This section adds still another complication to our already vexatious problem and permits the very accumulation contrary to the policy of our courts and the statutes against accumulations.\footnote{Bourne v. Bourne, 240 N. Y. 172, 148 N. E. 180 (1925).}

Our conclusion is, therefore, that the Kentucky rule with the modification hereinbefore suggested provides an equitable rule of distribution, \textit{i.e.}, that all dividends from earnings whether they be ordinary or extraordinary, whether declared in cash, bonds, scrip or stock, whether accumulated from earnings prior or subsequent to the creation of the trust estate, shall go to the life tenant.

The safety of the corpus is amply protected from impairment by statutes which prohibit declarations of dividends unless declared out of earnings.

If, however, a rule of apportionment is deemed necessary, it is submitted that it should be applied for the benefit of both the life tenant and remainderman.

The life tenant will therefore be charged with the earnings accumulated prior to the commencement of the life tenancy, and the remainderman will be charged with an amount equal to the earnings accumulated during the life tenancy. In this way we retain the rule of apportionment. Let us extend it so that in its application it will treat both the life tenant and remainderman equitably, not sacrificing the interests of the former for the benefit of the latter.

B. F.

\textbf{Corporations—Contract to Purchase Its Own Stock—Mutuality.}—In England, unless expressly authorized, a corporation has no power to acquire its own stock.\footnote{Trevor v. Whitworth, L. R., 12 App. Cas. 409 (1887).} The reason attributed for this rule is that such a purchase effects a reduction of the capital of the corporation, thereby tending to fraud. In most jurisdictions in the United States, including New York, it is well established that in the absence of express restriction, a corporation may purchase its own stock, providing it is not to the prejudice of creditors or stockholders.\footnote{City Bank of Columbus v. Bruce, 17 N. Y. 507 (1858); Vail v. Hamilton, 85 N. Y. 453, 457 (1881); Joseph v. Raff, 82 App. Div. 47, 54, 81 N. Y. Supp. 546, aff'd 176 N. Y. 611, 68 N. E. 1118 (1903); Cook on Corporations, Vol. 1 (7th ed) Sec. 311.} It is entitled to buy in its own stock out of surplus, but if the purchase would render the corporation insolvent, such an act would be deemed ultra vires, and too, under the Penal Law,\footnote{Sec. 664.} a direc-
tor who votes to apply the funds of a corporation, except surplus, directly or indirectly, to the purchase of shares of its own stock, is guilty of a misdemeanor.

Although a corporation may have a surplus at the time of such purchase, if the time of payment is deferred and the corporation subsequently becomes insolvent, the fact that it had such surplus is not decisive of the case if it is insolvent when the time for payment arrives. In a leading case, in discussing the rights of creditors in connection with such a purchase, the court said:

“If at the time the stockholder receives payment for his stock and payment prejudices the creditors, payment cannot be enforced. If the stockholder sells his stock to a corporation which issued it, he sells at his peril and assumes the risk of the consummation of the transaction without encroachment upon the funds which belong to the corporation in trust for the payment of its creditors. The rights of the creditors of the corporation cannot be defeated by the fact that at the time the transaction was entered into the seller of the stock and the officers of the company who purchased it were acting in good faith and supposed that the corporation was solvent.”

Hence, it is of no consequence if a corporation is solvent and enters into such a contract in good faith; if it later becomes insolvent or is made so by the transaction, and is in that condition at the time when payment is to be made, the vendor cannot as against creditors withdraw assets from the corporation upon which they have a superior right of lien. These assets constitute a trust for the benefit of creditors whose obligations must be discharged in full before the right of any stockholder to any portion thereof can be considered.

The burden of proof, in actions involving contracts for such purchase, is, by the Federal Courts, placed upon the vendor to show that the vendee corporation has a surplus out of which payment can be made for the stock, while the New York Court of Appeals has held, where the corporation is attempting to avoid its obligation that the burden of showing that there are no surplus profits and that the

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4 Re Fechheimer Fishel Co., 212 Fed. 357, 363 (C. C. A., 2nd Circ., 1914). In this action a stockholder had surrendered his stock to the corporation, for which he received its note; the corporation became insolvent and claim was made for payment of the note. The court deferred the time of payment until the claims of creditors had been satisfied in full.

5 1 Cook, Corporations, Sec. 9.


purchase was ultra vires and in contravention of the provisions of the Penal Law falls upon the corporation.\(^8\)

In considering such an agreement, the Court of Appeals said: \(^9\)

"The contract itself, therefore, was perfectly legal subject to certain limitations upon its enforceability. If when the time came defendant had a sufficient surplus, the contract would be enforced. If it had not, the contract could not be enforced."

The agreement in this case was made with one who bought the stock on the corporation's promise to employ him in its business, with the right reserved to the corporation to discontinue his employment at its option and in the event of such discontinuance, the corporation bound itself to repurchase the employee's stock if he so desired. What the court held was that the agreement was not invalid but that its enforceability depended upon whether "when the time came it had a sufficient surplus." \(^10\)

The most recent case on the subject is Topken, Loring & Schwartz Inc. v. Schwartz.\(^11\) The plaintiff corporation entered into an agreement with the defendant, one of its employees, whereby the corporation employer agreed to purchase and the employee agreed to sell any shares of stock of the corporation that he might own at the termination of the period of his employment. The employment was terminated and the defendant refused to abide by his purported contract, whereupon the corporation brought this action to specifically enforce the agreement. Although there was an intimation that the defendant had been an employee of the plaintiff and the purported contract in suit was subject to the terms of a contract of employment, the court treated the transaction as a sale contract and not a contract of employment. Writing for the unanimous court, Judge Crane held that the agreement could not be specifically enforced by the corporation; that the agreement on the part of the corporation to purchase the stock could only be enforced if the corporation had a surplus from which to make payment for the stock; that any impairment of

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\(^8\) Richards v. Ernst Weiner Company, 207 N. Y. 59, 100 N. E. 592 (1912); Strodli v. Farrish-Stafford Co., 148 App. Div. 890 (1911). As was said by Scott, J., writing for the Appellate Division in the Richards case, 145 App. Div. 353, 356, 129 N. Y. Supp. 951 (1st Dept. 1911): "The law will not presume, unless forced to do so, that a person intends to do an illegal act. It will not, therefore, presume that the parties intended to make an illegal contract. The contract itself, therefore, was perfectly legal subject to certain limitations upon its enforceability. If when the time came defendant had sufficient surplus the contract would be enforced. If it had not the contract could not be enforced. In defending against plaintiff's attempt to enforce it the burden rested upon defendant (corporation) to show that it would be illegal to do so, for there is no presumption one way or the other as to the existence of a surplus."

\(^9\) Supra Richards v. Ernst Weiner Company at 65.

\(^10\) Ibid.

\(^11\) 249 N. Y. 206, 163 N. E. 735 (1928). This case is reviewed in 42 Harv. L. Rev. 829 (1929).
the corporate capital for that purpose would be illegal under the Penal Law; that the promise, though binding on the employee, might or might not be binding on the corporation employer, depending on whether or not it had a surplus; therefore, it followed that the contract, not being mutually binding, lacked consideration and was unenforceable.

The court inferred that if the defendant had been given employment and the employment had furnished the price or the consideration for his agreement to return the stock at the end of his employment, that would constitute a contract resting not on a mutuality of promise, but upon a consideration given and paid in part by the corporation; such a contract would be good unless it appeared that the stock would be purchased out of capital. After stating the principles governing the right of a corporation to acquire its own stock, the court said: 12

"Whichever way we look at it there were certain conditions under which the corporation would be unable to perform its promise to purchase the stock and under which the courts would declare its contract so to do illegal. If, therefore, we consider the contract in question, as we must, one dependent upon mutual promises for the consideration, we have the defendant promising that at a certain time he will sell at a certain price and the plaintiff promising to buy. The promise is binding upon the defendant but may or may not be binding upon the plaintiff. It is as if the plaintiff had a choice to buy or not as it pleased. By 'binding' I mean that the corporation could execute the contract by purchasing the stock out of its surplus, but could not, without violation of the law, purchase its stock when it had no surplus. Under these circumstances, we have a contract not mutually binding, and, therefore, lacking in consideration."

Under the pronouncement of the Court of Appeals in Richards v. Ernst Wiener Co. 13 and cases involving similar contracts, it is manifest that the vendor's right to an enforcement of the contract turns on the condition of the assets at the time payment is to be made and he can only be paid out of a surplus, if any there be. However there must first be a valid contract giving rise to a legal right upon which to predicate an action for specific performance. This is the distinction between the Richards case and the Topken case. The purported contract in the latter, was to rest upon mutuality of promise. There was a binding promise on the part of the vendor, but only an illusory promise upon the part of the vendee corporation. It is apparent that the existence or non-existence of a surplus is a

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13 Supra Note 9.
matter within the control of the corporation. Assuming that the corporation was successful and building up a surplus from the operations of the business—yet it is entirely within its discretionary powers to declare dividends, or otherwise dispose of its surplus, so as to prevent the enforcement of the agreement. An illusory promise does not give rise to a valid and binding contract.

Hence in consummating an executory contract for the purchase of shares of its own stock by a corporation, it is necessary that there be a consideration, other than the promise of the corporation for the promise of the stockholder. The mere promise of the corporation to purchase is not sufficient since it may or may not be binding.

R. L.