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PROTECTION OF CREDITORS UNDER THE PROPOSED FLORIDA BUSINESS CORPORATION ACT¹

FLOYD A. WRIGHT*

The prime object of law in general is to protect legitimate interests against abuses. That is particularly true of corporation law since the State extends to corporations special advantages not enjoyed by individuals, and the exercising of such advantages often presents greater possibilities of such excesses. Hence, one of the aims of a modern business corporation is to provide protection against corporate abuses.² Such safeguards purport to protect (1) the public, (2) minority shareholder groups, and (3) creditors of the corporation. The scope of this discourse is confined to a few of the more important provisions in the proposed Act directed at giving to the latter of these groups greater safety than is afforded under existing statutes.

One of the most neglected phases of statutory law is the matter of promotion of the corporate unit. No statutes have adequately dealt with the subject, and most states, like Florida, have no statutory provisions, either directory or regulatory, relating to promoters. A few years back this author searched out the names of a dozen or so of the more prominent authors on the subject of corporate promoters and wrote each of them relating to the advisability of statutory regulation of promoters. Without exception, all replies were emphatically in favor of it. Some were mostly concerned with restrictive stipulations against promotional abuses, while others emphasized the importance of directory provisions aimed at establishing a guide or pattern for directing the promotional activities.

The proposed Act contains special provisions³ aimed at protecting parties who extend credit to promoters of a proposed corporation. It requires that the promoter be competent to contract, and, unless the contract specifically negatives such liability, he is liable to creditors who extend

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1. This proposed modern Act was presented to the last session of the Florida Legislature, but, owing to other urgent legislative matters, the legislators were unable to sufficiently familiarize themselves with its contents within the time limit of the session to enable them to evaluate its merits. As a result, the proposed bill was assigned to an interim committee to be analyzed, studied, and reported back to the next session. If adopted, the proposed Code will supersede Chapters 610 to 615, inclusive, Florida Statutes Annotated.

2. Mr. Thomas W. Dalquist, referred to the California Business Corporation Act as ". . . a workable instrument, highly adaptable to our infinite modern business needs, which at the same time strikes a sound balance between flexibility and liberty of management on the one hand, and a safeguard and protection against corporate abuses and oppression on the other." *Henry W. Ballantine*, 37 CALIF. L. REV. 171, 176 (1949).

"The essential qualities of such a modern act are: (1) definiteness, (2) completeness, (3) consistency, (4) liberality which permits a broad comprehensive corporate set-up, with liberal flexibility as to financing, powers, purposes, management, etc., and (5) rigid restraints against abuses." *Wright and Baughman, Past and Present Trends in Corporation Law: Is Florida in Step?* 2 MIAMI L.Q. 69, 99 (1947).

3. The formula fixing the scope of liability under promoters' contracts is fully set out in Section 9 of the proposed Act.

credit to him on behalf of the proposed corporation. That liability continues until the corporation is formed, and if the credit were extended for purposes necessary in organizing the company, it *ipso facto* shifts to the corporation upon its coming into being. If the credit is extended to the promoter for the purpose of gaining special benefits or advantages to the corporate unit, which matter could not reasonably wait till after incorporation, then, in the event the corporation accepts the contract, a novation is effected and liability shifts to it. All other contracts which are purely corporate in nature and have no direct relation to the promotional function must be entered into by the corporation as such, and the general rules of agency and contract law apply. Likewise, if the corporation accepts benefits under such other contracts the general principles of quasi contracts prevail in fixing liability.

These provisions remove the extreme uncertainty under present law. Existing Florida statutes do not touch on the matter, and, if we turn to the court decisions, we find almost as many conflicting theories as there are cases. It must be remembered that *uncertainty* in law, especially corporate law, is *bad law*. That, with corporations, results from the management being confronted with a dilemma; it must either refrain from acting at all as to such matters, or go ahead subject to the peril of possibly costly litigation. And, of course, such uncertainty affects with equal impact creditors of the corporation.

Often a creditor upon suing a corporation is met with the defense that all the mandatory conditions prerequisite for becoming a *de jure* corporation have been met and therefore he has no entity to sue. He at least may be subjected to the burden of establishing the existence of a *de facto* corporation. Section 14 of the proposed Act provides that corporate existence begins when the Secretary of the State issues the certificate of incorporation. Such certificate, or a certified copy thereof (which may be procured from the Secretary of State or from the clerk of the circuit court of the judicial circuit of the county where the corporation's registered office is located) shall serve as conclusive evidence of such corporate existence.⁴ Moreover, Section 235 provides that in all civil actions or proceedings against a corporation, it shall not be necessary to prove the existence of such corporation unless its existence be expressly denied by a verified averment in the pleadings. Section 14 of the proposed Act completely abrogates the troublesome *de facto* entity.⁵ Once a certificate of incorporation is issued, only the State can question the existence of a *de jure* corporation.

4. Section 232.

5. *De facto* corporations have been recognized by the Florida courts. *City of Winter Haven v. A. M. Klemm & Son*, 132 Fla. 334, 181 So. 153 (1938), *rehearing denied*, 133 Fla. 525, 182 So. 841 (1938); *Municipal Bond & Mortgage Corporation v. Bishop's Harbor Drainage Dist.*, 133 Fla. 430, 182 So. 794 (1938). In *Municipal Bond & Mortgage Corporation v. Bishop's Harbor Drainage Dist.*, 154 Fla. 246, 17 So.2d 226 (1944), the Supreme Court pointed out that the basis of a "de facto corporation" is a

Section 12 provides:

a. No corporation being formed under this Act may begin, engage in, or transact any business or incur any indebtedness, except such business and indebtedness as shall relate to the obtaining of subscriptions or other matters incidental to the organization of such corporation, until:

(1) The consideration for its shares, in an amount not less than the amount of stated capital to be paid in before the corporation will begin business, as set forth in the articles of incorporation, has been fully paid in to the promoters, incorporators, or the corporation itself. . .

b. The amount . . . shall not be less than one thousand dollars in cash or in property⁶ taken at a fair valuation.

The main purpose of requiring such amount to be paid in as a prerequisite to engaging in corporate business or incurring indebtedness other than to cover organizational expenses is to protect creditors who have extended credit to the promoters in behalf of the proposed corporation. One thousand dollars would not seem to be too much to cover attorneys' fees and other organizational expenses. That is especially true today with present monetary inflation. This higher amount would give added protection to preincorporation creditors.

Too, it is advisable to require the initial amount to be paid in before any general corporate indebtedness (other than for organizational expenses) is incurred. Present Florida statutes make it a prerequisite only to beginning business. It would be quite possible that considerable general corporate indebtedness might be incurred before the corporation engaged in general corporate business. Such further indebtedness would tend to defeat the purpose of the requirement, namely, to safeguard preincorporation creditors.

law or charter authorizing it, and an attempt in good faith to comply with the law in its creation and in the conduct of its business.

This proposed Act purports to completely abolish the de-facto-corporation concept from the law of Florida. The Oklahoma Corporation Code Committee in its notes remarked: "We have endeavored to avoid every suggestion that there might be such a creature as a corporation de facto. We purposely used the prefix 'pseudo' and purposely omitted the use of 'de facto'. We hope to bury the de facto corporation so deep it can never be disinterred by the courts." 18 OKLA. STAT. ANN., § 1.14, Draftsman's Note, Subsec. c.

Most modern acts have abolished the de facto corporation by making the issuing of the certificate of incorporation conclusive as to corporate existence, following the English Companies Act. Ill. Bus. Corp. Act, § 49; La. Gen. Corp. Laws, § 10; 18 OKLA. STAT. ANN. § 1.14; 15 PA. STAT. § 2852-207; Wash. Gen. Corp. Laws, § 9; U.B.C.A. § 9. However, the Minnesota Act, MINN. STAT. ANN. § 301.08, has caused some confusion in that jurisdiction by the added provision, "Nothing in this section shall limit the existing rules of law as to corporations de facto, nor as to corporations by estoppel." See critical comments thereon by Hoshour, 20 MINN. STAT. ANN., p. 190. See also Chi. Bar Ass'n, Ill. Bus. Corp. Act Ann. § 49.

6. Many states, such as Delaware, Illinois, Kansas, Kentucky, Louisiana, Michigan, and Minnesota, place the minimum at \$1,000, while Florida, Indiana, Ohio, Oklahoma, and Washington only require \$500 capital to be paid in. It must be borne in mind that at the time these other acts were adopted \$500 was worth more in terms of economic goods than \$1,000 is today. This author in drafting the Oklahoma Act believed at the time that \$500 was adequate, but now he strongly feels that it is insufficient.

There is considerable confusion and inconsistency in the provisions in our present statutes relating to such initial payments.⁷

Section 16 requires that every corporation shall maintain a registered office in Florida and that specified records and information be kept therein, while Section 17 provides that a registered agent be maintained at the registered office, and further stipulates that service of process may be had on such agent, or in any other manner now or hereafter permitted by law, and, if any domestic corporation or any foreign corporation transacting business in this State fails to maintain such registered agent, service may be had upon the Secretary of State. It goes without saying that it is essential to creditors of corporations that they be provided with a definite means of procuring service of process in the event they be required to resort to court proceedings in asserting their claims.

The proposed Act purports to completely wipe out the *ultra vires* bugaboo which has unnecessarily bedeviled creditors in the past. All modern business corporation acts have abrogated *ultra vires* as a defense, and a

7. See FLA. STAT., §§ 612.03 (4), 61.56, and 611.05 (1949).

Section 612.03, in stating what must be set forth in the certificate of incorporation, provides: "(4) The amount of capital with which the corporation will begin business, shall not be less than five hundred dollars."

Section 611.05 states: "No corporation shall transact any business until it has had the letters patent with a certified copy of the charter recorded in the office of the clerk of the circuit court of the county wherein the principal place of business is located, and has also filed with the Secretary of State and with said clerk . . . duplicate affidavits by its treasurer that ten per cent of its capital stock has been subscribed and paid, which affidavit shall be recorded by the clerk of the circuit court in the incorporation book; provided, that if the corporation be one with shares of capital stock of no par value only, then and in that event the affidavits by its treasurer must be filed with the Secretary of State and with said clerk, that not less than one thousand dollars of capital stock has been paid in in money. If any corporation shall transact any business before complying with these requirements, or if any corporation chartered by a special act of the legislature shall transact any business before filing said duplicate affidavits and paying the charter fees required by law to the secretary of state for the state treasury, its officers and directors, shall be personally liable for all of the corporation debts as if they were members of a general partnership and not stockholders of a corporation."

Quaere: Do the requirements in § 611.05 apply to all corporations, including those formed under Chapter 612? If you were an attorney organizing a corporation under Chapter 612, would you run the chance of the officers of the corporation being subjected—should the court construe the provisions to be all-inclusive—to the possible penalties under this section by failing to comply with its provisions? The wording of the section is very broad; it starts off with the words "No corporation." The Secretary of State informed this writer that in organizing corporations under Chapter 612, some attorneys comply with these requirements while others don't.

Section 612.56 provides: "No corporation shall commence business until the amount of capital specified in its certificate of incorporation as the amount of capital with which it will commence business has been paid in. If any corporation shall violate this provision, its directors shall be personally liable for the debts of the corporation, but such liability shall not exceed in the aggregate the amount of capital specified in its certificate of incorporation as the amount of capital with which it will commence business."

Penalties comparable with those assessed in this latter section are found in the statutes of many states, but laws of no other state provide penalties as severe as those set out in Section 611.05. Imagine an incorporator, officer, or director having such a possible penalty thrust upon him merely because his attorney failed to record such affidavits or pay the required fees to the Secretary of State!

few other states have special provisions aimed at abolishing this distressing monstrosity which never should have been afforded judicial recognition.⁸

The various legislative attempts to release its fangs from corporate jurisprudence have resulted in provisions varying widely in form and content. Since the courts have employed various props to support and sustain the erroneous *ultra vires* concepts, the proposed Florida Act aims at chopping off the various props by specifically negating each respective theory, thus eliminating every possibility of corporate creditors being barred from relief on the ground that the contract was *ultra vires*. *First*, Section 18 of the proposed Act eliminates the lack-of-capacity theory by providing that "All corporations shall have and possess general corporate capacity and want of such capacity shall never be made the basis of any claim or defense at law or in equity." *Second*, Section 19 brushes aside the constructive-notice principle by stipulating that "No public records, as such, shall serve as constructive notice of any limitations upon the powers of . . . any corporation . . ." *Third*, Section 20 extends to corporations extremely broad general powers, thus making it less possible for corporations to engage in activities beyond their powers. *Fourth*, Section 24 specifically abrogates the possibility of avoiding, invalidating, rendering unenforceable, or otherwise affecting liability, arising out of any conveyance, transfer, or other transaction, contract, or tort, executed, entered into, or committed as between any corporation and a party without the corporation, on the theory that such acts were *ultra vires* on the part of such corporation.

The provisions of the proposed Act purport to carefully single out each of the hypotheses supporting the outmoded *ultra vires* doctrine, and, after pronouncing each *dead*, to place each in its own little sepulcher, and in turn carve the respective obituaries above the portals of each. Already the law reports evidence an over-expanded graveyard of just claims of corporate creditors which have fallen the victims of a misconceived juridical fantasy.

Section 21 denies to corporations the right to plead usury as a defense. This effects no change in the present law of this State."

8. No other place in American jurisprudence has there been evidenced as much confusion as has existed in relation to the *ultra vires* problem. The Kansas Supreme Court stood alone in applying a logical interpretation to the *ultra vires* concepts. As early as 1907 that court, in the absence of any statutory provisions, refused to recognize *ultra vires* as grounds for avoiding a contract which otherwise would be enforceable. *Harris v. Independence Gas Co.*, 76 Kan. 750, 92 Pac. 1123 (1907), 13 L.R.A. (N.S.) 1171. Vermont, in 1915, adopted the earliest statutory limitations on the *ultra vires* doctrine. *Vt. Laws 1915, No. 141, § 15; Gen. Laws of Vt., 1917, § 4923.*

The legislature of this State has left the problem untouched, and the Florida Supreme Court has followed the so-called "New York Doctrine" of *ultra vires*. *Randall v. Mickle*, 103 Fla. 1229, 138 So. 14, 86 A.L.R. 804 (1931), *aff'd* 103 Fla. 1229, 141 So. 317, 86 A.L.R. 804 (1932); *Palm Beach Estates v. Croker*, 106 Fla. 617, 143 So. 792 (1932); *Orlando Orange Groves Co. v. Hale*, 107 Fla. 304, 144 So. 674 (1932); *Brown v. Marion Mortgage Co.*, 107 Fla. 727, 145 So. 413 (1932); *Manatee County v. Cassidy*, 122 Fla. 536, 155 So. 834 (1934).

9. *FLA. STAT. ANN. § 612.62* (1949), provides: "No corporation shall interpose the defense of usury in an action in any court of this state." Moreover, a domestic corporation chartered prior to the adoption of this provision in 1925 could not plead usury. *Matlack Properties, Inc., v. Southern Nat. Bank*, 120 Fla. 77, 162 So. 148 (1935). The

Usury statutes are aimed primarily at protecting the small borrower who through financial hardship readily becomes the victim of ruthless lenders. On the other hand, if creditors of corporations were to be faced with the defense of usury, it would be impossible for financially-distressed corporations to dispose of their bonds at times when the market would only absorb such securities when offered at a heavy discount.

It is possible that the incorporators may want to give additional financial strength to the corporation by making the shares assessable. This, of course, would afford additional safety to creditors of the corporation. Florida statutes not only have not provided for assessable shares, but it can be implied from F.S.A. § 612.10 that such shares are not permissible. The last sentence in the section states:

Any and all shares issued for the consideration, or for not less than the consideration prescribed or fixed in accordance with the provisions of this section, shall be fully paid and nonassessable.

There is nothing vicious about assessable shares if subscribers and purchasers thereof are duly protected against the possibility of procuring such shares thinking them to be nonassessable. Also, a modern act which denies to corporations the privilege of strengthening their financial structure by making shares assessable could not be referred to as extending to corporate management "the broadest and most flexible powers." Florida incorporators who desire to form a company with assessable shares should not be forced to go to some other state, nor should promoters in another state which had failed to provide for incorporation with such shares be barred from incorporating in Florida.

The proposed Act not only fully provides for share assessment,¹⁰ but makes it practically impossible for an innocent party to mistake assessable for nonassessable shares. Section 26 provides that, "No shares, class of shares, or series of any class of shares shall be assessable unless made assessable in conformity with the provisions of this Act, and then only as specifically provided in, or as effected through the exercise of power or authority thus delegated by, the articles of incorporation." Section 90 requires that certificates evidencing nonassessable shares, or shares not otherwise encumbered or subject to a lien or any other impairment, be printed on white paper, while certificates evidencing shares that are not fully paid or nonassessable shall be on blue paper. Section 92 stipulates

Supreme Court construed the provisions in the statutes which date back to 1903, providing that corporations had the power to borrow money "at such rates of interest, and upon such terms as the company or its board of directors shall authorize or agree upon," as empowering corporations to fix the interest rate on their obligations and thus removing usury as a defense. Thus, under FLA. STAT. ANN. § 610.04, a corporation could not set up usury as a defense, irrespective of the provision in § 612.62.

10. Sections 26 to 36, inclusive, thoroughly cover the matter of assessments. Cf. Cal., Corp. Code Ann., §§ 2700-14; 18 OKLA. STAT. ANN. §§ 121-130. The proposed Act combines the remedies for enforcing calls and assessments in the sections above referred to. The statutes in other states generally treat call and assessments separately as to enforcement of payment, but there seems to be no reason for such duplication.

that, "If the shares be assessable and the assessments are collectable by personal action, the fact shall be plainly stated on the face of the certificate."

Since modern acts require much more information in the share certificate than earlier statutes, it seems essential that every possible device be employed to warn purchasers as to the shares being subject to calls, liens, assessments, or other impediments. Merely inserting a clause or phrase in the certificate with considerable content is not enough protection of unwary purchasers. Many reasonably cautious businessmen accept mortgages, insurance policies, and other documents without reading all of the contents which are set out at length and often in fine print. For many years some companies have used white certificates to evidence fully paid shares and blue certificates for installment shares. This writer recalls that many years back he owned shares in a building and loan company, some of which were fully paid while others were installment shares. The former were evidenced by certificates printed on white paper while the certificates of the latter were on blue paper.

Subsection *c* of Section 81 provides that, "No promissory note, or other obligation of the subscriber, or promise of future services shall constitute consideration, in whole or in part, for shares allotted by such corporation."¹¹ This regulation is further amplified by Subsection *d* of Section 90 which reads:

Upon the receipt by a domestic corporation of a promissory note, bill of exchange (other than a check drawn by the proposed shareholder), or any other promise or obligation to pay as consideration for shares, no share certificate shall be issued therefor,¹² or

11. This subsection follows substantially ILL. ANN. STAT. c. 32, § 157.18; Ohio Gen. Corp. Act, § 22; 18 OKLA. STAT. ANN. § 1.76; PA. STAT. § 2852-604.

Although some courts have taken a contrary view, the majority of cases hold that an unsecured promissory note does not meet the requirements of a statute which provides that shares may be allotted only for money paid, labor done, services rendered, or property actually received. *Lepanto Gin Co. v. Barnes*, 182 Ark. 422, 31 S.W. 2d 746 (1930); *Sohland v. Baker*, 15 Del. Ch. 431, 141 Atl. 277, 58 A.L.R. 693 (1927); *First Nat. Bank v. Connell*, 8 App. Div. 427, 40 N.Y.S. 850 (1896); *Western National Bank v. Spencer*, 112 Tex. 49, 244 S.W. 123 (1922). However, an early Florida case held that a bond was valid consideration for an allotment of shares. *Southern Life Ins. and Trust Co. v. Lanier*, 5 Fla. 110, 58 Am. Dec. 448 (1853). Even though a promissory note may not be considered as adequate consideration for an allotment of shares, the payment of the subscription may be enforced for the benefit of corporate creditors. *Washer v. Smyer*, 109 Tex. 398, 211 S.W. 985, 4 A.L.R. 1320 (1919).

The wrong results from the allotting of shares as fully paid when the consideration, whether it be in cash, property, or services, has not actually been received. In all jurisdictions, even under the proposed Florida Act, there would be no objection if the shares were not allotted as fully paid and the notes received were demand notes. Since the terms of a promissory note taken upon the allotment of shares would be considered a part of the subscription contract, the provisions of Subsection *c*, Section 25, of the proposed Act would permit a time note to be received for shares, but the subscription price could not be considered as being paid until the note was satisfied. Subsection *d* of Section 25 provides that all calls for subscription payments must be uniform, but the first clause in Subsection *c* modifies that requirement.

12. After further study and consideration, it is doubtful that the withholding of the certificate is necessarily essential. It is believed that it would be more in conformity with the general tenor of other provisions of the Act if this clause were changed to read as follows: "no certificate other than a blue certificate of shares evidencing that the shares are not fully paid shall be issued therefor."

shall such shares be considered paid for until such note, bill of exchange (other than a check drawn by the proposed shareholder), or other promise or obligation to pay, has been paid.

The purpose of these provisions is to prevent the allotting of bonus or watered shares. Creditors of the corporation have the right to assume that the capital of the corporation has not been thus diluted. Many cases, especially the earlier decisions, hold that the capital of a corporation is a "trust fund" for the benefit of the creditors, and that such creditors may recover from subscribers who have not paid in the full consideration for their shares in the event the assets of the corporation are inadequate to meet their claims.¹³ Others have allowed a recovery against such subscribers on the ground that constructive fraud has been committed against such creditors.¹⁴ Since the above provisions prevent a bare promise of the subscriber to do some future act from being consideration for shares, directors who have allotted shares on such a basis would be personally liable under Section 88 for corporate debts to the extent of the deficiency in consideration.

Present Florida statutes contain no specific provisions on accepting promissory notes, or promises to render future services, for allotment of shares.¹⁵ What would be the result, under the provisions of F.S.A. § 612.12 if a corporation were to allot shares as fully paid upon receiving half of the consideration in cash and a promissory note for the balance? Could the corporation, or creditors of the corporation, collect upon the note? The last sentence in Section 612.12 reads:

If upon the certificate issued to represent such stock the amount paid thereon shall be specified, the holder thereof shall

13. *Thoms & Brenneman v. Goodman*, 165 C.C.A. 449, 254 F. 39 (1918); *Jackson v. Arlton Banking Co.*, 214 Ala. 483, 108 So. 359, 45 A.L.R. 1026 (1926); *California Nat. Supply Co. v. Black*, 48 Cal. App. 122 (1920); *John W. Cooney Co. v. Arlington Hotel Co.*, 11 Del. Ch. 286, 101 Atl. 879 (1917); *Forcum v. Symmes*, 106 Fla. 510, 143 So. 630 (1932); *Guinness v. Remick*, 228 Mich. 461, 200 N.W. 120 (1924); *Bottlers' Seal Co. v. Rainey*, 243 N.Y. 333, 153 N.E. 437 (1926). See *Ellis and Sayre, Trust-Fund Doctrine Revisited*, 24 WASH. L. REV. 44 and 134 (1949).

14. *In re Phoenix Hardware Co.*, 161 C.C.A. 384, 249 F. 410 (1918) (an actual fraudulent intent need not be shown). *Rhode v. Dock-Hop Co.*, 184 Cal. 367, 194 Pac. 11, 12 A.L.R. 437 (1920); *Ewing v. Gmeinder*, 170 Minn. 242, 212 N.W. 446 (1927); *Strong v. Crancer*, 335 Mo. 1209, 76 S.W. 2d 383 (1934); *Laing v. Hutton*, 138 Ore. 307, 6 P.2d 884 (1932); *Tintic Indian Chief Min. & Mill Co. v. Clyde*, 79 Utah 337, 10 P.2d 932 (1932).

15. FLA. STAT. ANN. § 611.06 (1949) states that "all payments of stock and of interest money shall be made in lawful money of the United States unless it be stated in the charter that the capital stock or some therein designated portion of the stock shall be payable in property, labor or services at a just valuation to be fixed by the incorporators, or by the directors at a meeting called for that purpose. Property, labor or services may also be purchased or paid for with capital stock at a just valuation of such property, labor or services, to be fixed by the directors of the company at a meeting called for that purpose."

Section 612.10 provides that consideration for non-par shares shall not be less than that fixed in the charter, and if not so fixed, then at not less than that fixed by the shareholders or board of directors, while Section 612.11 provides that par shares "may be issued only for consideration having a value . . . at least equivalent to the full par value." Section 612.12 permits the issuance of certificates for partly paid shares if so provided in the charter. There seems to be no reason for requiring authorization in the charter in order to issue certificates evidencing partly paid shares.

not be subject to any liability to the corporation except for the payment of the amount shown by such certificate as unpaid.

This provision casts some doubt on the question as to whether or not the subscriber would be liable at all to either the corporation or its creditors if the certificate stated that the shares were fully paid when no consideration whatsoever was received for the shares.

The present Florida statutes have no provisions allowing a corporation to confer on bondholders or other creditors the right to share in the control of the corporation, or to inspect the corporate records. Section 61 of the proposed Act reads:

The articles of incorporation of any domestic corporation may confer upon its bondholders or other creditors, or any class or classes thereof, the right to vote and otherwise represent shares to the extent and subject to the conditions, qualifications, and limitations expressed in such articles.¹⁶

Flexible provisions are found in Section 74 authorizing the delegation of power to creditors to inspect the corporate records.¹⁷ The articles may extend to such creditors the absolute right to inspect, or provide that such may be subject to any conditions or limitations contained in the by-laws.

As previously stated, Section 16 of the proposed Act requires that every corporation maintain a registered office within the State and keep adequate records therein. The empty shell supplied under present statutes of this State falls far short of providing to shareholders adequate information, not to mention creditors.¹⁸

If protection is to be afforded to creditors, it is essential that legal safeguards be thrown around the corporate assets. It is important that certain funds be required to be paid in, and it is equally vital that legal restraints be placed on the paying out of corporate funds once they are paid in. There are two main sources of incoming funds, *viz.*, (1) consideration received for allotment of shares, and (2) corporate earnings.

It is cardinal that the enterprise be adequately capitalized and that the real value of allotted shares be actually paid in cash or its equivalent in

16. States with more progressive corporation laws quite generally have like or similar provisions in their statutes. Del. Gen. Corp. Law, § 29; La. Gen. Corp. Laws, § 32, VIII; Mich. Gen. Corp. Laws, § 36; MINN. STAT. ANN. § 31.26, subd. 12; N. J. STAT. ANN. 14:10-10.1; 18 OKLA. STAT. ANN. § 1.67; PA. STAT. § 2852-317.

17. Subsection *c* provides that, "The articles of incorporation or by-laws of a domestic corporation may confer upon its bondholders or other creditors, or any class or classes thereof, the same right of inspection of records as provided in this Section for shareholders, or subject to any conditions or limitations contained in the by-laws." A large number of jurisdictions allow the authorization of inspection of the corporate records by creditors of the corporation. Some, like in the above provision, permit such authorization when so stipulated in the articles and permit the addition of a stipulation that such right of inspection may be limited by restrictions in the by-laws. Others permit such inspection when provided in either the articles or by-laws. A large number require that the authorization be set out in the articles. A few statutes give judgment creditors the same absolute right to inspect as shareholders in the absence of any special provision in the articles or by-laws. In some instances the provision concerning the inspection of records is combined with the stipulations authorizing voting by creditors.

18. FLA. STAT. ANN. § 612.60 (1949) provides that a judgment creditor of a corporation may inspect the share ledger, but no mention of other records is made.

property. This Act, like all of the other modern B.C.A.'s, provides for a primary capital, which is referred to as "stated capital," and a secondary form of capital, labeled "capital surplus."¹⁹ This semi-capital is very essential in affording greater protection to holders of preferred shares. However, since creditors come in ahead of shareholders, even of preferred shares, it provides an equally vital safeguard to creditors.

Section 84 fixes the amount which must be allocated to stated capital as follows:

(1) The aggregate par value of all allotted shares having par value;

(2) The aggregate of all consideration stated in monetary terms received for all allotted shares without par value, except such portion thereof as shall have been designated as capital surplus pursuant to Section 85 of this Act; and

(3) The aggregate of all amounts previously transferred from surplus to stated capital upon the declaration of share dividends or by a resolution of the board of directors or shareholders.²⁰

The stated capital is guarded very carefully and can only be cut into for the purpose of paying operational expenses, debts, or in redeeming shares. It cannot be used for the latter purpose unless the stated capital is left unimpaired after such redemption.

Holders of redeemable shares cannot assume the role of creditors. Section 80 c provides:

Insofar as any class of shares be made subject to redemption by the articles of incorporation, such right of redemption shall be exercisable at the option of the corporation only . . .

19. The other modern Acts all use the term "paid-in surplus." This term is somewhat a misnomer, as the funds may not have been *paid-in*; they could have been transferred on the books to this fund from some other source within the corporation, such as from earnings or from the general surplus. The American Bar Association Committee in its "Model Act" substituted the appellation "capital surplus." It is quite certain that this terminology is more apropos, and therefore it is used in the proposed draft.

Florida law follows the old theory of dividing the corporate fund into *capital* and *surplus*.

"Stated capital," "capital surplus" or "paid-in surplus," and "surplus" are mere accounting terms used to categorize the corporate assets for accounting purposes. They are sums shown on the balance sheet which represent the extent to which the assets exceed the corporate debts. All of the funds thus labeled may be used to pay creditors. These sums are pyramided with the stated capital at the bottom, the capital surplus above that, and the surplus still further up. The distribution of funds which are lower in the pyramid is subjected to much greater limitations than those near the top. In order to have any surplus there must be assets enough above the apex of the pyramid to equal the aggregate of corporate debts.

The purpose of legal rules is to require that the accounting balance sheet show certain amounts or balances on the credit side before the management may pay out funds for certain purposes. The nature of the purpose for which funds are to be dispersed determines what the credit balance must show before disbursements for such purpose may be made. General surplus may be used for a broad number of purposes, while the purpose for which capital surplus is used is more limited. Finally, stated capital is subject to distribution for still more restricted uses.

20. This section is closely similar to provisions found in all modern acts. Cf. Cal., Corp. Code Ann. § 1900; ILL. ANN. STAT. c. 32, § 157.19; MINN. STAT. ANN. §§ 301.02, subd. 10, and 301.21; 18 OKLA. STAT. ANN. 1.79; 15 PA. STAT. § 2852-614; Hills' Model Act, § 6 (48 HARV. LAW REV. 1360 [1935]).

This avoids the possibility of holders of redeemable shares coming in and syphoning off the assets of the corporation at the expense of the creditors.

Sections 129 and 130 set up staunch safeguards to protect creditors and holders of shares with a liquidation preference. Funds paid to shareholders as dividends or for the redemption of shares are treated quite similarly in the proposed Act.²¹ In each instance the corporate funds are being distributed among the shareholders, hazarding the security afforded creditors. Thus, strict regulations are imperative as a protection to the latter.

Section 82 provides that par shares may only be allotted for consideration not less than the par value of such shares, that non-par shares may not be allotted for an amount less than the highest liquidation preference of such shares having a liquidation preference, and that other non-par shares may be allotted for such consideration as fixed by the board of directors unless the articles reserve to the shareholders the right to fix such consideration. The shares must be allotted at the real value thereof, and the consideration must actually be paid in.²²

No share dividends may be issued, except in the case of a split-up of shares,²³ unless an amount equal to the required consideration therefor be transferred from surplus or undivided profits to stated capital,²⁴ or upon an exchange or conversion of shares.²⁵

Delaware permits any portion of the consideration received for non-par shares to be allocated to general surplus, thus permitting such consideration to be returned to the shareholders as dividends. Section 85 of the proposed Act requires that at least two-thirds of such consideration go into stated capital and that the balance be allocated to capital surplus. This gives much greater protection to creditors than is afforded under the Delaware law. The proposed Act also requires that a fair value be fixed on the assets of the corporation in determining if funds are available for paying dividends or for redemption of shares.²⁶

Under-capitalized companies have been one of the worst hazards that creditors have had to face. If a corporation is capitalized for only \$500 or \$1000 and contracts heavy indebtedness, the security of creditors is inadequate even though the capital is unimpaired. For instance, suppose a corporation has capital of \$1000 and has debts of \$200,000. If its assets equal \$201,000, it has an apparent solvency and its capital is unimpaired. Any additional funds could be paid out as dividends without subjecting anyone to liability under the present laws of this State. It could be very possible that the directors might overvalue the assets although acting in good faith, or there might be a sudden drop in property values. In either

21. See Sections 125-143.

22. Cf. provisions of Florida statutes, *supra* note 16.

23. Sections 81 *d*, and 127 *a*.

24. Sections 82 *d*, 86, and 127.

25. Sections 82 *e*, and 86 *b*.

26. Section 128.

event, the company would be woefully insolvent. This would cast a loss upon the creditors and might force the company into liquidation.

This author in making a cursory survey of the capitalization of corporations in the Miami area found that a large percentage of them had a capitalization of \$500. That could mean that all of them could be solvent today with unimpaired capital and, should there be a sudden drop in values, a month later all might be insolvent. Of course, many may have either little or no indebtedness or have a substantial surplus built up. But, be that as it may, a sudden slump in values certainly would throw scores of those companies not thus voluntarily protected into bankruptcy and in turn create grave economic difficulties. The law should require a safer margin, at least before returning any funds to the shareholders in the dividends or for redemption of shares. The proposed Act allows a capitalization as low as \$1000 but no shares may be redeemed²⁷ or dividends paid to shareholders²⁸ unless after such payments the total corporate assets shall exceed one and a fourth the amount of the corporate indebtedness.

The proposed Act also provides adequate remedies and procedures whereby creditors of an insolvent corporation may seek relief from third parties who are obligated to the corporation. Section 33 fully provides for effecting calls and assessments on shareholders of an insolvent corporation to the extent of their stock liability insofar as necessary to satisfy the corporation's liability to its creditors. Section 88 places liability on both directors and shareholders who have defrauded the corporation through the allotment of shares for inadequate consideration.

Section 15 c provides that "Any promoter, incorporator, director, or other officer of any corporation who shall authorize, ratify, or participate in any acts in violation of the provisions of this Section, shall be jointly and severally liable for the debts or liabilities of the corporation arising therefrom to an amount not exceeding the unpaid portion of such stated capital, to be paid to the corporation for the benefit of such creditors."

Section 139 provides that directors (except those who dissented or were absent) who authorize unlawful payments to shareholders shall be liable to creditors of the corporation for the amount of such payments, and Section 140 sets forth the form of procedure to be pursued by such creditors in enforcing such obligation. Section 143 subjects shareholders who unlawfully receive such payments from the corporation to similar liability on behalf of creditors of the corporation.

Under the provisions of Section 144 any officer or director who authorizes any loan to any officer or director of the corporation upon the company shares as security becomes liable to creditors to the amount of such loan or extension of credit.

Section 186 places liability on behalf of creditors on officers who are

27. Section 126 (3).

28. Section 130 a (4).

guilty of failing to give due notice to known creditors or who otherwise commit acts of malfeasance in winding up a corporation. In each instance, throughout the Act, liability resulting from any malfeasance on the part of the officers or shareholders inures to the creditors to the extent of the damage caused them.

Section 162 removes all uncertainty as to liability, of the surviving corporation in the case of a merger and of the resulting corporation in the case of a consolidation, as to creditors of the constituent corporations. This section in part provides:

When such merger or consolidation has been effected: . . .

(4) Such surviving or resulting corporation shall thenceforth be subject to and liable for all the liabilities and obligations of each and all of the constituent corporations so merged or consolidated; and any claim existing, or action or proceeding pending, by or against any of such corporations may be prosecuted to judgment as if such merger or consolidation had not taken place, or such surviving or resulting corporation, as the case may be, may be substituted in the place of such corporation or corporations. Neither the rights of creditors nor any liens upon the property of any of such corporations shall be impaired by such merger or consolidation.

Unless the articles of incorporation otherwise provide three-fourths of the creditors of any corporation organized under this Act may enter into a compromise agreement with the corporation to petition the circuit court to undergo a reorganization under supervision of the chancellor of such court.²⁹ Thus, a means of effecting a reorganization is provided without delay and the expense of unnecessary litigation.

The following section (Sec. 166) further provides for reorganization, and procedures connected therewith, carried out under a federal reorganization under an Act of Congress. Section 209 sets forth the necessary execution and contents of Articles of Reorganization to be filed after a reorganization has been effected by the circuit court, under Section 165, or by a federal court, under Section 166. These reorganization provisions will serve to provide more expeditious relief to the corporation as well as the creditors than is now available.

The Uniform Stock Transfer Act³⁰ is extremely inadequate regarding the matter of levy and attachment by creditors on corporate shares of debtors. The U.S.T.A. makes a share certificate practically negotiable. Substantially the same protection is afforded a holder in due course of such certificate as is given to such holder of a negotiable bill or note. Thus,

29. Section 130 *a* (+).

30. FLA. STAT. ANN. C. 614 (1949).

Section 614.16 (U.S.T.A. § 14) provides: "A creditor whose debtor is the owner of a certificate shall be entitled to such aid from courts of appropriate jurisdiction, by injunction and otherwise, in attaching such certificate or in satisfying the claim by means thereof as is allowed at law or in equity, in regard to property which cannot readily be attached or levied upon by ordinary legal process."

The proposed Act omits entirely this section. It is believed not to be essential with the alternate remedy provided in the Act.

about the only remedy a creditor has is to have the sheriff levy upon the certificate by seizure thereof. Suppose the certificate cannot be seized, then what? Thereupon the equity court may order the debtor to deliver it up. But suppose he does not have it, then what? The court then may enjoin him from negotiating it and order the shares sold on execution. But what does the purchaser get? Suppose the former certificate shows up years later in the hands of a holder in due course, then what?

In such case the purchaser at the execution sale gets nothing. Suppose the company has purported to cancel the former certificate and has issued a new one to the purchaser at the execution sale.³¹ And suppose further that this duplicate certificate has passed through the hands of several holders for value. Moreover, suppose all of the shares of the corporation had been issued and the Constitution of the particular state provided that an overissue of stock was *void*. Then, of course, the duplicate certificate would be void. Under any circumstances it would not be favored over the original certificate in the hands of a holder in due course. Otherwise, the negotiability of the certificate would be meaningless.

Many such tangles have arisen under the U.S.T.A.³² The net result has been that the scheming debtor could remain judgment proof although he owned a million dollars' worth of shares.

Under Section 13 of the U.S.T.A. the only sure procedure would be by seizure of the share certificate. If such were done, the matter of establishing the debtor's property interest in it would not be too difficult in most instances. But as long as a negotiable certificate is out an injunction or court order may not prevent it from reaching the hands of a holder in due course.

The proposed Act³³ extends to the creditor a more complete remedy or remedies. Subsection *a* of Section 104 provides a remedy comparable to that of U.S.T.A. § 13, while Subsection *b* offers an alternate procedure

31. Section 614.15 further provides that "Shares of stock may be attached or levied upon, under execution, as now provided by law, and any sale under attachment or execution, as now provided by law, shall be recognized by the corporation in which such shares were so sold upon production of a bill of sale duly executed by the officer making such sale and a new certificate shall be issued to the purchaser at such sale." This section replaces Section 13, U.S.T.A.

32. *Miller v. Kaliwerke Aschersleben Atkien-Gelleschaft*, 276 F. 206 (1921), *aff'd* 283 F. 746 (1922); *Columbia Brewing Co. v. Miller*, 281 F. 289 (1922); *Sutter Invest. Co. v. Keeling*, 123 Cal. App. 323, 11 P.2d 418 (1932); *Trade Bond & Mortgage Co. v. Schwartz*, 303 Ill. App. 165, 24 N.E.2d 892 (1940); *Walkins v. Simplex Time Recorder Co.*, 316 Mass. 217, 55 N.E.2d 203 (1944); *State ex rel. North American Co. v. Koerner*, 357 Mo. 908, 211 S.W.2d 698 (1948); *Wallack v. Stein*, 102 N.J.L. 517, 133 Atl. 81 (1946), *aff'd* 103 N.J.L. 470, 136 Atl. 209 (1947); *Elgart v. Mintz*, 124 N.J.Eq. 136, 200 Atl. 488 (1938); *Johnson v. Wood*, 15 N.J.Misc. 150, 189 Atl. 613 (1936); *Luks v. Luks*, 106 N.J.Eq. 160, 150 Atl. 346 (1930); *Wallack v. Stein*, 102 N.J.L. 517, 133 Atl. 81 (1926), *aff'd* 103 N.J.L. 470, 136 Atl. (1927); *Mulock v. Ulizio*, 102 N.J.L. 251, 131 Atl. 622 (1926); *Bowen v. McGee*, 14 N.J.Misc. 7, 182 Atl. 28 (1935); *Knight v. Shutz*, 141 Ohio St. 267, 47 N.E.2d 267, 150 A.L.R. 138 (1943); *Hodes v. Hodes*, 176 Ore. 102, 155 P.2d 564 (1945); *Snyder Motor Co. v. Universal Credit Co.*, 199 S.W.2d 792 (Tex. 1947).

33. Sections 104-110.

"in the event it be impossible or inconvenient to proceed under the method provided for in Subsection a." This alternate procedure permits an attachment or execution through the corporation. The subsequent sections set forth the steps to be taken in proceeding to levy an execution through the corporation. After the levy is thus made, and one year has elapsed,³⁴ if no holder in due course gives notice or intervenes, the shares may be sold upon execution, cutting off all rights of the former owner or anyone taking through him. In the event another claimant of the shares intercedes during the one-year period, the evidence will be much fresher, enabling the ownership rights to be determined with less difficulty than would be the case if the matter remained in abeyance until the certificate might show up some time in the remote future.

This method leaves the corporation in the clear. The execution sale cuts off all claims under the old certificate, avoiding the possible dilemma of having two certificates evidencing the same shares outstanding at the same time. But, more important, it gives a more effective remedy to the creditor. The only burden it places on anyone is that it requires a purchaser of shares evidenced by a certificate issued over a year prior to contact the corporation to find out if the shares have been levied upon through the corporation before he consummates the purchase.

This alternate method of levy and execution on corporate shares was first adopted in 1947 as a part of the Oklahoma Business Corporation Act. The bankers, brokers, and investment companies of that state exerted every possible influence in getting the measure enacted. The State Bankers Association appointed a special committee to work with the legislature and state bar in promoting its adoption. Mr. Gum, President of the Bankers Association, in reply to a question concerning the one-year period of limitation, remarked: "That is not vital; we always contact the corporation before we accept shares as collateral on loans. The all important problem is to be able to reach the shares held by our defaulting debtors."³⁵

It is doubtful if these provisions in Section 614.15, FLA. STAT. ANN., developed a satisfactory solution of the problem. Is it to be implied that shares might be sold and transferred under this provision (*supra* note 32) while the certificate remained in the hands of the debtor, or even in the hands of a holder in due course? Much confusion could arise under such a situation. The Commissioners' Note on Section 13, U.S.T.A. states:

This section, like the similar provision in the Warehouse Receipts Act and the Sales Act, is an advance upon existing law. It is an advance which seems even more necessary in regard to the certificates of stock than in the case of bills of lading or warehouse receipts. Common law does not universally protect the purchaser

34. Section 108.

35. The fact that 11 jurisdictions (California, Connecticut, Florida, Georgia, Hawaii, Kansas, Missouri, Montana, New Hampshire, Vermont, and West Virginia) have made changes in Section 13 of the Uniform Act, indicates that the legislatures have not been satisfied with the remedy it offers. Moreover, Colorado has omitted this section entirely.

of a stock certificate against attachment on the books of the company, even though the transfer of the certificate preceded the attachment. Cook, § 487 *et seq.* By statute, in Massachusetts one who attaches stock on the books of a corporation prior to a sale of the certificate, is postponed to even a subsequent purchaser. *Clews v. Friedman*, 182 Mass. 555, 556, 66 N.E. 201. There is obviously chance for the greatest fraud if this is not so. Yet if the subsequent purchaser is preferred, it is clearly improper ever to allow an attachment of stock unless some method is adopted to prevent a subsequent transfer of the certificate. Otherwise it is impossible to realize on the attached property since there would always be a possibility of a subsequent transfer of the original certificate. 6 Uniform Laws Ann. 18.

In conclusion, this author wishes to emphasize the fact that one of the paramount objectives of this proposed Act has been to afford every possible protection to parties extending credit to corporations. One of the major tasks confronting corporations is to secure adequate financing and establish ample credit. Protection of creditors by appropriate legal safeguards is essential to wholesome corporate growth and expansion. The terms of this Act place no undue burdens whatsoever upon honest corporate management. Nowhere in commercial and industrial life should dishonesty be condoned, much less rewarded.