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THE development of systems of supervision and investigation as to the promotion of corporations, with a view towards weeding out the unsound or the fraudulent, may, to some extent, have tended to render the promoters of corporations more conservative. The millennium, however, is far from being at hand, and the day of the Western Surety Company and kindred promotions is not yet a thing of the past. So long as there are persons of ability who are unprincipled in their methods and unduly technical in their maneuvers, questions as to a corporation's rights and liabilities arising under a contract made with its promoters, or by them with others, will continue to appear. It is to such questions that this paper will be briefly addressed.

The first question to be considered is as to what is a promoter. Generally he is one who alone or with others takes it upon himself to organize a corporation; to procure the necessary execution of the articles of incorporation, to file the articles with the proper officers and see that a certificate of incorporation is issued for the company. Ordinarily his work terminates when the company has been organized and the directors have taken over its affairs. It is a question of fact and not of law as to when the promoter commences operations as such, and when he ceases to be such. While he acts as a promoter he occupies a fiduciary relationship towards the corporation and also towards the subscribers to the company's stock. It is important, therefore, to determine just when he commences to be a promoter and just when he ceases to be such. Quite frequently he may, after the organization of the company, retain his character as a promoter, by dominating the policies of the company, without being an officer or director thereof. In such cases he retains his rights and obligations as a promoter.

In all cases where a corporation can be shown to have become a party to a contract, made by or with its promoters, the following circumstances must be shown by the pleading and established by the evidence:

1. The parties to the contract must have mutually expected that a certain corporation was to be organized.

2. That the contract shows that it was to be with the company that was expected to be organized.

3. That the organization would be such that the contract was one of such a character as to be proper for the corporation to make under its powers, as shown by its articles of incorporation.

4. That the persons who control the corporation were individually acquainted with the material provisions of the contract, and

5. That after the corporation came into existence that it did perform certain corporate acts that recognized the existence of the contract.

We will try to discuss these matters in their order:

Circumstance No. 1: It is hard to conceive of any case coming up under the title of this thesis where much attention must be given to this requirement. It needs no extended discussion. A mere statement of it as a circumstance required to be pleaded is probably sufficient. The parties referred to include the promoter or the promoters on one side and the other contracting parties on the other side.

Circumstance No. 2: It is not required that the contract show that it was made to be with the company in the exact name under which it was actually organized, if in fact it was the same corporation that was contemplated. This qualification of the rule is established in Colorado in a case decided in 1894 by the Colorado Court of Appeals. It is the case of the *Colorado Land & Water Company vs. Adams,* reported in 5 C. A. 190. The facts in this case as stated in the opinion were, in a general way, as follows: One Henry was soliciting subscriptions for water rights in a corporation that he was then contemplating organizing. The memorandum of the contract with the plaintiff was a note made January 28, 1890. A few days later the corporation was organized. Henry was the president of the company and as such negotiated further with the plaintiff in regard to the contract. The name of the contemplated corporation, as stated in the memorandum was "The Colorado Land & Canal Company". The corporation as organized was "The Colorado Land & Water Company". The court held that the difference in the name of the company as organized was immaterial, that the Corporation that was organized was the one contemplated by the parties. It was

a case of specific performance, and relief was granted to plaintiff.

Circumstance No. 3: This is a matter that does not require extended discussion. The forms of articles of incorporation as now in use are all so general in their powers that it is only the exceptional case when the question would arise as to the lack of the authority of the company. However, it is undoubtedly an essential averment to be made in the complaint on any case of this character.

Circumstance No. 4: This is one of the circumstances which is more frequently discussed in such cases. The general rule is well established that the directors and officers of a corporation are chargeable as said officers or directors with the knowledge of facts that they each had individually as promoters of the company. It is clear, that those who control the corporation after it has been formed bring the knowledge to the corporation that they had as promoters. The knowledge of the minority members of the board of directors or that of some of the officers charged with the business, is not sufficient to charge the corporation with knowledge. The assumption of knowledge on the part of the corporation can only be sustained where the controlling force of the corporation has that knowledge. In those cases where the controlling power of the corporation is vested in persons who were not previously promoters of the company, an entirely different situation exists, then actual knowledge of the individuals who are in control of the affairs of the company, of all the material provisions of the contract must be shown before the corporation can be considered a party to the contract.

There are some qualifications of the general rule that the knowledge had by a promoter is imputed to the company by reason of the fact that he later becomes a member of the board of directors or an officer of the company. A corporation is not charged with notice of facts known to the promoter in a transaction between him and a corporation in which he is acting for himself and not for the corporation. The general rule, that the knowledge of the agent is imputed to the principal, rests upon the presumption that the agent will disclose what it is his principal's business to know and the agent's duty to impart. Where the facts are such that by reason of the

selfish interests of the promoter or for any other reason there is an antagonism between the company and the promoter, then the reason for the rule ceases and the rule fails.

Circumstance No. 5: This is the one circumstance that is referred to in the greater majority of opinions on these cases. The circumstance is that after the corporation comes into existence that it did perform certain corporate acts that recognized the existence of the contract.

The general rule under this circumstance is as follows: it is not essential to bind the corporation that a formal action be taken by the officers and directors in approving the contract, to ratify it. Any conduct by those in charge of the company's affairs, or acts, deeds or correspondence that show the company is interested in the contract and dealing therein is sufficient to make the contract that of the company.

There is a Colorado case which has followed this general rule in substance. It is the case of *Possell vs. Smith,* reported in 39 Colo. 129. This was a case where corporate liability was claimed on a contract with the promoters of a company for the purchase of an air compressor. It does not appear in the opinion as to whether delivery of the compressor was made before or after the organization of the company nor does it appear whether any of the promoters constituted the officers or the directors of the company. The rule announced was that, when the corporation used the compressor and the directors individually had knowledge of all the material facts regarding the contract, that the company was liable. It was also held specifically that it was not necessary for the board of directors in a body, or at a meeting assembled, to formally adopt and ratify the contract in order to establish the liability of the company. The facts showed that the company used the compressor; that a majority of the directors of the company knew all the material facts involved in the contract; and the knowledge that they had, as individuals, of such facts, established the liability of the corporation.

There is another Colorado case which will undoubtedly be of keen interest because it establishes the right of an attorney to fees charged for drafting the articles of incorporation of a corporation, and supervising the filing thereof. The facts shown were that plaintiff had served as the attorney for

the company for several years after it was organized. The real point in issue before the Supreme Court was as to the attorney's right to compensation for his services to the promoters. The court approved the rule that where the promoters and directors were the same persons after the corporation came into existence, that was in fact a ratification of the promoters' contract of employment, and that no formal acts by the board of directors or the officers of the company were necessary to establish the company's liability on the contract. The case referred to is *Expansion Company vs. Campbell,* 62 Colo. 410.

There is a line of cases wherein the courts have required that a showing be made of actual corporate action of ratification, before the corporation can be considered to be a party to the contract. This rule is laid down in Illinois, and was stated in the case of *Erd, et al., vs. Rapid Transit Corporation,* and reported in 206 Ill. App. 350. The opinion was handed down in April, 1917. The matter involved attorney's fees for services rendered in perfecting the organization of the corporation, including the by-laws of the organization meeting, the stockholders' meeting and that of the board of directors. The evidence tended to show that the officers of the company and the board of directors accepted the benefits of the plaintiff's services. It appeared that the contract for the plaintiff's services was made with the promoters of the company and that the same persons were thereafter the directors of the company, and also that the company had received the full benefit of plaintiff's services. The court took the position that as there was no express corporate action specifically assuming the contract by the corporation that the corporation was not a party to it. This is an extreme case and an exception to the general rule established in other jurisdictions. It is the most extreme case of this character that we have been able to find. The court in deciding the case for the defendant corporation, quoted with approval from 10 Cyc, 265, the following language:

> "It is difficult to understand how the corporation is to be estopped by accepting benefits it had no power to reject without uncreating itself."

The courts have done quite a bit of unnecessary theorizing in order to state a good explanation of how a corporation can

become a party to a contract which was made before the corporation came into existence. The frequency with which this problem came up to the judiciary, and the equities that were apparent in many of the cases, required that the rights of persons who dealt with promoters in good faith should be protected regardless of the theories upon which the protection was to be given.

Of the theories advanced to sustain the liability of a corporation upon contract of its promoters, the one stated in the majority of the cases is that of ratification. This theory has been the subject of very strong attacks both by the text writers and the courts, and cannot be said to be an entirely satisfactory ground, however, it is the Colorado rule without any criticisms or suggestions.

Another term that has met with more favor in describing what takes place when a corporation becomes liable upon the contract made by a promoter is "Adoption". There is little less objection to this term than there is to ratification, if the contract has actually been effectuated between the promoter and the one seeking to enforce it, the strict principle of contract, not to permit a third person to make himself a party by mere adoption without any consideration flowing to or from him, must be disregarded. The corporation can make itself responsible for the acts and representations of a promoter by adoption. Adoption may be implied from the acts or acquiescence of the corporation without any express acceptance. The corporation has knowingly received the benefit from the arrangement or understanding entered into by the promoters, it will not be permitted to deny that it agreed to it. There are numerous authorities in South Dakota, Texas, New York, Minnesota, and in our own state in this regard.

There are two other grounds that have been suggested by some Courts as the theory upon which the liability of a corporation upon a contract made with its promoters has been sustained; the first of these is novation, that is that the corporation's liability is substituted for the liability of the promoter. The other is that the proposition made by the promoter was a continuing offer to be accepted or rejected by the corporation when it came into being, and upon its acceptance, becomes an original contract on its part. The theory of these

last two grounds is material in affecting the personal liability of the promoters. Neither of these grounds have been used in Colorado.

Much of the difficulty of this subject has resulted from the fact that the first two grounds were the ones originally advanced, and that they were not strictly satisfactory, because it was difficult, on scientific principles to see how a contract made before a corporation came into being could be ratified or adopted by it. On the other hand there was the injustice and absurdity in denying liability of the corporation merely because of the technicality that its incorporation so changed the character of the operating forces which created the contract that it was not liable thereon, when the directing minds continued to be the same after as before incorporation, and all parties participating in the transaction intended and understood that the contract was to be that of the corporation.

The rule as to personal liability of a promoter for a contract made by him as such is governed by the general rules of contracts. Presumably the contract is his. If he made it with the general understanding that the contract was limited to the corporation to be formed then he probably will escape personal liability in regard to it. Only where the agreement is specifically of that character will he escape personal liability.

Conceivably, there are circumstances where neither the promoter or the corporation are liable on the contract sought to be established. It is clear, however, that where the promoters of a company make a contract in the name of a proposed company, and thereafter fail to perfect the organization of the company, then they are personally liable on the contract.

Every corporation formed must have its promoter. It need not have a father and a mother, but it must have one of them. Some person or persons must do the work required to prepare the proper papers and obtain the articles of incorporation. In practically every case an attorney is employed to perfect the incorporation. Other expenses must be incurred before the corporation comes into existence. Fortunately in nearly all of such cases there is no dispute about the discharge of these expenses. It is only one case in a hundred where a controversy comes up as to the payment of the expenses of incorporation. In each of these hundredth cases the same tech-

nical question exists that the company before it is formed can make no contracts, can incur no liabilities on a contract in its name, and can claim no benefits by reason of such contract.

This discussion has been devoted almost in its entirety to the questions as to the liabilities incurred under such contracts, rather than the benefits obtained thereby. The reason for discussing the matter in such a way is that practically all of the cases reported dealt with liabilities instead of benefits. The contract in question, like all other contracts, works both ways. The same rules apply whether the establishing of the contract will result in the imposition of liability or the bestowal of a benefit.