far only suits by the corporation upon the other party's breach of the contract have been considered. A more complex situation is presented by the cases dealing with the remedies of

the other party where the corporation is in default.⁵⁷ Upon the deliberate refusal of the corporation to comply with the other party's demand for the shares contracted for on or within a reasonable time after the date for their creation, he may maintain a bill for specific performance provided: (1) shares of the class and number contracted for are not readily obtainable elsewhere; or (2) the reasonable sale value of such shares is indeterminable; and (3) the rights of existing shareholders will not be thereby violated.⁵⁸

In order to defeat the other party's claim to specific performance, it must always appear that he did not automatically become a shareholder upon the agreed date; for if he became a shareholder and his action is regarded as one to compel the corporation specifically to recognize him as such, the fact that similar shares are readily obtainable elsewhere will not be allowed as a defense.⁵⁹ In short, equity is unwilling to compel the corpora-

⁵⁷ Unless the contract to create shares clearly indicates that the other party is not to become a shareholder on or after the agreed date until the corporation has done some further act, such as issuing a certificate or accepting tender of payment, the courts tend to regard the other party, if he is not in default, as holder of the shares contracted for when the agreed date has arrived. Consequently, there are few cases involving specific performance of a contract to create shares as distinguished from actions for specific recognition of the plaintiff as an existing shareholder. Furthermore, in many cases in which the plaintiff might have obtained specific performance he has been content to sue at law for damages. See *infra* p. 780.

⁵⁸ *Baumhoff v. St. Louis & Kirkwood R. R.*, 205 Mo. 248, 104 S. W. 5 (1907) (specific performance granted, the value of the shares being indeterminable); *Pendery v. Carelton*, 87 Fed. 41 (C. C. A. 8th, 1898) (specific performance granted, and the plaintiff awarded that fraction of the corporation's assets which the shares contracted for would have entitled him to, the corporation having in the interim sold all of its property and ceased to do business); *Barker v. Troy & Rutland R. R.*, 27 Vt. 766 (1855) (plaintiff awarded an election to require defendant either to deliver the shares or to pay the highest market value of the shares after the suit was begun and before final judgment); *Ross v. Union Pacific Ry.*, Fed. Cas. No. 12,080 (C. C. Kan. 1863) (specific performance denied, the shares being readily purchasable elsewhere); *Bernier v. Griscom-Spencer Co.*, 161 Fed. 438 (C. C. S. D. N. Y. 1908) (specific performance denied, there being no proof that the shares could not be readily purchased elsewhere or that they had any peculiar value); *Kruse v. Hudson County Brewing Co.*, *supra* note 30 (specific performance denied on the ground that there were no "equities" in favor of the plaintiff; the case contains an excellent discussion of the ambiguity of the terms "subscriber" and "subscription contract").

⁵⁹ *Moore v. Truitt*, 97 Okla. 288, 223 Pac. 708 (1924); *Applegate v. Wellsburg B. & T. Co.*, 68 W. Va. 477, 69 S. E. 901 (1910); *Robey v. Hardy*, 63 Utah 231, 224 Pac. 889 (1924); *Cushman v. Thayer Mfg. Co.*, 76 N. Y. 365

tion to increase the number of units into which its membership is divided if similar shares are obtainable elsewhere, but will act to prevent the corporation from decreasing the number of units of membership by "disowning" a member, even though such shares are readily purchasable on the market. This distinction is hardly tenable. Granting that in the latter case the legal remedy may be inadequate if it necessitates a succession of actions at law by the shareholder to enforce his rights and powers, it may be similarly inadequate in the first case if the corporation refuses to recognize the other party as a shareholder after he has used his money damages to purchase shares on the market. Moreover, even though shares similar in class and number to those contracted for can be readily purchased elsewhere, money damages may not be adequate, especially if the contract relates to a large block of shares, as the contemplated increase in the corporation's capital will not result from a purchase of the shares on the market.

One of the chief sources of confusion in this type of case is the tendency to regard the shares which a corporation contracts to create as "property" of the corporation. A contract by a corporation to create shares is not comparable to a contract to sell coal, nor even to a contract by a shareholder to transfer his shares to another. When the buyer of the coal or of the shares from an existing shareholder receives the equivalent in kind of the thing contracted for, the transaction is a *fait accompli*. But the performance of a contract to create shares necessarily involves a continuing relationship between the corporation and the other party, the fulfillment of which may well require a degree of judicial supervision. For these reasons, plus the difficulty of determining in many instances whether a contract to create shares has or has not resulted in shareholdership, equity should take jurisdiction of actions arising out of contracts to create shares, where the corporation is materially in default, to the same extent

(1879); *Davenport v. Piano Implement Co.*, 70 Ill. App. 161 (1897); *Scherck v. Montgomery*, 81 Miss. 426, 33 So. 507 (1902); *Westminster Bank v. New England Electrical Works*, 73 N. H. 465, 62 Atl. 971 (1906); *Feckheimer v. National Exchange Bank*, 79 Va. 80 (1884); BALLANTINE, *op. cit. supra* note 37, § 155; I MACHEN, *op. cit. supra* note 2, §§ 515, 934.

as of actions to be "restored" to corporate membership. For those who cherish the doctrine of mutuality, it might again be noted that by the weight of authority the corporation is accorded an action for the full contract price when the other party is in default, without regard to its ability to find another purchaser elsewhere.⁶⁰

Although the right of a shareholder with respect to the creation of additional shares by his corporation is usually described by the term "pre-emptive right," this is a two-fold legal relation: (1) if he be a voting shareholder, he has a right to that proportion of the additional voting shares proposed to be created which the number of voting shares then held by him bears to the total number of voting shares then outstanding; and (2) he has a right not to have the value of his interest with respect to dividend payments and capital distribution adversely affected by the creation of additional shares at less than their reasonable sale value.⁶¹ Consequently, if the corporation has entered into a contract to create shares the performance of which would violate either of these rights of existing shareholders, equity will not grant specific performance to the other party, although he may be entitled to damages for breach of contract if, at the time of contracting, he neither knew nor had reason to know that the rights of existing shareholders would be violated by performance of the contract.

THE MEASURE OF THE OTHER PARTY'S RECOVERY UPON BREACH BY THE CORPORATION

Where the circumstances entitle the other party to specific performance, this remedy is cumulative and not exclusive. In every case of breach by the corporation of its contract to create shares as to the other party, he may elect either to "disaffirm" the transaction and recover his "advance payments," or to "affirm" and recover damages.⁶² In other words, he can compel the

⁶⁰ See *supra* note 54.

⁶¹ See BUSINESS ASSOCIATIONS RESTATEMENT (Am. L. Inst., Tentative No. 1, 1928) §§ 11-20; see also the writer's article, *Shareholders' Pre-emptive Rights* (1929) 38 YALE L. J. 563.

⁶² *Watkins v. Record Photo. Abstract Co.*, 76 Ore. 421, 149 Pac. 478 (1915); *DeLamar v. Fidelity Loan & Investment Co.*, 158 Ga. 361, 123 S. E. 116 (1924); *Mutual Loan Society, Inc. v. Stowe*, 15 Ala. App. 293, 73 So. 202 (1916).

corporation either: (1) to repay him any money, pay him the reasonable value of any services, restore to him any property or its equivalent in money and cancel any instrument that he may have paid, rendered, conveyed, or given to the corporation on account of the contract, with appropriate adjustment of interest or rental value;⁶³ or (2) to pay him the "value" of the shares contracted for less any unpaid balance of the contract price, with appropriate adjustment of interest. As has been heretofore noted, the corporation may be in default through its refusal to tender to the other party an appropriate share certificate or otherwise to recognize him as a shareholder, although he became a shareholder on the agreed date. An action for the recovery of "advance payments" will lie only if the other party is not a holder of the shares contracted for at the time of the action;⁶⁴ the theory behind this distinction apparently being that if the other party automatically became a shareholder, his remedies against the corporation for its wrongful conduct are those of any shareholder who has been "disowned" by the corporation, and that these remedies do not include recovery from the corporation of that which he may have paid to it.⁶⁵

If the other party elects to sue for damages the most difficult problem is to determine the "value" of the shares contracted

⁶³ *Rumery v. Standard Seed Tester Co.*, 194 Iowa 325, 189 N. W. 667 (1922); *Berner v. Bankers' Mortgage Co.*, 268 S. W. 658 (Mo. 1925); *Watkins v. Record Photo. Abstract Co.*, *supra* note 62; see *Swazey v. Choate Mfg. Co.*, 48 N. H. 200, 202 (1868); *DeLamar v. Fidelity Loan & Investment Co.*, *supra* note 62, at 366, 123 S. E. at 118.

⁶⁴ *Arnold v. Suffolk Bank*, 27 Barb. 424 (N. Y. 1857); see *Mutual Loan Society, Inc. v. Stowe*, *supra* note 62, at 298, 73 So. at 205; *Robey v. Hardy*, *supra* note 59, at 239, 224 Pac. at 892.

⁶⁵ This distinction may be traced to deceptive sales analogies, themselves of doubtful validity. Moreover, owing to the frequent impossibility of categorically determining whether the other party is or is not a shareholder, the difficulties of applying the distinction are extreme. In both instances the corporation has failed to do an act which it was under a duty to the other party to perform. The important consideration is the material or essential character of the corporation's breach of duty, rather than whether or not the other party was technically a shareholder at the time of the breach. If, in the light of the surrounding circumstances, including the institutional practices (or "trade customs") involved, the right of the other party is of sufficient significance to justify a variety of sanctions, he should in both cases be accorded the secondary right, at his election, to a return of his consideration; if not, he should in both cases be denied this right.

for. Some courts have gone so far as to use the par value of the shares in estimating the other party's damages, regardless of market value.⁶⁶ Other courts have adopted the market value at the time the action was brought,⁶⁷ and still others the market value at the time of the corporation's breach.⁶⁸ It may well be that none of these methods of evaluating the other party's damages is adequate and that the basis should be the highest market value of shares similar to those contracted for between the time of the breach and judgment, provided the other party made his election to recover damages with reasonable promptitude after knowledge of the breach.

The right of the other party to damages is contingent upon his having demanded the shares contracted for;⁶⁹ and the mere failure of the corporation to tender is insufficient in the absence of such a demand.⁷⁰ But acceptance by the other party of a late tender of the shares contracted for does not wholly terminate his right to damages, and he can still recover the excess, if any, of the value of the shares on the agreed date over their value on the date of their creation.⁷¹ Furthermore, in the event of such late "tender" and acceptance, the other party is entitled to dividends declared subsequent to the contract date for the creation of the shares.⁷² He has, however, no claim to dividends declared prior to that date.⁷³

⁶⁶ *Wheeler v. Ocker & Ford Co.*, 162 Mich. 204, 127 N. W. 332 (1910); *cf.* *Moore v. Hudson River R. R.*, 12 Barb. 156 (N. Y. 1851); *Barker v. Troy & Rutland R. R.*, *supra* note 58.

⁶⁷ *Barker v. Troy & Rutland R. R.*, *supra* note 58.

⁶⁸ *New England Oil Refining Co. v. Wiltsie*, 3 F. (2d) 424 (C. C. A. 1st, 1925); *Boody v. Rutland & Burlington R. R.*, 24 Vt. 660 (1853); *Katleman v. Leon's, Inc.*, 110 Neb. 129, 193 N. W. 254 (1923); *Mutual Loan Society, Inc. v. Stowe*, *supra* note 62; *Coray v. Perry Irrigation Co.*, 50 Utah 70, 166 Pac. 672 (1917).

⁶⁹ *Weaver v. Consumers' Box Board & Paper Co.*, 246 Pa. 438, 92 Atl. 553 (1914); *Martin v. Fox & Wisconsin Improvement Co.*, 19 Wis. 552 (1865).

⁷⁰ *Moore v. Hudson River R. R.*, *supra* note 66.

⁷¹ *Rock v. Gustaveson Oil Co.*, 61 Utah 399, 214 Pac. 301 (1923).

⁷² *Arapahoe Cattle & Land Co. v. Stevens*, 13 Colo. 534, 22 Pac. 823 (1889); *Union Screw Co. v. American Screw Co.*, 11 R. I. 569 (1877).

⁷³ *Union Screw Co. v. American Screw Co.*, *supra* note 72.

CONCLUSION

This article might properly include many other interesting problems arising out of contracts to create shares than those dealt with herein, were it not for the tyranny of time and space. One of the most interesting of these omitted phases concerns the effect upon the legal relations of the parties to the contract of certain corporate acts occurring between the date of contracting and the time for the creation of the shares. For example, does the right of the other party to shares survive against a new corporation into which the contracting corporation was consolidated during this interval? What, if any, amendments of the articles of association during this interval will exonerate the other party from performance of the contract? Will a change in the share structure of the corporation or in the incidents of shares outstanding affect the rights and duties of the contracting parties? These and kindred problems, however, can be much more adequately dealt with in a separate article.

Many of the controversies arising out of transactions for the creation of shares are the result of a deplorable lack of precision either on the part of the contracting parties or of the draftsman of the agreement. The chief object of this paper is to point out some of the major difficulties fostered by this lack of preciseness, and to emphasize the necessity in such transactions of categorically stating when and under what circumstances the other party is to become a shareholder, and of expressly stipulating the legal relations of the parties with respect to the various combinations of fact most likely to arise.