COMPENSATION OF PROMOTERS.

The compensation of promoters for services rendered in securing subscriptions of stock for a projected corporation, and the expenses incurred in incorporating a company, presents a question concerning which the courts have promulgated various rules.

It would be anomalous to speak of services of a promoter rendered subsequent to the incorporation of a projected corporation.

No rule which will cover the facts in every case has been stated, but it is generally said, that a corporation is not liable for services rendered by a promoter, and that this freedom from liability rests upon the same principal as the freedom from liability on contracts of promoters entered into in behalf of a projected corporation.[1] At the time the services are rendered by the promoter, there is no corporation in existence, and there being no entity which can receive the services, there can be no contract on behalf of the corporation to pay for them, *a fortiori* the corporation cannot be liable on an implied promise to pay for such services.

Promoters stand in a fiduciary relation to the proposed corporation as a legal entity, and to the individual stockholders.[2] Standing in this relation, they must exercise the utmost good faith. The hardships that would result to the projected corporation, if promoters were allowed to make contracts, under the terms of which, they would receive compensation for services performed in incorporating a company are obvious.

The English courts at an early date recognized, that though a promoter purport to act on behalf of the projected corporations he cannot be treated as an agent, there being no nominal principal then in existence, hence, there is no contractual relation between the corporation and the third party.[3] Promoters cannot bind projected corporations by contracts entered into prior to incorporation,—the promoters themselves are liable on these contracts.[4]

Recognizing the trust relation existing between the promoter on the one hand, and the corporate entity and the individual stockholders on the other, courts have placed every safeguard about

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[1]Marchard vs. Loan etc. Assoc., 26 La. Ann. 389; Weatherford vs. Granger, 86 Tex. 350; Contracts: Van Noy vs. Insur. Co., 168 Mo. App. 287; States ex rel vs. Bank, 197 Mo. 574; Hill vs. Gould, 129 Mo. 106.

[2]Brooker vs. Trust Co., 254 Mo. l. c. 156.

[3]Bley vs. Assurance Co. Ltd., 34 L. T. Rep. N. S. 1909; Kelner vs. Baxter, L. R. 2 Com. Pl. 174; Melheds vs. Ry., L. R. 9 Com. Pl. 503.

[4]Kerridge vs. Hesse, 9 Carr V. P. 200.

the latter. The corporate entity exists only in contemplation, it is a creation of the law, and the courts are bound to protect it.

Logically, the promoter of a projected corporation should look to his associates for compensation and expenses. The fact that the latter subsequently become the stockholders of the proposed corporation should not, of itself, be sufficient to associate the corporation with the salary and expenses of the former. It is only because the associates of the promoter, who are, in nearly all cases, promoters themselves, subsequently become holders of stock in the projected corporation, that the corporate entity has been drawn in the past into controversies concerning compensation of promoters.

Textbooks on the subject of promoters, broadly state the rule that a corporation is not liable to promoters for compensation.[5] Following the statement of the rule, are numerous exceptions, which, when considered carefully, are clearly not within the purview of the rule. They are cases in which the courts have had under consideration services rendered to a corporation subsequent to its incorporation.

In *New York & New Haven Railroad Co. vs. Ketchum*,[6] a very early case, the court discusses, at length, promoters' compensation. The questions propounded by the Court in this case are of vital importance in all actions to recover compensation for services rendered to a projected corporation by promoters. Resorting to an interrogative form of argument, the Court asks, how stockholders can be held liable for incumbrances which they had no voice in creating? How these services can be said to have been rendered at the request of the company when there was no company in existence? How a few persons can combine and agree with one of their number that he shall receive large commissions for doing work for an entity which is not in existence? The court then discusses the breach of faith toward the stockholders, who pay the charter price of their stock, and who expect to take it free from incumbrances other than those recited in subscription blanks. These are the inquiries which should be brought to the attention of every court when considering questions concerning compensation of promoters.

The services of a promoter are of illusory value to the corporate entity under any circumstances, and the confidence reposed

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[5] 7 R. C. E. 54.
[6] N. Y. & N. H. R. R. Co. vs. Ketchum, 27 Conn. 179.

in a promoter by the projected corporation should never be used for personal profit.

It is universally recognized that a corporation is not bound by contracts made in its behalf, prior to its incorporation. Some broad statements have been made to the effect that a corporation may ratify these contracts. However, courts have recognized the fallacy of this expression, and, in recent cases, have stated more conservatively that corporations may ratify contracts made prior to incorporation, if, at the time of the ratification, there is in fact a making of a new contract. Ratification presupposes a power to make at the time the contract was entered into, and, there being no corporate entity then in existence, there consequently cannot be a subsequent ratification.[7]

There are two early cases which seem to uphold the theory that a company is liable for services rendered prior to the incorporating of the company.[8] The more recent of the two accepts the earlier one as controling its decision. This early case, while broadly stating that the corporation is liable for these services, is inconsistent in its holdings, in that, recovery is refused for services rendered voluntarily, on the grounds that there is no subsequent promise to pay for them and that there could be no previous promise, as, at the time of the rendition of these services, there was no one capable of making a promise. The court then holds that the corporation is liable for services rendered in procuring stock subscriptions necessary for a full organization of the company, though there is no expressed promise for their payment, the services being necessary, it is stated that the promise for their payment would be implied. The court looses sight of the fact that there was no corporate entity at the time the stock was susbscribed, to accept the services, or promise to pay for them. In this case, however, it appears that there was a vote taken, subsequent to the incorporation of the company, for the payment of these services. This vote closely resembles the attempt frequently made by corporations to pay their directors for past services, which, it is recognized, is giving away corporate property without just compensation. This question was not brought to the attention of the court and was not passed on by it.

Many attempts have been made to follow the decisions in these early cases without following their reasoning. In these attempts

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[7]Royal Casualty Co. vs. Puller, 186 S. W. 1099.
[8]Low vs. R. R. Co., 45 N. H. 370; Hall vs. R. R. Co., 28 Vt. 401 (1856).

the courts say that the corporation by accepting the stock subscriptions, receives the benefit of a contract made in its behalf, and must take it subject to the burdens. The question then arises, what burdens should be assumed by the corporation?

Mr. Lindley, L. J.[9]

> "If I order a coat and receive it, I get the benefit of the labor of the cloth manufacturer, but does anyone dream that I am under any liability to him? It is a mere fallacy to say that, because a person gets the benefit of work done by someone, he is liable to pay the person who does the work."

This argument is pertinent to the question of compensation to be received by a promoter. The stock subscriptions obtained by a promoter are not obtained at the solicitation and request of the corporate entity, and when the corporate entity does receive the money invested for stocks by stockholders, it does so under a contract with the stockholder. Because the promoter induced the stockholder to invest this money, it does not necessarily follow that the corporation, by accepting it, becomes liable to the promoter for his services in procuring it. If a corporation accepted these services, with a burden to pay the promoter for his services, then every contract entered into between contracting parties, might be subject to a burden unknown to one of the parties.

There can be no estoppel on the part of the corporation because it accepts stock subscriptions. A refusal on its part would require an entity, and, without stock subscriptions, there exists no entity. How can the corporation be estopped by accepting benefits which it has no power to reject without undercreating itself?[10]

The case of *Cushion Heel Shoe Co. vs. Hartt*,[11] is the most recent case on the question of compensation of promoters. In this case the plaintiff, who was experienced in the manufacture of shoes, inserted in a shoe journal, an advertisement for a shoe factory to locate in the City of Fort Wayne. He received an answer from a man named Johnson, who was the patentee of a certain cushion heel shoe. Subscription lists were prepared, and the plaintiff sought subscriptions. The plaintiff testified that he had been promised the position of Superintendent when the factory was established, and that he would be paid for his time and his expenses in securing stock subscriptions. The Company was or-

[9]Re Rotterham Alum vs. C. Co., 50 L. T. Rep. N. S. 219.
[10]10 Cyc. 264.
[11]103 N. E. 1063 (Ind. Sup. Ct.)

ganized, and, subsequent to its incorporation, plaintiff told the directors and officers that he expected to be paid for his services. It was not shown that the Board of Directors ever acted on plaintiff's claim. Plaintiff contended that, by accepting the results of his services, and receiving the benefits thereof, the defendant was bound, by an implied contract, to pay for such services. It was held that, certainly, under ordinary circumstances, a corporation is not bound by contracts made for its benefit by promoters until ratification, either expressed or implied, after its organization; that an implied contract is limited in its application to contracts in which the promoters are interested, but that the promoters, in dealing with the corporation, must act openly and in good faith, as the promoter stands in a fiduciary relation to the corporation as a legal entity and to its individual stockholders, with respect to their property rights in their stock. That this relation requires a full disclosure of the remuneration the promoter is to receive, and, upon failing to disclose it, he is guilty of fraud and cannot honestly receive any remuneration for his services. That the stockholders are entitled to take their stock free from incumbrances placed upon it at a time when they had no voice in creating the same, and that there is no estoppel, as the corporation must receive stock subscriptions in order to incorporate and before incorporation, there is no entity which can reject the services.

The Court, in this case, speaks of a ratification of contracts, using the term in a limited sense, there being in fact no ratification because of the previous inability to enter into a contract. The subsequent act of the corporation being the making of a new contract, all the elements of a contract being present.

The confusion which results from general statements made by courts, relative to compensation to promoters, is illustrated by the case of *Taussig vs. Railroad*,[12] a case in which the Court had under consideration the payment of a director for services rendered partly before incorporation and without an agreement. It is stated that, where services are rendered under such circumstances as to raise a fair presumption that the officer intended or understood that they were to be paid for, or ought to have so understood the Company, on receiving such services, is liable to pay the reasonable value for the same. The Court does not discuss or consider that, where services are rendered and there is no entity to receive

[12]Taussig vs. R. R., 166 Mo. 29.

the same or no one capable of understanding that they should be paid for, there, logically, can be no recovery.

This is an action for professional services rendered immediately before, and subsequent to incorporation. The opinion contains a lengthy discussion of the rights of officers or directors of a corporation to recover for services not within the scope of their office and a closing statement that payment for the services rendered prior to the incorporation of the Company may be recovered on an implied contract.

This latter proposition is stated generally, but not in such terms as to allow recovery for services where the promoter does not appear as a contracting party, as services rendered in securing stock subscriptions. The services rendered prior to incorporation in this case are analogous to the sale of property by a promoter to the corporation. The promoter appears in the contract, express or implied, and the corporation has a knowledge of his existence and his rights, and if he deals openly and in good faith with the corporation, there is no reason why he should not recover. Compensation to him in this instance is a burden which should follow the contract. The Court does not discuss nor did it have before it the question of compensation where the promoter does not appear as a contracting party, where the promoter merely induced a party to contract with the corporation. Nevertheless, this case is cited in a recent publication as authority for the proposition, that a corporation must take the benefits of contracts of promoters subject to the burders.[13] This, in a restricted and limited sense, is true, but only when it appears that the promoter is a contracting party. In cases where the promoter does not appear as a contracting party, the corporation can not by making a contract, be obliged to perform a burden unknown to it at the time of making the said contract.

A brief survey of the cases, an example of each being cited leads to the conclusion that the rule, that a corporation is not liable for the services of a promoter, should be strictly adhered to, and in no case should the courts deviate from this rule. The promoter has a cause of action against his associates, if they refuse to compensate him for the expenses incurred and services rendered in the incorporation of a company. They are the ones he should look to for compensation. The honest unsuspecting stockholders, who pay a fair price for their stock should not take it encumbered with

[13] 7 R. C. L. 54.

a burden unknown to them, and the corporate entity should not be required to pay for a service which it could not solicit or request, and which it, by becoming an entity accept.

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