

## CHAPTER TWO

### PROMOTERS

#### Section 2.01 Generally

##### A. Term defined.

A corporate "promoter" is one who is a "self-constituted organizer who finds an enterprise or venture and helps to attract investors, form a corporation and launch it in business, all with a view to earning promotional profits." *Daly v. Jackson*, 226 Or 471, 478, 360 P2d 542, 545 (1961). Another court has described a corporate "promoter" to be "one who alone or with others forms a corporation and procures for it the rights, instrumentalities and capital to enable it to conduct its business." *Goodman v. Darden, Doman & Stafford Associates*, 100 Wash 2d 476, 670 P2d 648, 650, n 2 (1983).

The term "promoter" is one broadly used to describe the person who brings the corporation into existence. It is a business term, not particularly a legal term. *King Features Syndicate v. Courier*, 241 Iowa 870, 43 NW2d 718, 722 (1950).

One court described a "promoter" to be "one who undertakes to bring about the incorporation, procure for the corporation the rights and capital by which it is to carry out the purposes set forth in its charter, and establishes it as able to do business." (citations omitted) *Harry Rich Corp v. Feinberg*, 518 So2d 377 (Fla 3d DCA 1987). The Delaware courts have described a "promoter" as:

In a comprehensive sense "promoter" includes those who undertake to form a corporation and to procure for it the rights, instrumentalities and capital by which it is to carry out the purposes set forth in its charter, and to establish it as fully able to do its business. Their work may begin long before the organization of the corporation, in seeking the opening for a venture and projecting a plan for its development, and may continue after the incorporation by attracting the investment of capital in its securities and providing it with the commercial breath of life. *Blish v. Thompson Automatic Arms Corp.*, 30 Del Ch 538, 64 A2d 581, 594-5 (1948)(quoting *Henderson v. Plymouth Oil Co.*, 15 Del Ch 40, 131 A 170).

See also *In re Rothman*, 204 BR 143 (BC ED Pa 1996); *Koppitz-Melchers, Inc. v. Koppitz*, 315 Mich 582, 24 NW2d 220, 226-7 (1946).

Promoter status attaches regardless of the term used by parties involved. Thus, even though a person may sign a contract as "treasurer" before the

## Section 2.01

corporation is formed, a court may treat that person as a promoter for purposes of analyzing his/her liability on the contract. *Clinton Investors Co. v. Watkins*, 146 AD2d 861, 536 NYS 2d 270 (1989).

Whether or not a person is a promoter is a question of fact. *Id.*; *Arent v. Bray*, 371 F2d 571 (4<sup>th</sup> Cir 1967).

An attorney is not a promoter simply by doing the legal work necessary to form a corporation. *Arent v. Bray*, 371 F2d 571 (4<sup>th</sup> Cir 1967).

The term "promoter" in a corporate law context has some similarities to, but is not necessarily as broad as, the term "promoter" in the securities law context. See 17 CFR § 230.405.

Although a promoter is usually a natural person, an entity such as a corporation can be a promoter. *Molander v. Raugust-Mathwig, Inc.*, 44 Wash App 53, 722 P2d 103 (1986).

### **B. Incorporators distinguished.**

Although the terms "incorporator" and "promoter" may sometimes be used interchangeably, they are not synonymous and one does not become a promoter merely by serving as the corporation's incorporator. *Benton v. Minneapolis Tailoring & Manufacturing Co.*, 73 Minn 498, 76 NW 265 (1898).

The term "incorporator" is the title used by the person whose limited role it is to sign and file the articles of incorporation and, if no initial directors are set forth in the articles, to elect the first directors and organize the corporation. ORS 60.044 and 60.057.

A person may be both a corporation's incorporator and its promoter.

A more detailed discussion of incorporators is contained in Section 3.02 of this book.

### **C. Multiple promoters.**

A corporation may have more than one promoter. Promoters may contract among themselves regarding the division of stock, compensation and other lawful matters. *Kincaid v. Lazar*, 405 NE2d 615 (Ind App 1980); *In re Estate of Doelger*, 164 Misc 590, 299 NYS 565 (1937); *Swafford v. Levin*, 117 Wash 681, 202 P 254 (1921).

Some courts have held that prior to incorporation, promoters are to be treated as partners or joint venturers. *Malisewski v. Singer*, 123 Ariz 195, 598 P2d 1014 (1979); *Refrigeration Engineering Co. v. McKay*, 4 Wash App 963, 486 P2d 304 (1971); *McRee v. Quitman Oil Co.*, 16 Ga App 12, 84 SE 487 (1915). One Oregon decision referred to promoters as "joint adventurers." *Abrams v. Puziss*, 235 Or 60, 62, 383 P2d 1012, 1013 (1963).

## Section 2.02

Another court has held that the relationship among promoters is a complex factual issue not easily categorized:

The relationships among promoters are not such as can be readily classified or categorized, but their rights and duties as among themselves should be based on the particular contractual relationship entered into by them, their common goals, their specific function within the group of promoters, and their relative knowledge and contribution to the total scheme. Their rights and duties should then be determined according to the equities presented, taking into account whether they are all on equal footing as co-promoters, whether some are partners and some are agents, or whether some other actual relationship exists among them. Such a determination becomes basically a question of fact. (citations omitted) *Schuette v. Winternitz*, 498 P2d 1183, 1185 (Colo App 1972).

If there are two or more promoters and one promoter enters a contract within the scope of the promotion, all the promoters are liable on that contract. *Refrigeration Engineering Co. v. McKay*, 4 Wash App 963, 486 P2d 304 (1971). This is consistent with the view that promoters are partners prior to incorporation. Not all jurisdictions follow this broad view. *Shoreham Hotel Ltd. Partnership v. Wilder*, 866 F Supp 1 (D DC 1994).

### **D. Modern trend.**

In its traditional sense, the concept of a "promoter" has become outdated. At one time, a corporation could not begin doing business until it had received subscriptions for a certain amount of its capital stock. *McVicer v. Cone*, 21 Or 353, 28 P 76 (1891); *Birge v. Browning*, 11 Wash 249, 39 P 643 (1895). One can infer from early case law that a significant period of time would often elapse between the date the articles were filed and the date the corporation started doing business. Most "promoter cases" involve legal disputes arising during this lengthy period.

Today, a corporation usually starts doing business almost immediately after its articles are filed. Today, a promoter is usually already serving as a director and/or officer by the time he/she takes the action which is the basis for the legal dispute. Today, a "promoter case" is much more likely to be an action against a director or officer, rather than against the person known only as the "promoter."

## **Section 2.02 Fiduciary Duty**

A promoter has a fiduciary relationship to the corporation and to its subsequent shareholders. *Park City Corp. v. Watchie*, 249 Or 493, 439 P2d 587 (1968); *Smith v. Bitter*, 319 NW2d 196 (Iowa 1982); *Jeff v. Utah Power & Light Co.*, 12 A2d 592 (Me 1940); *Ennis v. New World Life Insurance Co.*, 97 Wash 122, 165 P 1091 (1917). A promoter owes a duty of utmost good faith to both. *Mangold v. Adrian Irr. Co.*, 60 Wash 286, 111 P 173 (1908).

Most courts have held that promoters owe the same duty to the corporation as trustees owe to the beneficiaries of a trust. *Hamilton v. Hamilton Mammoth*

## Section 2.02

*Mines*, 110 Or 546, 223 P 926 (1924). The argument that a promoter cannot owe a fiduciary duty to a corporation not yet in existence has been brushed aside as overly technical. *Colville Valley Coal Co. v. Rogers*, 123 Wash 360, 212 P 732 (1923).

Promoters who breach their fiduciary duty are liable for any gain or profit which they realize from the breach. *Krause v. Mason*, 272 Or 351, 537 P2d 105 (1975); *Koppitz-Melchers, Inc. v. Koppitz*, 315 Mich 582, 24 NW2d 220 (1946). The Washington Supreme Court has said:

From this fiduciary relation it follows that the promoters must deal with the persons who come into the organization as members or stockholders, in the utmost good faith. . . . Neither will they be permitted, either by fraud or silence, to use their position for the purpose of speculation. The general rule conceded and adopted by the authorities is that under such circumstances promoters [sic] cannot take advantage of their position to make secret profits out of their transactions with or on behalf of the proposed corporation or the incorporators. . . . "Justice demands that the promoters of the company should not abuse the confidence placed in them by the stockholders, or derive any unjust advantage through their control over the organization or management of the company." . . . If the promoters obtain secret profits out of any transactions, and either they themselves become members of the board of director, or persons under their control are elected as such directors, and the board thus composed adopts and ratifies the voidable transaction,—this, it has been held, will create no impediment to proceedings by stockholders for redress. *Ennis v. New World Life Insurance Co.*, 97 Wash 122, 135, 165 P 1091, 1095 (1917)(quoting Thompson on Corporations 2nd Ed).

Promoter liability is discussed in Section 2.05 of this book.

### **A. Disclosure duty.**

Promoters have a duty to disclose to the corporation and to its shareholders all material facts touching upon the promoter's relationship with the corporation. This duty includes the promoter's obligation to disclose any compensation, profits or advantages derived from the corporation or from persons dealing with the corporation. *Wills v. Nehalem Coal Co.*, 52 Or 70, 96 P 528 (1908); *Bowers v. Rio Grande Investment Co.*, 163 Colo 363, 431 P2d 478 (1967); *Killween v. Parent*, 23 Wis 2d 244, 127 NW2d 38 (1964).

The well-settled general rule is that promoters of a corporation must act in the utmost good faith in dealing on behalf of and with the corporation. If they undertake to sell property to the corporation, and in doing so obtain a secret profit, it is a breach of trust and a fraud on the corporation. For such conduct, promoters are liable to the corporation, either at law or equity according to the circumstances of the case. The corporation may recover damages at law for the fraud, or in a proper case may rescind the transaction and recover what it has parted with. *Ft. Myers Development Corporation v. J. W. McWilliams Co.*, 97 Fla 788, 122 So 264, 267 (1929).

Another court has said:

It is now established without exception that a promoter stands in a fiduciary relation to the corporation in which he is interested, and that he is charged with all the duties of good faith which attach to other trusts. In this respect he is held to the high standards which bind directors and other persons occupying fiduciary relations. *Koppitz-Melchers, Inc. v. Koppitz*, 315 Mich 582, 24 NW2d 220, 227 (1946)(quoting

## Section 2.02

*Old Dominion Copper Mining & Smelting Co. v. Bigelow*, 203 Mass 159, 89 NE 193, 201).

Thus, a promoter who purchases land for \$5 per acre and then immediately resells it at a profit to the promoter's corporation – without disclosing such fact – has breached the promoter's duty to that corporation. *Mangold v. Adrian Irr. Co.*, 60 Wash 286, 111 P 173 (1908).

### **B. Transactions between promoter & corporation.**

A promoter's fiduciary duty to the corporation does not prohibit business dealings between the promoter and the corporation. Promoters are permitted to sell property to the corporation, as long as they are "open" about their profits and all other aspects of the transaction. *Colville Valley Coal Co. v. Rogers*, 123 Wash 360, 212 P 732 (1923). Promoters can, and usually do, purchase stock in the corporation. Promoters may purchase stock, provided the purchase price is fair and provided the purchase price (or value) exchanged for the stock is disclosed. *State ex rel Carriger v. Campbell Food Markets, Inc.*, 60 Wash 2d 478, 374 P2d 435 (1962).

Transactions between a promoter and the corporation are more likely to be upheld if approved or ratified by an independent board and/or by the shareholders. *Downey v. Byrd*, 171 Ga 532, 156 SE 259 (1930); *Dickerman v. Northern Trust Co.*, 176 US 181 (1900).

### **C. Secret profits.**

Promoters are not prohibited from earning profits out of their dealings with or on behalf of the corporation. In fact, one Oregon case described a "promoter" to be a person motivated by a desire "to earning promotional profits." *Daly v. Jackson*, 226 Or 471, 478, 360 P2d 542, 545 (1961). Rather, promoters are only prohibited from earning **secret** profits. *Rugger v. Mt. Hood Electric Co.*, 143 Or 193, 20 P2d 412, 21 P2d 1100 (1933).

Fraud to be actionable must result in injury, and it nowhere appears that injury has resulted to any one because of such exchange. It does not appear but that subsequent stockholders purchased with full opportunity for investigation into the condition and assets of the company, and that the stock they purchased was fully worth the sum paid therefor. If, therefore, subsequent stockholders obtained full value, there can be no element of injury or fraud as to them. *Inland Nursery and Floral Co. v. Rice*, 57 Wash 67, 69, 106 P 499, 499 (1910).

A promoter "is bound to disclose to [the shareholders] fully all material facts touching his relation to them, including the amount which he is to get for his services as promoter." *Wills v. Nehalem Coal Co.*, 52 Or 70, 76-7, 96 P 528, 531 (1908). For example, in *Park City Corp. v. Watchie*, 249 Or 493, 439 P2d 587 (1968), the promoter was held liable to the corporation for failing to disclose to it that the promoter had received a commission on a property acquisition by a third party, where the third party turned around and sold the property to the corporation.

## Section 2.03

On the other hand, a promoter is not liable for “secret” profits if the shareholders know about these profits. “The word ‘secret’ implies as much.” *Birbeck v. American Toll Bridge Co. of California*, 23 Del Ch 83, 2 A2d 158, 165 (1938).

The promoter’s conduct will be carefully scrutinized to determine if there were improper secret profits. *Dickerman v. Northern Trust Co.*, 176 US 181 (1900); *George Washington Memorial Park Cemetery Assoc. v. Memorial Development Co.*, 140 NJ Eq 181, 55 A2d 675, 687 (1947).

The corporation may sue the promoter to recover secret profits, but “recovery is limited to the profit actually made by the promoters in the transaction.” *Johndahl v. Columbus Trotting Ass’n, Inc.*, 104 Ohio App 118, 147 NE2d 101, 113 (1956).

See Comment, *Accountability of Promoters to the Corporation for Profits*, 12 WASH L REV 30 (1937).

### **D. Multiple promoters.**

If there are two or more promoters, each promoter will usually owe a fiduciary duty to the other. *Pollard v. Pollard's L. L. & L., Inc.*, 279 Or 467, 568 P2d 1387 (1977); *Wilson v. McClenny*, 262 NC 121, 136 SE2d 569 (1964); *Morris v. Whittier Amusement Co.*, 123 Cal App 121, 10 P2d 1017 (1932).

## Section 2.03 Breach of Duty

Promoters who breach their fiduciary duty are liable for any gain or profit which they may realize from the breach. *Krause v. Mason*, 272 Or 351, 537 P2d 105 (1975); *Koppitz-Melchers, Inc. v. Koppitz*, 315 Mich 582, 24 NW2d 220 (1946). See Section 2.05 of this book.

### **A. Claims against promoter are usually claims of corporation, not shareholders.**

Generally, a claim against a promoter for breach of fiduciary duty to the corporation is a corporate claim, not a claim belonging to individual shareholders. *Wills v. Nehalem Coal Co.*, 52 Or 70, 96 P 528 (1908); *Fletcher v. Stapleton*, 123 Cal App 133, 10 P2d 1019 (1932); *Masberg v. Granville*, 201 Ala 5, 75 So 154 (1917).

As with a breach of fiduciary duty lawsuit against an officer or director, a shareholder must bring such a lawsuit derivatively, with damages payable to the corporation. *Krause v. Mason*, 272 Or 351, 537 P2d 105 (1975); *Koppitz-Melchers, Inc. v. Koppitz*, 315 Mich 582, 24 NW2d 220 (1946) *Cassidy v. Rose*, 108 Okla 282, 236 P 591 (1925); *Huffman v. Ellen Mining Co.*, 118 Wash 546, 204 P 197 (1922). As with other derivative lawsuits, attorney fees may be recoverable by the shareholder if the lawsuit results in benefit to the corporation. *Krause v. Mason*, 272 Or 351, 537 P2d 105 (1975).

## Section 2.03

A more detailed discussion of derivative lawsuits is contained in Section 8.05 of this book.

### **B. Exception - shareholder claims against promoter.**

There are exceptions to the general rule that only the corporation – not an individual shareholder – has a claim against the promoter.

At one time, statutes required corporations to raise a minimum amount of money before beginning operations. Under these statutes, courts have held shareholders had individual – not derivative – claims against the promoter if the promoter permitted the corporation-to-be-formed to use subscriber funds before all subscriptions were sold, *Miller v. Denman*, 49 Wash 217, 95 P 67 (1908), or if the promoter permitted the corporation-to-be-formed to enter into a contract and subsequently failed to obtain the required number of subscriptions. *Stern v. Fletcher American Co.*, 204 Ind 35, 181 NE 37 (1932).

Corporate statutes today generally do not contain a minimum capital requirement. But sometimes by contract, a promoter promises to escrow all subscribers' funds until a minimum amount is raised. If the promoter jumps the gun and releases funds early, subscribers likely would have an individual claim – not a derivative claim – against the promoter for breach of contract.

Under the trend which increasingly recognizes individual claims among shareholders in close corporations, presumably a shareholder in a close corporation would have an individual claim against the promoter for breach of fiduciary duty. For a more detailed discussion of individual claims among shareholders in a close corporation, see Section 8.03 of this book.

A shareholder generally has an individual common law claim directly against the promoter when the promoter uses fraud to induce the purchase of stock. *Killeen v. Parent*, 23 Wis 2d 244, 127 NW2d 38 (1964); *Downey v. Byrd*, 171 Ga 532, 156 SE 259 (1930); *Grover v. Cavanagh*, 40 Ind App 340, 82 NE 104 (1907).

A promoter's breach of fiduciary duty may also form the basis for an individual claim by the shareholders under the securities laws, particularly if the promoter was involved in the stock sale to the complaining shareholders. See for example ORS 59.115; ORS 59.137; 15 USC § 77i; 15 USC § 78j(b).

### **C. Remedy.**

If a promoter breaches his/her fiduciary duty to the corporation, the corporation has available the same remedies it would have against any agent, officer or director who breached his/her fiduciary duty. Such remedies may include damages and/or disgorgement.

A corporation may not have a remedy, however, if its promoter was the only shareholder at the time of the promoter breached that duty. For instance, one early

## Section 2.05

case held that a corporation did not have a direct claim against a promoter who transferred over-valued property to the corporation in exchange for 100% of the corporation's stock. *Hamilton v. Hamilton Mammoth Mines*, 110 Or 546, 223 P 926 (1924). See also *Jeff v. Utah Power & Light Co.*, 12 A2d 592 (Me 1940). A person who later purchases the stock from the promoter may, however, have a direct claim against the promoter for common law fraud and/or violations of the securities laws.

## Section 2.04 Promoter Compensation

A corporation clearly has the right to enter into a contract with its promoter to compensate the promoter for his/her pre-incorporation services. *Parrott v. Collins*, 87 Ga App 533, 74 SE2d 485 (1953); *Annotation*, 8 ALR 2d 723. Such compensation may be in the form of cash, stock or other property. Stock compensation is the most common form of compensation. See *Bowers v. Rio Grande Investment Co.*, 163 Colo 363, 431 P2d 478 (1967); *Bailey v. Interstate Airmotive, Inc.*, 358 Mo 1121, 219 SW2d 333 (1949).

Absent a contract, most courts have held that a promoter has no right to compensation for services during the pre-incorporation period. *Kincaid v. Lazar*, 405 NE2d 615 (Ind App 1980); *Lindsey v. Pasco Power & Water Co.*, 203 F 251 (9<sup>th</sup> Cir 1913).

One Oregon case implies a promoter has no *quantum meruit* claim for compensation. *Abrams v. Puziss*, 235 Or 60, 383 P2d 1012 (1963). But see *Labor Investment Corp. v. Russell*, 405 P2d 1008 (Okla 1965)(equity permitted promoter to recover under *quantum meruit* theory for services he performed under a contract which later turned out to be unenforceable due to a technicality).

A more detailed discussion of promoter compensation is contained in Brockelbank, *The Compensation of Promoters*, 13 OR L REV 195 (1934).

## Section 2.05 Liability of Promoter to Third Parties

If a promoter executes a contract on behalf of a corporation before the corporation is formed, the promoter is usually personally liable on the contract. ORS 60.064; *Brijm, LLC v. Output Systems, Inc.*, 100 Conn App 143, 917 A2d 605 (2007); *Equipto Division Aurora Equipment Co. v. Yarmouth*, 134 Wash 2d 356, 950 P2d 451 (1997); *Illinois Controls, Inc. v. Langham*, 70 Ohio St 3d 512, 639 NE2d 771 (1994); *Royal Development and Management Corp. v. Guardian 50/50 Fund V, Ltd.*, 583 So2d 403 (Fla 3d DCA 1991); *Jones v. Burlington Industries, Inc.*, 196 Ga App 834, 397 SE2d 174 (1990).

The liability of the promoter for a contract will depend upon the terms of the contract and the intent of the parties. There is a strong inference that a person intends to make a contract with an existing entity, rather than the to-be-formed corporation.



## Section 2.05

(citations omitted) *Molander v. Raugust-Mathwig, Inc.*, 44 Wash App 53, 58, 722 P2d 103, 107 (1986).

Thus, a promoter is liable on the contract unless the other party agrees to look only to the corporation-to-be-formed for performance.

It is frequently desirable as a practical matter to obtain options, enter into contracts for the purchase of land, buildings, machines and materials, and for the performance of services prior to the incorporation of the business unit for whose benefit such transactions are to be consummated.

\* \* \* \*

It is settled by the authorities that a promoter, though he may assume to act on behalf of the projected corporation and not for himself, will be personally liable on his contract unless the other party agreed to look to some other person or fund for payment. *Sherwood & Roberts-Oregon, Inc. v. Alexander*, 269 Or 389, 394, 525 P2d 135, 138 (citations omitted)(1974).

The Washington Court of Appeals has said:

The rules governing promoter liability are well settled. Ordinarily, a corporate promoter is personally liable on any contracts he or she makes for the benefit of a corporation not yet in existence. The subsequent organization of the corporation does not discharge the promoter from liability, unless the parties agree that his or her liability should cease at that time. Similarly, absent agreement of the parties, a promoter will not be discharged from contractual liability if the corporation subsequently adopts or ratifies his contract. A plaintiff can ordinarily, therefore, look to both the promoter and the corporation for compensation for a breach of the preincorporation contract. (footnote & citations omitted) *American Seamount Corp. v. Science and Engineering Associate, Inc.*, 61 Wash App 793, 798, 812 P2d 505, 508-9 (1991).

Another court has said:

A prerequisite to these contractual rights is the validity of preincorporation contracts and the capacity of individuals to enter into contracts on behalf of unformed corporations. Indeed, "[c]ontracts are frequently made by promoters on behalf of corporations which they expect to organize. Often, the terms of these contracts are such that if the corporation were already in existence, the contract would be that of the corporation and not of the promoter. But as it is impossible for the corporation to contract before it comes into existence, the contract is treated as that of the promoter even though the language of the contract is appropriate for a contract by the corporation." *Brjm, LLC v. Output Systems, Inc.*, 100 Conn App 143, 917 A2d 605, 612-3 (2007)(quoting *Williston, Contracts*).

On the other hand, at least one court has held: "The general rule is a promoter's personal liability on a pre-incorporation contract entered with a third party is determined by the intent of the parties at the time of contract." *Company Stores Development Corp. v. Pottery Warehouse, Inc.*, 733 SW2d 886 (Tenn App 1987).

Absent novation, a promoter remains liable on the contract even though the corporation agrees to become liable thereon. *Talaria Waste Management, Inc. v. Laidlaw Waste Systems, Inc.*, 827 F Supp 843, 846 n 7 (D Mass 1993); *Quest Eng'g Solutions, Inc. v. Wilbur*, 2011 Mass App Unpub LEXIS 770.

## Section 2.05

If after its formation either the corporation expressly assumes the contract or the corporation ratifies the promoter's act and accepts the full benefits of the contract, both the corporation and its promoter will become liable on the contract and the plaintiff may file suit against one or both. *Illinois Controls, Inc. v. Langham*, 70 Ohio St 3d 512, 639 NE2d 771 (1994); *Crown Controls, Inc. v. Smiley*, 110 Wash 2d 695, 756 P2d 717 (1988); *Malisewski v. Singer*, 123 Ariz 195, 598 P2d 1014 (1979).

### **A. General rules of agency apply.**

Under general rules of agency, an agent for a non-existent principal is personally liable for acts undertaken on behalf of that nonentity. *Illinois Controls, Inc. v. Langham*, 70 Ohio St 3d 512, 639 NE2d 771, 781 (1994); *Maxwell's Electric, Inc. v. Hegeman-Harris Company of Canada, Ltd.*, 18 Wash App 358, 567 P2d 1149 (1977); RESTATEMENT OF AGENCY (SECOND) §§ 322 & 326.

Prior to incorporation, a promoter is the agent for a nonexistent entity.

If one contracts as agent, when in fact he has no principal, he will be personally liable. A promoter though he may assume to act on the behalf of the projected corporation and not for himself, can not be treated as an agent of the corporation, for it is not yet in existence; and he will be personally liable on his contract, unless the other party agreed to look to some other person or fund for payment. (citations omitted) *Wiggins v. Darrah*, 135 Ga App 509, 218 SE2d 106, 107-8 (1975).

See also *Kelley v. RS & H of North Carolina, Inc.*, 197 Ga App 236, 398 SE2d 213 (1990); *Coopers & Lybrand v. Fox*, 758 P2d 683 (Colo App 1988); *C. & H. Contractors, Inc. v. McKee*, 177 So2d 851 (Fla 2d DCA 1965); *White & Bollard, Inc. v. Goodenow*, 58 Wash 2d 180, 361 P2d 571 (1961).

### **B. Exception – third party agrees to look only to corporation.**

There is an exception to the general rule.

A promoter is not liable if the other party to the contract knew the corporation was not yet in existence, but nevertheless agreed to look only to the corporation for payment. *Sherwood & Roberts-Oregon, Inc. v. Alexander*, 269 Or 389, 525 P2d 135 (1974); *Betchard-Clayton, Inc. v. King*, 41 Wash App 887, 707 P2d 1361 (1985); *Tin Cup Pass Limited Partnership v. Daniels*, 195 Ill App 3d 847, 553 NE2d 82 (1990); *Goodman v. Darden, Doman & Stafford Associates*, 100 Wash 2d 476, 670 P2d 648 (1983).

A third party's intent to look only to the corporation may be proven by language in the contract or by circumstantial evidence. *Goodman v. Darden, Doman & Stafford Associates*, 100 Wash 2d 476, 670 P2d 648 (1983).

The promoter may also escape liability if there is a novation after incorporation and the third party agrees only to look to the corporation for performance. *Talaria Waste Management, Inc. v. Laidlaw Waste Systems, Inc.*, 827 F Supp 843, 846 n 7 (D Mass 1993).

## Section 2.05

### **C. Promoter remains liable even if corporation assumes contract.**

Absent novation, a promoter remains liable on a pre-incorporation contract, even though the contract is assumed or ratified by the corporation after incorporation. *Talaria Waste Management, Inc. v. Laidlaw Waste Systems, Inc.*, 827 F Supp 843, 846 n 7 (D Mass 1993); *Clinton Investors Co. v. Watkins*, 146 AD2d 861, 536 NYS2d 270 (1989). "This view is founded upon the well-settled principle of the law of contracts that a party to a contract cannot relieve himself from its obligations by the substitution of another person, without the consent of the other person." *Illinois Controls, Inc. v. Langham*, 70 Ohio St 3d 512, 639 NE2d 771, 781 (1994).

The rules governing promoter liability are well settled. Ordinarily, a corporate promoter is personally liable on any contracts he or she makes for the benefit of a corporation not yet in existence. The subsequent organization of the corporation does not discharge the promoter from liability, unless the parties agree that his or her liability should cease at that time. Similarly, absent agreement of the parties, a promoter will not be discharged from contractual liability if the corporation subsequently adopts or ratifies his contract. A plaintiff can ordinarily, therefore, look to both the promoter and the corporation for compensation for a breach of the preincorporation contract. (footnote and citations omitted) *American Seamount Corp. v. Science and Engineering Associate, Inc.*, 61 Wash App 793, 812 P2d 505, 508-9 (1991).

If a corporation either expressly assumes the contract or if it later ratifies the promoter's act and accepts the contract's benefits, both the corporation and its promoter will be liable. *Crown Controls, Inc. v. Smiley*, 110 Wash 2d 695, 756 P2d 717 (1988). In such case, the promoter would likely have a claim against the corporation for indemnity.

### **D. Miscellaneous.**

If there are two or more promoters and one of the promoters enters a contract within the scope of the promotion, all of the promoters are liable. *Refrigeration Engineering Co. v. McKay*, 4 Wash App 963, 486 P2d 304 (1971). Not all jurisdictions follow this broad view. *Shoreham Hotel Ltd. Partnership v. Wilder*, 866 F Supp 1 (D DC 1994).

Because a promoter who enters into a contract in the name of a nonexistent corporation becomes a party to the contract, the promoter may enforce the contract in the promoter's individual capacity. *White v. Dvorak*, 78 Wash App 105, 896 P2d 85 (1995). See also *Hoppe v. Percheron Associates, LLC*, Case No: 11-cv-03233-CBS (D Colo Aug 1, 2012) ("At the heart of the mutuality requirement is the notion of fundamental fairness."); *T Street Development LLC v. Dereje*, 2005 US Dist LEXIS 38713, at \*14-15 (DDC December 19, 2005) (holding that a promoter liable under a contract must also have the right and standing to enforce that same contract under the principle of mutuality); *Fish v. Tandy Corp.*, 948 SW 2d 886, 890

## Section 2.06

(Tex App Fort Worth 1997) ("Because any enforceable agreement is mutual and binding on both parties, logic indicates a promoter who is liable under an agreement may also make a claim under such a contract."); *In re Berris*, 2009 WL 1139085, at \*2-4 (Bankr SD Fla April 27, 2009) (holding mutuality should extend to allow the Debtor who executed the purchase contract at issue to sue on behalf of the non-existent entity); *Gardner v. Madsen*, 949 P2d 785, 789 (Utah Ct App 1997) ("The individual who signs a contract in the name of a nonexistent corporation can be a party to the contract.").

Promoters are generally not personally liable for post-incorporation acts of the corporation. *Anders v. Metropolitan Life Ins. Co.*, 314 Ill App 196, 40 NE2d 739 (1942). *But see Georgia Portland Cement Corp. v. Harris*, 178 Ga 301, 173 SE 105 (1934)(promoter continues to be liable for post-incorporation acts when the promoter so dominates the corporation that the corporation may be deemed to be the mere puppet of the promoter).

A corporation is usually not liable for the pre-incorporation acts of its promoter. *Fisk v. Leith*, 137 Or 459, 467, 299 P 1013, 3 P2d 535 (1931).

A corporation may have the right to sue third parties for their fraudulent representations made to promoters prior to incorporation. *Nationwide Motorist Association of Michigan, Inc. v. Freeman*, 405 F2d 699 (6<sup>th</sup> Cir 1969); *Crystal Pier Amusement Co. v. Cannan*, 219 Cal 184, 25 P2d 839 (1933).

A discussion of promoter liability is contained in Flores, *The Case for Eliminating Promoter Liability on Preincorporation Agreements*, 32 ARIZ L REV 405 (1990); Miller, *Liability of Organizers, Members and Officers of Private Corporation under the Indiana Law*, 4 Ind L J 183 (1928).

A discussion of a corporation's liability for acts of its promoter is contained in Section 11.01 of this book.

## Section 2.06 Promoter Liability for Acts of Defective Corporation

Prior to 1953 in Oregon, a promoter could assert as a defense in an action by a creditor that a defective corporation was a *de facto* corporation. This defense is no longer available.

A *de facto* corporation is one in which (i) the promoters made a good faith effort to organize a corporation, (ii) the corporation made a colorable or apparent attempt to comply with the law, and (iii) the corporation attempted to exercise corporate powers. *Brown v. Webb*, 60 Or 526, 120 P 387 (1912). If a court found a *de facto* corporation to exist, third parties (other than the state) could not collaterally attack the corporation's existence and seek personal liability against those who executed contracts on behalf of the *de facto* corporation.

## Section 2.07

In 1953, the Oregon legislature abolished the *de facto* corporation defense. *Timberline Equipment Co., Inc. v. Davenport*, 267 Or 64, 514 P2d 1109 (1973); *Sherwood & Roberts v. Alexander*, 269 Or 389, 525 P2d 135 (1974). Under the 1953 statute, promoters were personally liable for any contracts which they entered into on behalf of the corporation prior to the filing of articles, absent an agreement with the third party to the contrary.

Under the 1987 Act, all persons purporting to act on behalf of a corporation – knowing no corporation exists – are jointly and severally liable for all liabilities created while so acting. ORS 60.054; *Equipto Division Aurora Equipment Co. v. Yarmouth*, 134 Wash 2d 356, 950 P2d 451 (1997); *Royal Development and Management Corp. v. Guardian 50/50 Fund V, Ltd.*, 583 So2d 403 (Fla 3d DCA 1991). Such liability requires actual knowledge; constructive knowledge is not enough. *Silvers v. R&F Capital Corp.*, 123 Or App 35, 858 P2d 895 (1993). Theoretically, a promoter may lack actual knowledge that the articles have not been filed.

The filing of the articles with the Secretary of State's office is conclusive proof the incorporators have satisfied all conditions precedent to incorporation (except in certain proceedings initiated by the state). ORS 60.051(2). See Section 6.04 of this book.

A more detailed discussion of *de facto* corporations is contained in Section 3.04 of this book.

### Section 2.07 Watered Stock

At one time, shareholders were liable to the corporation, and ultimately to corporate creditors, for the par value of each share of stock purchased, less the amount the shareholder actually paid for the share. See Section 10.11 of this book.

Promoters often received shares for their pre-incorporation services to the corporation. When promoters received shares only for their services, such shares were sometimes referred to as "watered stock." In the past, courts generally held promoters liable for the par value of their "watered stock." *McAllister v. American Hospital Ass'n.*, 62 Or 530, 125 P 286 (1912); *Fox v. Seattle Contract Copper Co.*, 98 Wash 557, 168 P 185 (1917).

Under the 1987 Act, the concept of par value has been abandoned. Shareholders are now liable to the corporation "to pay the consideration" promised for such shares. ORS 60.151(1). See also Sections 3.09 and 10.11 of this book. Not only is cash an acceptable form of consideration for shares, pre-incorporation services and contracts for future services are also acceptable forms of consideration.

## Section 2.07

ORS 60.147(2); *Yeoman v. Public Safety Center, Inc.*, 241 Or App 255, 250 P3d 411 (2011).

ORS 60.147(3) requires the board to determine whether the consideration received for shares is adequate. The business judgment rule applies to that determination. *Smith v. Schmitt*, 112 Or 687, 699, 231 P 176 (1924); *In the Matter of Delk Road Associates, Ltd.*, 37 BR 354 (ND Ga 1984); *Garbe v. Excel Mold, Inc.*, 397 NE2d 296 (Ind App 1979). When the directors are also promoters, their judgment as to the adequacy of the consideration is subject to scrutiny.

The judgment of the directors of a corporation upon the value of property or stock to be taken and accepted by the corporation in exchange for its own stock in payment of a subscription contract, the exercise of which, when acted upon, is made conclusive by statute, refers to an honest attempt to determine the value of the property or stock by a board of directors representing the corporation alone and jealous of its right and interests and anxious to secure for the corporation all that it is justly entitled to. Anything less than that is dishonest and fraudulent. The directors may be honestly mistaken. They may exercise a very poor judgment and make a very poor bargain, but this is wholly immaterial so long as they have no personal interests of their own to further and act fairly and honestly by the corporation they profess to represent. *Atwell v. Schmitt*, 111 Or 96, 106, 225 P 325, 328 (1924).

A more detailed discussion of the conflicts faced by directors in such circumstances is contained in Section 5.16 of this book.

A corporation itself cannot sue its promoters for an inadequate purchase price if the promoters received 100% of the initial shares, even though the promoters later sold these shares to others. *Hamilton v. Hamilton Mammoth Mines*, 110 Or 546, 223 P 926 (1924); *Lake Mabel Development Corp. v. Bird*, 99 Fla 253, 126 So 356 (1930). Under some circumstances, however, a new purchaser of the shares may have a claim against the promoter/seller for violations of the securities laws.

Proof of the consideration paid for shares may be through the minutes of a board of directors' meeting, but proof may also be by testimony or other evidence. *Frisch v. Victor Industries, Inc.*, 51 Wash App 377, 753 P2d 1000 (1988). Once issued, there is a presumption that a share was issued for consideration. *Id.*; *Murphy v. Panton*, 96 Wash 637, 165 P 1074 (1917).