# Liabilities for transactions before incorporation

     A.PROMOTERS--a promoter participates in the formation of the corp, usually arranging compliance with the legal requirements of formation, securing initial capital, and entering into necessary contracts on behalf of the corp during the time it’s being formed.

              a)Fiduciary Duties to Each Other--Full disclosure and fair dealing are required between the promoters and the corp and among promoters themselves.

     B.CONTRACTS MADE BY PROMOTERS ON CORP’S BEHALF

          1.RIGHTS AND LIABILITIES OF CORPORATION:

              a)English Rule--the corp is not directly liable on pre-incorporation contracts even if later ratified. Rationale: the corp was not yet in existence at the time the promoter was acting.

              b)American Rule--the corp is liable if it later ratifies or adopts pre-incorporation K.

              c)Corporation’s Right to Enforce Contract--under either rule, the corp may enforce the contract against the party with whom the promoter contracted, if it chooses to do so.

          2.RIGHTS AND LIABILITIES OF PROMOTERS.

              a)Liability on Pre-incorporation Contract--generally, promoters are liable if the corp rejects the pre-incorporation contract, fails to incorporate, or adopts a contract but fails to perform, unless the contracting party clearly intended to contract with the corporation only and not with the promoters individually.

              b)Right to Enforce Against the Other Party--if a corp is not formed, the promoter may still enforce the contract.

     C.OBLIGATIONS OF PREDECESSOR BUSINESS--a corporation that acquires all of the assets of a predecessor business does not ordinarily succeed to its liabilities, with exceptions:

              a)Exceptions--the successor corp may be liable for its predecessor liabilities if:

                 1)the new corp expressly or impliedly assumes the predecessor obligations (the creditors of the old corp may hold the new corp liable as third-party beneficiaries);

                 2)the sale was an attempted fraud on the creditors; or

                 3)the predecessor is merged into or absorbed by the successor.

IV.POWERS OF THE CORPORATION.

     A.CORPORATE POWERS--generally, corporate purposes and powers are those expressly set forth in the corporation’s articles, those conferred by the statute, and the implied powers necessary to carry out the express powers. Transactions beyond the purposes and powers of the corporation are ultra vires.

          1.TRADITIONAL PROBLEM AREAS--the following three powers are particularly significant express powers, since older statutes did not specifically confer them:

              a)Guarantees--modern statutes confer the power to guarantee the debts of others if it is in furtherance of the corporate business;

              b)Participation in a Partnership--present-day statutes explicitly allow the corp to participate with others in any corp, partnership, or other association;

              c)Donations--because the general rule is that the objective of a business corporation is to conduct business activity with a view to profit, early cases held that charitable contributions were ultra vires; the modern view permits reasonable donations without showing the probability of a direct benefit to the corp.

     B.AGENCY

          1.DEFINITION--agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other to so act." Rest2dAg

              a)Parties to an agency relationship--Principal & Agent. Thus, three essential elements of an agency relationship:

                 1)Manifestation by principal that agent shall act for him in some undertaking;

                 2)Acceptance by the agent; and

                 3)Understanding that the principal is in control of the undertaking.

                     I)Note that these are factual issues; if they are satisfied, then the relationship is one of agency, regardless of what the parties themselves call it (but the parties' labels may provide evidence of their intent)

          2.CATEGORIES OF AGENCY

              a)Actual Express Authority--authority is the power of the agent to affect the legal relations of the principal by acts done in accordance with the principal's manifestations of consent to him." Rest §7. Operative word is "manifestation" . If he says, do something, it's express ‑‑ but the manifestation may include implied assent to other things as well, which is-->

              b)Actual Implied Authority--unless otherwise agreed, authority to conduct a transaction includes authority to do acts which are incidental to it, usually accompany it, or are reasonably necessary to accomplish it." Rest § 35

              c)Apparent Authority ‑‑ a.k.a. "ostensible authority"--apparent authority is the power to affect the legal relationships of another person by transactions with third persons, professedly as agent for the other, arising from and in accordance with the other's manifestations to such third persons." Rest §8. But note that the manifestation includes allowing the agent to represent accurately his own authority.

              d)Inherent Authority--this is the authority that inheres in an office. General agent (agent authorized to conduct a series of transactions involving continuity of service): P is bound if A is acting in the interests of P and A does an act usual or necessary with respect to the authorized transactions ;

                 1)Unusual activities--depositing corporate checks on a personal account is an unusual activity, and the bank should make inquiry if the person is authorized to do that; otherwise, the bank is liable to the principal for lost money (Mohr)

              e)Ratification--ratification is the affirmance by a person of a prior act which did not bind him but which was done or professedly done on his account, whereby the act, as to some or all persons, is given effect as if originally authorized by him." Rest § 82. The principal can affirm by words, or by deeds. This includes the failure to repudiate the subject matter when presented, suing to enforce the obligation, retaining the benefits of the transaction. Note several things:

                 1)Ratification assumes that the principal was not previously bound. If the principal had been previously bound, then the liability would be based on another agency theory.

                 2)It doesn't matter to whom the affirmance is made. It could be to the agent, to the third party, or anyone else or nobody at all. Why? Because what was lacking in the original contract was merely his expression of assent to the relationship of agency. The terms are fixed, the third party believes he has an agreement, all that's missing is the opposite party. So the President of the firm's note to himself that the affirms may be sufficient. If there are some formalities required to authorize an act ‑‑e.g., sealed instruments, deeds ‑‑ then there might be additional formality required for affirmance.

              f)Estoppel--purported principal either (a) intentionally or carelessly causes the belief that a purported agent is acting on his behalf, or (b) sits silently knowing that such belief exists without taking reasonable steps, and the third party relies detrimentally.

     C.ULTRA VIRES TRANSACTIONS--those beyond the purposes and powers, express and implied, of the corporation. Under common law, shareholder ratification of an ultra vires transaction nullified the use of an ultra vires defense by the corporation.

          1.TORT ACTIONS--ultra vires is NO defense to tort liability.

          2.CRIMINAL ACTIONS--claims that a corporate act was beyond the corp’s authorized powers are NO defense to criminal liability.

         3.CONTRACT ACTIONS--at common law, a purely executory ultra vires contracts were NOT enforceable against either party; fully performed contracts could NOT be rescinded by either party; and, under the majority rule, partially performed contracts were generally enforceable by the performing party, since the nonperforming party was estopped to assert an ultra vires defense.

          4.STATUTES--most states now have statutes that preclude the use of ultra vires as a defense in a suit between the contracting parties, but permit ultra vires to be raised in certain other contexts:

              a)Suits Against Officers or Directors--if performance of an ultra vires contract results in a loss to the corp, it can sue the officers or dirs for damages for exceeding their authority.

              b)Suit By State--these limiting statutes do NOT bar the state from suing to enjoin a corp from transacting unauthorized business.

              c)Broad Certificate Provisions--when the certificate of incorporation states that the purpose is to engage in any lawful activity for which corp may be organized, ultra vires is unlikely to arise.