

Corporation Stock Repurchase Agreements; Mutuality of Obligation and Illusory Promises

Leo Salon

Follow this and additional works at: <https://scholarship.law.stjohns.edu/lawreview>

Recommended Citation

Salon, Leo (1941) "Corporation Stock Repurchase Agreements; Mutuality of Obligation and Illusory Promises," *St. John's Law Review*: Vol. 15 : No. 2 , Article 8.

Available at: <https://scholarship.law.stjohns.edu/lawreview/vol15/iss2/8>

This Note is brought to you for free and open access by the Journals at St. John's Law Scholarship Repository. It has been accepted for inclusion in St. John's Law Review by an authorized editor of St. John's Law Scholarship Repository. For more information, please contact lasalar@stjohns.edu.

* * * Only where the idea has been reduced to concrete form prior to its disclosure to and appropriation by the defendant may recovery be had upon an implied contract.

This case clarifies the rule laid down in *Anderson v. Distler*.⁵⁶ There the court referred to abstract ideas and stated that they could not be the subject of a property right or a contract. The better rule is that they may be the subject of a contract as parties may contract concerning anything that is not illegal or contrary to public policy, and once the idea is made the subject of a contract, then no matter how abstract in form it may be, the idea is protected.

V

Much as it is desired to support the originator or inventor of an idea and create a property right therein, in the face of the definite stand taken by all the courts, it would be difficult to reverse themselves and create a property right where they claim none existed. A careful analysis of the decisions shows two common elements. The originator may protect himself by an *express* contract. No property right or implied contract will be recognized. Naturally, obtaining an express contract is not a simple procedure, as most people wish to know something about which they contract. Also, the court will only enforce the contract if it is definite and not merely an agreement to agree, which is unenforceable.⁵⁷ Because of the difficulties surrounding the creation of a contract, the best remedy to protect the author of an idea is by legislative enactment creating a property right in ideas. The definition of "property" is general enough⁵⁸ so that ideas can be classified as intangible, incorporeal property and, as such, subject to protection as any other personal property.

ROBERT M. POST.

CORPORATION STOCK REPURCHASE AGREEMENTS; MUTUALITY OF OBLIGATION AND ILLUSORY PROMISES

A corporation, subject to the provisions of its charter and by-laws, has the inherent power to purchase its own stock.¹ Such power

⁵⁶ See note 39, *supra*.

⁵⁷ See note 41, *supra*.

⁵⁸ See note 31, *supra*.

¹ *West Penn. Chemical and Mfg. Co. v. Prentice*, 236 Fed. 891 (C. C. A. 3d, 1916); *Verplanck v. Ins. Co.*, 11 Edw. Ch. 84 (N. Y. 1831); *City Bank of Columbus v. Bruce and Fox*, 17 N. Y. 510 (1858); *Laue v. Bethlehem Steel Corp.*, 243 App. Div. 57, 276 N. Y. Supp. 173 (1st Dept. 1934).

if unlimited may prove dangerous to both stockholders and creditors. Therefore, even at common law the power was not absolute. For example, if the capital of a corporation was impaired the contract would not be enforced.² The policy is to preserve the capital of the corporation which is deemed to be held in trust for benefit of creditors.³ Therefore, where no creditors or adverse interests existed, the corporation could repurchase regardless of its financial condition. This seems to be the law today notwithstanding statutes.⁴

The common law to a great extent still governs, for the New York Stock Corporation Law, unlike that of other states, contains no provisions regulating the repurchase of a corporation's own stock.⁵ However, Section 664⁶ of the New York Penal Law, relating to the misconduct of officers and directors of stock corporations, and the court's interpretation⁷ thereof have fulfilled the need. The policy remains the same and a corporation may repurchase its own stock today, provided the purchase is paid for from surplus.⁸ Since the corporation may repurchase its stock it is of course not illegal for the corporation to contract to do so. Although the corporation need not have a surplus at the time the contract is made,⁹ it must have a surplus at the time of payment or else the contract is unenforceable.¹⁰ Lack of surplus is a matter of defense and the burden of proof rests with the corporation.¹¹

² West Penn. Chemical and Mfg. Co. v. Prentice, 236 Fed. 891 (C. C. A. 3d, 1916); McIntyre v. E. Bement's Sons, 146 Mich. 74, 109 N. W. 45 (1906); Hoover Steel Ball Co. v. Schaefer Ball Bearing Co., 90 N. J. Eq. 164, 106 Atl. 471 (1919).

³ See note 2, *supra*.

⁴ Cross v. Beguelin, 226 App. Div. 349, 235 N. Y. Supp. 336, *aff'd on other grounds*, 253 N. Y. 262, 169 N. E. 378 (1929).

⁵ PRASHKER, CASES AND MATERIALS ON THE LAWS OF PRIVATE CORPORATIONS (1937) 353, 354.

⁶ N. Y. PENAL LAW § 664 ("Misconduct of officers and directors of stock corporations. A director of a stock corporation, who concurs in any vote or act of the directors of such corporation, or any of them, by which it is intended: * * *

"5. To apply any portion of the funds of such corporation, except surplus, directly or indirectly, to the purchase of shares of its own stock,

"Is guilty of a misdemeanor.").

⁷ Richards v. Ernst Wiener Co., 207 N. Y. 59, 100 N. E. 592 (1912); Van Slochem v. Villard, 207 N. Y. 587, 101 N. E. 467 (1913); Laue v. Bethlehem Steel Corp., 243 App. Div. 57, 276 N. Y. Supp. 173 (1st Dept. 1934).

⁸ See note 7, *supra*; Topken, Loring and Schwartz, Inc. v. Schwartz, 249 N. Y. 206, 163 N. E. 735 (1928); Greater N. Y. Carpet House v. Herschmann, 258 App. Div. 649, 17 N. Y. S. (2d) 483 (1st Dept. 1940).

⁹ City of Columbus v. Bruce and Fox, 17 N. Y. 510 (1858); Richards v. Ernst Wiener Co., 207 N. Y. 59, 100 N. E. 592 (1912); Strodl v. Farish-Strafford Co., 145 App. Div. 406, 130 N. Y. Supp. 35 (1st Dept. 1911); Moses v. Soule, 63 Misc. 203, 118 N. Y. Supp. 410 (1909).

¹⁰ *In re* Fechheimer Fishel Co., 212 Fed. 357 (1914); Richards v. Ernst Wiener Co., 207 N. Y. 59, 100 N. E. 592 (1912).

¹¹ See note 10, *supra*.

I

In New York the problem has arisen in regard to what is sufficient consideration on the part of the corporation for such a repurchase agreement. It has been held that employment of the seller by the corporation is sufficient consideration.¹² Also a repurchase agreement arising out of the original transaction of sale, whose repurchase clause will become effective upon the happening of certain contingencies, has been upheld on the ground that the original consideration supporting the contract of sale supported the contract of repurchase.¹³ However, the promise by the corporation to repurchase, standing alone, has been held to be insufficient consideration. The decision was rendered by the New York Court of Appeals in the case of *Topken, Loring and Schwartz, Inc. v. Schwartz*.¹⁴ The corporation agreed with its employee that it would purchase and the employee agreed to sell any shares of stock of the corporation that he might have at the termination of his employment. The corporation sued for specific performance but the court in denying it held that the corporation's promise to purchase was illusory, for it could only be enforced if it had a surplus at the time of payment. Section 664 of the New York Penal Law would render illegal a payment out of capital. The promise might or might not be binding on the corporation and hence, not being mutually binding, lacked consideration.

It should be recognized that the greater part of the court's decision is *dicta*. There was sufficient ground for denying specific performance without holding that there was no mutuality of obligation and no contract at all. The corporation tendered no money for the stock, claiming the stock had no book value which was to determine the price. Since it would be inequitable to order the transfer of the certificates for nothing, specific performance was properly denied. But this does not necessarily prove that there was no contract at law. "Lack of mutuality, as the phrase is used by courts of equity, is not necessarily any objection to the existence of a contract."¹⁵ Perhaps what has been labeled lack of mutuality was lack of adequacy of consideration, a doctrine the examination of which the courts have many times evaded merely saying inadequacy is no defense.¹⁶

Although merely *dicta* the court's opinion has nevertheless become important for it appears to have been followed in the Appellate

¹² *Richards v. Ernst Wiener Co.*, 207 N. Y. 59, 100 N. E. 592 (1912); *Topken, Loring and Schwartz, Inc. v. Schwartz*, 249 N. Y. 206, 163 N. E. 735 (1928).

¹³ *Strodl v. Farish-Strafford Co.*, 145 App. Div. 406, 130 N. Y. Supp. 35 (1st Dept. 1911).

¹⁴ This and associated cases are considered in (1929) 3 ST. JOHN'S L. REV. 276.

¹⁵ *Hunt v. Stimson*, 23 F. (2d) 447 (C. C. A. 6th, 1917); 1 WILLISTON, CONTRACTS § 140.

¹⁶ (1927) 27 COL. L. REV. 178.

Division.¹⁷ Hence an analysis is necessary. The decision seems to have resulted in the anomaly that a corporation cannot contract on the basis of a promise, to do in the future what it has a right to do in the present. This does not further the policy of preserving capital since the condition concerning payment only out of surplus can operate in the future¹⁸ as well as in the present. To avoid the restraint on contracting imposed by the *Topken* case, other consideration must be found where it otherwise would be natural to merely rely upon the corporation's promise. Since the repurchase is the end in view, the other consideration will usually be of small value. It therefore seems that the seller would hardly be better protected, for the corporation would still be in a position to avoid the obligation that was primarily considered, *i.e.*, to repurchase. In other words the corporation would still have a way out, while the other contracting party gains no compensating benefit in regard to practical values.

In the late case, *Greater New York Carpet House v. Herschmann*,¹⁹ the same defense as in the *Topken* case was interposed by the defendant, but the Appellate Division found consideration and specific performance was granted. The plaintiff corporation and the defendant's testator and another, sole stockholders of the plaintiff corporation, arranged a plan whereby the corporation would take out life insurance policies on the lives of both stockholders payable to the corporation. The proceeds thereof would be used to purchase the deceased's stock. The purpose of the agreement was to give the surviving stockholder complete control. The purpose of the insurance was to set aside a special surplus fund with which to purchase the stock. In regard to consideration the court speaks of seals and other mutual promises, which were likewise present in the *Topken* case, but rests the case on the following statement, "While not expressly recited in the contract, we think that it is necessarily to be inferred from its terms that the corporation bargained to pay the premiums for the said insurance * * * the corporation did in fact pay said premiums * * * This constituted a detriment to the corporation."²⁰

The factual distinctions between the *Topken* case and the *Herschmann* case are manifold but there is only one point of distinction with regard to the law. Consideration was implied in the latter case whereas it was not implied in the former. If such implication was erroneous then the *Herschmann* case, according to the *dicta* of the *Topken* case which it restated, was incorrectly decided for nothing would remain but the illusory promise. But if the *dicta* in the

¹⁷ *Greater N. Y. Carpet House v. Herschmann*, 258 App. Div. 649, 17 N. Y. S. (2d) 483 (1st Dept. 1940).

¹⁸ *Richards v. Ernst Wiener Co.*, 207 N. Y. 59, 100 N. E. 592 (1912).

¹⁹ *Greater N. Y. Carpet House v. Herschmann*, 258 App. Div. 649, 17 N. Y. S. (2d) 483 (1st Dept. 1940).

²⁰ *Greater N. Y. Carpet House v. Herschmann*, 258 App. Div. 649, 651 17 N. Y. S. (2d) 483, 485 (1st Dept. 1940).

Topken case is erroneous also, *i.e.*, if the corporation's promise to purchase is not illusory, the decision in the *Herschmann* case is nevertheless correct. There would be an enforceable bilateral contract based on mutual promises.

The inference of consideration in the *Herschmann* case violates the rule that no promise may be implied from an act where a double motive existed for doing the act.²¹ In the words of the court "the agreement, in order to create a fund with which to pay for the stock, provided that the company take out life insurance policies on the lives of both stockholders, payable to the corporation; that the proceeds of this policy were to be set apart as a special surplus account to furnish the purchase of the stock."²² The court points out that the motive for and the purpose of the insurance was to secure a surplus, and then infers that it was the consideration bargained for. This is manifestly inconsistent. The Restatement of Contracts, Section 75, says, " * * * Consideration must actually be bargained for as the exchange for the promise. * * * The existence or non-existence of a bargain where something has been parted with by the promisee or received by the promisor depends on the manifested intention of the parties." It can hardly be said that such intention was manifested in this case. The corporation was the beneficiary of the policy; it paid the premiums; it could have ceased paying the premiums without any liability. The deceased received no benefit from the policy and he only looked to the promise as beneficial consideration. Regardless of what actually may have been relied upon no promise may be implied from an act where a double motive existed as here. The court cannot determine without doubt whether the insurance was secured as a consideration or as means to avoid the consequences of Section 664. Another indication of the error is that the Court of Appeals refused to make a similar implication in the *Topken* case. If the employment therein had furnished the consideration the contract would have been binding. The inference was not made though the fact existed. Moreover, it is common practice to have repurchase agreements in consideration of employment; the insurance policy devise is unique.

Assuming there were sufficient grounds for the inference in the *Herschmann* case, is the seller in a better position than the seller in the *Topken* case? The contract is no less illusory in fact. The corporation is not bound nor the seller protected to any greater degree. The agreement to set aside the insurance money as a special surplus

²¹ WHITNEY, LAW OF CONTRACTS (3d ed. 1937) 22 ("Sec. 16. No Promise Implied Where Double Motive Existed. * * * but where the question is whether a promise should be implied from a certain act no inference of such a promise is warranted unless the act can be explained only on that supposition."); *Trounstone v. Sellers*, 35 Kan. 447, 11 Pac. 441 (1886); *White v. Corlies*, 46 N. Y. 467 (1871); *Frankenberger v. Schneller*, 258 N. Y. 270, 179 N. E. 492 (1932); RESTATEMENT, CONTRACTS § 71.

²² *Greater N. Y. Carpet House v. Herschmann*, 258 App. Div. 649, 651, 17 N. Y. S. (2d) 483, 485 (1st Dept. 1940).

isn't valid if the capital is impaired so that creditors will be injured.²³ If the corporation was insolvent, the special surplus would vanish into the capital assets wherein the creditors would have a prior lien on the fund. It may be conceived that directors will issue bond or scrip dividends,²⁴ or declare dividends conditioned upon and payable out of the insurance fund, or otherwise manipulate the corporate finances to make the special surplus unavailable. If the parties intended to set aside the insurance fund to meet the repurchase obligation, do they no less contemplate setting aside the regular surplus for meeting the obligation?

II

Having concluded that the inference of consideration in the *Herschmann* case was incorrect but that the decision was correct nevertheless, the error of the *dicta* in the *Topken* case must be explained. That it has met with criticism²⁵ is some indication of its weakness.

1. Assuming that mutuality of obligation is necessary for bilateral contracts there are exceptions to the rule. Many contracts which have an illusory characteristic analogous to the bilateral repurchase agreement are held to be binding.

Requirement contracts are, by the great weight of authority, enforced.²⁶ Though "a seller by ceasing to manufacture may relieve himself from any performance and still keep a promise to sell all the goods he manufactures, and similarly a buyer by going out of business may avoid performance while still observing the terms of an agreement to buy all that he requires, these results can only be obtained by doing something which is in itself a legal detriment, namely the cessation of business. Even a promise to buy or sell only so much as the promisor chooses is a sufficient consideration when coupled with the agreement that whatever the buyer or seller chooses to sell or buy he will buy or sell to the promisee."²⁷

The Restatement of Contracts holds the same views.²⁸ The rea-

²³ Greater N. Y. Carpet House v. Herschmann, 258 App. Div. 649, 17 N. Y. S. (2d) 483 (1st Dept. 1940) (The court said: "For the reasons stated, any claim that despite the arrangement whereby a special surplus account was created to pay for the stock, because of the existence of other debts, there was no corporate surplus sufficient to pay the full purchase price of the stock, would in our opinion, constitute a defense to the present action.").

²⁴ PRASHKER, CASES AND MATERIALS ON THE LAW OF PRIVATE CORPORATIONS (1937) 754.

²⁵ See (1929) 42 HARV. L. REV. 829; Note (1929) 15 CORN. L. Q. 108; (1929) 29 COL. L. REV. 356.

²⁶ WHITNEY, LAW OF CONTRACTS (3d ed. 1937) 34, § 23; (1928) 28 COL. L. REV. 223.

²⁷ 1 WILLISTON, CONTRACTS § 104.

²⁸ RESTATEMENT, CONTRACTS § 2, illustration 4. "A says to B, 'I will em-

soning seems to be that even though as a matter of pure logic the condition is under the control of the promisor, yet the burden and hardship that would be necessary to endure in order to avoid the promise is so great that the law, recognizing the unreasonableness of such a course of action, holds that the promise is a legal detriment.²⁹

Is not the same reasoning applicable in regard to the requirement of surplus and its control? Although it may be otherwise in small, close corporations, it can hardly be considered that directors of large corporations with intricate financial structures, having in mind the risk, burdens, and dangers present in business, the Penal Law and the personal liability for misconduct, will manipulate the corporate surplus to avoid a repurchase agreement. Even in the small corporation there will ordinarily be no incentive or motive for surplus manipulation.³⁰ It seems that if a corporation has a surplus, the stock generally will maintain its worth as treasury stock and a monetary motive for avoidance will be absent. Likewise if the stock is of little value so that a corporation may not deem it wise to purchase, it will no doubt usually follow that the corporation will have no surplus and of course will not have to buy. If a corporation has made a bad contract and yet is able to perform, having a surplus, there is no valid reason why such business units, affording so many immunities as a method of carrying on business, should be protected from loss.

Other exceptions to the mutuality rule are just as strikingly analogous to the bilateral repurchase agreement as is the requirement contract. Section 84 of the Restatement of the Law of Contracts says, "Consideration is not insufficient because of the fact * * * sub (e) that it is a promise, and a special privilege not expressly reserved in the promise but given by the law, makes the promise or the whole agreement unenforceable or voidable."³¹ The illustrations given include the promises of infants, promises within the Statute of Frauds, and government promises. Contracts based upon such promises have always been enforced even though the option of pleading the defense of infancy, or the Statute of Frauds, or of withholding consent to be sued lies within the control of the respective prom-

ploy you for a year at a salary of \$5,000 if I go into business.' This is a promise, for although it is wholly optional with *A*, to go into business or not, he does not keep his word if he goes into business without employing *B*."

²⁹ WHITNEY, LAW OF CONTRACTS (3d ed. 1937) 35, § 23.

³⁰ Wisconsin Lumber Co. v. Green, 127 Iowa 350, 101 N. W. 742, 744 (1904) ("It goes without saying that the enforcement of these contracts will take the amount paid for the repurchase of the stock out of the earnings and assets of the company. But this is true in every case where a corporation is permitted to repurchase its own stock. However, its stockholders' liability is reduced by that amount, and, in the absence of fraud or a plea of insolvency on the part of the corporation, we do not see how either the stockholders or creditors are prejudiced, unless it appears that the corporation agreed to pay more for the stock than it was worth.").

³¹ Accord: 1 WILLISTON, CONTRACTS § 105; see (1928) 28 COL. L. REV. 1008, 1009 for examples.

isors. The bilateral repurchase agreement is a contract of the same specie as that of the Restatement illustrations and should fall within the exceptions to the mutuality rule. It is based on a promise but a special privilege not expressly reserved in the promise is nevertheless read into it by virtue of the interpretation of Section 664 of the Penal Law whereby the whole agreement is unenforceable if no surplus exists and the corporation proves the fact.

To make the case even stronger the tendency of the New York courts seems to be to find a valid contract wherever possible so as to carry out the intent of the parties.³² Thus doubtful contracts have been said to be "instinct with an obligation imperfectly expressed" and therefore binding.³³ It has been held that the very word "agreement" connotes a mutual obligation.³⁴ When a promise can be interpreted to mean either that the promisor has the arbitrary right to avoid performance or that the performance is conditioned upon unavoidable contingencies, New York courts have held that the latter construction is the one most likely to accord with the true intent of the parties.³⁵

If the bilateral repurchase agreement falls within the exceptions, the *dicta* in the *Topken* case is error and the *Herschmann* decision is correct.

2. If the case does not fall within the exceptions to the rule the case is not necessarily incorrect for there are some authorities who doubt the existence of the mutuality of obligation rule itself.³⁶

³² *Ga Nun v. Palmer*, 216 N. Y. 603, 610, 111 N. E. 223, 225 (1916) ("The canon of construction which prefers the meaning that will sustain rather than one that will defeat an instrument, reinforces these conclusions.").

³³ *Wood v. Duff-Gordon*, 222 N. Y. 88, 91, 118 N. E. 214 (1917); *Fellows v. Fairbanks Co.*, 205 App. Div. 271, 199 N. Y. Supp. 772 (4th Dept. 1923); *Meers v. Munsch-Protzmann Co.*, 217 App. Div. 541, 217 N. Y. Supp. 256 (1st Dept. 1926).

³⁴ *Baldwin v. Humphrey*, 44 N. Y. 609 (1871); *Benedict v. Pincus*, 191 N. Y. 377, 84 N. E. 284 (1908); *Moran v. Standard Oil Co.*, 211 N. Y. 187, 105 N. E. 217 (1914).

³⁵ *People ex rel. New York C. & H. R. R. v. Walsh*, 211 N. Y. 90, 105 N. E. 136 (1914); *Moran v. Standard Oil Co.*, 211 N. Y. 187, 105 N. E. 217 (1914); *Meade v. Poppenberg*, 167 App. Div. 411, 153 N. Y. Supp. 182 (1st Dept. 1915); *Sparks v. Brown, Inc.*, 184 N. Y. Supp. 557 (1st Dept. 1920); *Rice v. Miner*, 89 Misc. 395, 151 N. Y. Supp. 983 (1915); *News Syndicate Co., Inc. v. Philip Wolf, Inc.*, 136 Misc. 483, 241 N. Y. Supp. 403 (1930).

³⁶ See *Oliphant, Mutuality of Obligation in Bilateral Contracts* (1925) 25 COL. L. REV. 705, 723 ("When the foregoing studies have been made, we shall be more nearly able to say whether there exists in our law this supposed rule of mutuality. We may then find that the supposed rule is no more substantial than the formerly supposed rule of mutuality in the law of specific performance; that we have merely the well recognized rule of law [not equity] as to considerations and actual or prospective failure of consideration [*i.e.*, failure of performance by the plaintiff]; that we do not have a general rule that both parties to a bilateral contract are always subject to an action thereon or else neither is. On the other hand, we may very well find that there is such a general rule in the law of contracts, but, until the whole question is re-examined, sound scholarship precludes its assertion as an established truth, much less an

All agree, however, that a clearly illusory bilateral contract is unenforceable, not necessarily because it lacks mutuality but because the promisor has nothing to perform according to the terms of his promise. This would apply to unilateral contracts as well. Such promises lack bargaining power and no reasonable man would make an exchange in consideration therefor. But if the promise contains some bargaining power, no matter how small, it may be sufficient consideration.³⁷ A corporation's promise to repurchase must necessarily contain some bargaining power since sellers of stock attempt to contract in consideration therefor.

Another source of error is the failure to distinguish between an illusory promise and a promise based on a condition. The latter is sufficient consideration to support a contract³⁸ provided that the condition doesn't render the promise illusory. The test as to the illusory effect of the condition is whether the condition is within the arbitrary control of the promisor,³⁹ and not whether the event occurs or not.⁴⁰ The correct view of the repurchase agreement is that of a contract to buy the stock in the event that a surplus exists in the ordinary course of business at the time of payment. If the surplus exists the corporation must purchase, if not there is no failure of consideration. It was shown above that the surplus is not within the arbitrary control of the corporation. Under this view the *Topken dicta* is erroneous too.

3. Even on the basis that the *Herschmann* case is not within the exceptions and the mutuality of obligation rule does exist, the decision can be considered correct within the rules of unilateral contracts which do not need mutuality of obligation. It is well established that a promise which is originally too indefinite, illusory or otherwise insufficient as consideration may become sufficient when performed⁴¹ or tendered,⁴² thus removing the deficiency. Even when

axiom."); Ballentine, *Mutuality and Obligation* (1914) 28 HARV. L. REV. 121, 122, 129; supporting the rule: see Williston, *The Effect of One Void Promise in a Bilateral Agreement* (1925) 25 COL. L. REV. 857.

³⁷ 1 WILLISTON, CONTRACTS § 43 ("It is only where the option reserved to the promisor is unlimited that his promise becomes illusory and incapable of forming part of a legal obligation."); see (1928) 28 COL. L. REV. 997; Hunt v. Stimson, 23 F. (2d) 447 (C. C. A. 6th, 1917); News Syndicate Co., Inc. v. Philip Wolf, Inc., 136 Misc. 483, 241 N. Y. Supp. 403 (1930).

³⁸ WHITNEY, LAW OF CONTRACTS (3d ed. 1937) 98, 99, § 49; 1 WILLISTON, CONTRACTS § 112.

³⁹ RESTATEMENT, CONTRACTS § 2, Comment B.

⁴⁰ Holmes, J. in *Gutlon v. Marcus*, 165 Mass. 335, 336, 43 N. E. 125, said, "But, when a man acts in consideration of a conditional promise, if he gets the promise he gets all that he is entitled to by his act, and if, as events turn out, the condition is not satisfied, and the promise calls for no performance, there is no failure of consideration."; *Herrington v. Davitt*, 220 N. Y. 162, 115 N. E. 476 (1917).

⁴¹ *Gordon v. Schellhorn*, 95 N. J. Eq. 563, 123 Atl. 549 (1924); *Grossman v. Schenker*, 206 N. Y. 466, 100 N. E. 39 (1912); 1 WILLISTON, CONTRACTS § 106.

⁴² RESTATEMENT, CONTRACTS § 63 ("If an offer requests a promise from

the seller originally was not certain to secure performance, when he has received or is tendered in equity all that he has bargained for in a valid contract.⁴³ The parties originally intended to make a valid contract. Since the promisor has not withdrawn his promise, it must be considered in the nature of a continuing offer⁴⁴ and a valid unilateral contract arises on receipt of performance.⁴⁵ It would seem that an illusory promise plus performance should make at least as strong a case as one with no promise, but with performance alone. Therefore, where the corporation tenders the price, the seller not having disaffirmed, an enforceable unilateral contract arises. From this point of view the decision in the *Herschmann* case is correct and the *dicta* in the *Topken* case of no force.

III.

Since the *Topken* case limits the means of the corporation to exercise its power to acquire its own stock, it presents some corporation problems. For example, the decision seems to presume the possibility of bad faith on the part of directors in distributing the surplus. Such a presumption is not justified. The possibility that directors may anticipate other creditors and leave the corporation without assets, the stockholders being personally protected by the doctrine of limited liability, has never been held to nullify all other corporation contracts. Of course, such wronged creditors have remedies against shareholders and directors.⁴⁶

Assuming a repurchase agreement not affected by such inequities as were present in the *Topken* case, has equity the power and the means to enforce it? Equity has the power, if it chooses to exercise it. The same remedies available to creditors should be available to contracting shareholders. The purpose of Section 58 of

the offeree, and the offeree without making the promise actually does or tenders what he was requested to promise to do, there is a contract, subject to the rule stated in Sec. 56, provided such performance is completed or tendered within the time allowable for accepting by making a promise. A tender in such a case operates as a promise to render complete performance.").

⁴³ WHITNEY, LAW OF CONTRACTS (3d ed. 1937) 67, § 39; see RESTATEMENT, CONTRACTS § 63, Comment a.

⁴⁴ *Netherlands American Steam Nav. Co. v. Wagner*, 12 F. (2d) 640, 642 (C. C. A. 2d, 1926) ("Objection must be taken to a contract which may be unenforceable for lack of mutuality before it has been performed.").

⁴⁵ *Rubin v. Dairyman's League Co-op. Ass'n*, 284 N. Y. 32, 29 N. E. (2d) 458 (1940) (The Court of Appeals answered the argument that "such an exchange of promises was of no legal consequence because it was lacking in mutuality" by saying, "Such an argument disregards the rule that, 'Even when the obligation of a unilateral promise is suspended for want of mutuality at its inception, still, upon performance by the promisee a consideration arises which relates back to the making of the promise. (*Grossman v. Schenker*, 206 N. Y. 466, 468)").

⁴⁶ 2 COOK, CORP. (8th ed. 1923) § 548, N. Y. STOCK CORP. LAW §§ 58, 60; N. Y. PENAL LAW § 664.

the Stock Corporation Law is to make directors compensate for damage suffered from their wrongful acts.⁴⁷ It should apply when the surplus is fraudulently paid out and the contracting shareholder suffers damage thereby. Equity can do justice to all interests and iron out all difficulties by allocating the proper assets to their proper purpose.

Has equity the means and opportunity to interfere? The answer is that it must have, since it does interfere with corporate management in other cases.⁴⁸ The seller of the stock before the execution of the sale is a shareholder. As such, he enjoys rights, the exercise of which will enable him to get the evidence and material necessary for the court.⁴⁹ All stock corporations are required to keep at their offices correct books of account of all their business and transactions as well as a stock book.⁵⁰ Although there is a statutory right to inspect the stock book,⁵¹ the right to inspect books of account is still that of the common law.⁵² Furthermore, and perhaps what is most important, is that a stockholder owning three per cent (3%) of the shares of the corporation has the right to demand from the treasurer a financial statement of the affairs of the corporation.⁵³

It seems that the "way" is present to solve this legal problem, all that may be lacking is the "will"

Conclusion

In conclusion, it might be said that, although a corporation has the power to purchase its own stock subject to the condition that it pay therefor out of surplus, yet it may not bind a seller merely by virtue of its promise to buy. The fact came about by reason of the *dicta* in the *Topken* case to the effect that such a promise was illu-

⁴⁷ *Stratton v. Bertles*, 238 App. Div. 87, 263 N. Y. Supp. 466 (1st Dept. 1933) (Of the corresponding provision in the Stock Corporation Law of 1892, c. 688, § 23, it was said that it was clearly contemplated that the capital of the corporation should be preserved and, in addition to such sum, the other liabilities provided for, before any dividend should be made by a fire insurance corporation. 1894 OP. ATTY. GEN. 212).

⁴⁸ "As a general rule courts have nothing to do with internal management of business corporations, but, if the acts of directors are so unjust as to be evidence of fraud and intentional wrong, the courts may act. They may not compel directors to act wisely but may compel them to act honestly." *Jones v. Van Heusen Charles Co.*, 230 App. Div. 694, 696, 246 N. Y. Supp. 204, 208 (3d Dept. 1930), *Dodge v. Ford Motor Co.*, 204 Mich. 459, 170 N. W. 668 (1919).

⁴⁹ See PRASHKER, CASES AND MATERIALS ON THE LAWS OF PRIVATE CORPORATIONS (1937) 848.

⁵⁰ N. Y. STOCK CORP. LAW § 10.

⁵¹ N. Y. STOCK CORP. LAW § 113.

⁵² "Nothing more is required than that, acting in good faith for the protection of the interests of the corporation and his own interests, he desires to ascertain the condition of the company's business." *Varney v. Baker*, 194 Mass. 239, 80 N. E. 524 (1907).

⁵³ N. Y. STOCK CORP. LAW § 77.

sory; the corporation being compelled to buy only if it has a surplus, a fund which it controls. That in turn led to the conclusion that the contract was a nullity lacking mutuality of obligation. However, assuming that which many doubt, *i.e.*, that mutuality is essential, this promise is no more illusory than many analogous promises which serve as consideration. We have for example infants' promises, promises within the statute of frauds, promises of the government, promises to meet requirements, and promises to buy output. All such promises bind the promisee although the promisor may have an option not to perform and yet escape liability. Although specific performance was properly denied in the *Topken* case for a lack of equity on the plaintiff's side it becomes important to determine the soundness of the *dicta* as the case of *Greater New York Carpet House v Herschmann* is viewed. The holding in this case is also correct, but the *dicta* in the *Topken* case is affirmed by the Appellate Division and an incorrect inference of consideration is drawn so that the correct result is reached nevertheless. As matters stand there are two correct decisions based on two doubtful opinions.

LEO SALON.

THE PLEDGING OF BANK ASSETS TO SECURE DEPOSITS. INTRA OR ULTRA VIRES?

The insolvent condition of many banks in the last decade has served, more frequently, to bring to the attention of the courts a transaction whereby a bank hypothecates its liquid assets to secure a deposit. There is a contrariety of opinion as to whether such an act is within the authority of a bank, due mainly to the difference of economic views in applying statutes and formulating policies. It remains to determine the particular instances when a bank may pledge its assets to secure deposits and, in the absence of authority, the effect of such *ultra vires* acts. Any discussion of the powers of banks must of necessity be divided into separate treatments of national banks and state banks. In view of the problem involved, there must be a further distinction made between public and private deposits.

State Banks

In the absence of statute, expressly stating whether a bank has the right to pledge its assets, it becomes a question of public policy in the determination of the *intra* or *ultra vires* quality of such act.¹

¹ *Hellawell v. Hempstead*, 10 F. Supp. 771 (S. D. N. Y. 1935), *Luikart v. Aurora*, 125 Neb. 263, 249 N. W. 590 (1933).