

EXAMINERS' ANALYSIS OF QUESTION NO. 2

(1) Validity and Enforceability of the Agreement: A stock subscription, or a "subscription for shares," as it is referred to in MCL 450.1305, is a contract by which a subscriber agrees to purchase a certain number of newly issued shares of a corporation. Black's Law Dictionary. A subscription agreement may be made either before a corporation has been organized (called a preincorporation subscription) or after a corporation has been organized.

While a subscription agreement need not be in any particular form, *Gibson v Oswalt*, 269 Mich 300 (1934), a contract with a corporation to purchase its shares to be issued is a subscription agreement and not an executory contract unless otherwise provided. MCL 450.1305(3). General contract principles govern with regard to the elements of a subscription agreement (*Wheeler v Ocker & Ford Mfg Co*, 162 Mich 204 [1910]), in the absence of charter or statutory provisions to the contrary. Fletcher, *Cyclopedia of the Law of Private Corporations*, § 1401. Thus, a stock subscription is an offer made by the subscriber, which requires acceptance by the corporation. *Peninsular R Co v Duncan*, 28 Mich 130 (1873); MCL 450.1305(2), the consideration for the subscription is mutuality of obligation. *Co-operative Telephone Co v Katus*, 140 Mich 367 (1905). Generally, stock subscriptions must be for a definite number of shares, *Wheeler*, *supra*, and must state the amount that the subscriber agrees to pay. Fletcher *Cyclopedia of the Law of Private Corporations*, § 1477. Moreover, preincorporation subscriptions must generally indicate the nature and main purpose of the corporation to be formed. *Menominee Community Bldg Co v Rueckert*, 245 Mich 38 (1928).

Pursuant to MCL 450.1305(2), preincorporation subscriptions are irrevocable and may be accepted by the corporation for a period of 6 months, unless otherwise provided by the subscription agreement or unless all the subscribers consent to its revocation. Additionally, subscription agreements are not enforceable unless in writing and signed by the subscriber pursuant to MCL 450.1305(1).

In this case, the facts indicate that the agreements are preincorporation subscriptions, as the agreements were made before Muscle Machine was incorporated. The subscription agreements provided for the price, number of shares and the nature and purpose of the corporation. The offers were accepted by Muscle Machine after its organization on March 1, 2012. There is consideration

because both parties to the agreement are bound to perform: the subscribers must deliver the financing and Chris must deliver the shares. Thus, it appears that valid subscription agreements were created. Because the subscriptions were irrevocable for a period of six months, Dan's effort to cancel his subscription before it was accepted by Muscle Machine had no effect. MCL 450.1305(2). Additionally, as noted above, MCL 450.1305(2) provides that "if all the subscribers consent to its revocation" a pre-incorporation subscription agreement can be revoked. However, Bob has not expressed any desire to revoke the agreement, just to modify it by paying a lower price. And, there is no suggestion that all of them have agreed (or even discussed the idea) to seek revocation. Thus, under the facts, the issue of all the subscribers consenting to revocation is not a valid defense. However, if an applicant raises the issue and makes a reasoned argument that this is a possible avenue depending on Bob's ultimate desire, or is not based on Bob's desire to lower the price but not revoke, a point or two should be awarded.

That said, the subscription agreements are not equally enforceable against Bob, Dan and Greg. Because Greg orally agreed to the subscription and did not sign the document, the agreement cannot be enforced against him. See MCL 450.1305(1). Thus, because Greg no longer wishes to purchase the shares, Chris has no recourse against him.

(2) Remedies: MCL 450.1306 provides that, "unless otherwise provided in the subscription agreement," a stock subscription "shall be paid in full at the time, or in installments and at the times, as shall be determined by the board." In this case, the subscription agreement clearly required Dan and Bob to tender \$10,000 to Muscle Machine on or before May 1, 2012 in exchange for the stock certificates. When the money was not paid, both men were in default.

Where a subscriber defaults in his performance of a subscription agreement, MCL 450.1307(1)(a)-(c) permits a corporation several remedies. The remedies are cumulative, entitling the corporation to a "full and single recovery." MCL 450.1307(2). The corporation may:

- (1) Collect the amount due in the same manner as any other debt;
- (2) Sell the shares in a reasonable manner, in good faith and after giving notice to the subscriber. Any excess proceeds over the amount due (plus interest) are paid to the subscriber. Any deficiencies (plus interest) may be collected from the subscriber.
- (3) Rescind the subscription and recover damages for breach of

contract. In the absence of special circumstances, the measure of damages is the difference between the market price at the time the shares were tendered and the unpaid contract price.

Because payment in full was an explicit condition of the issuance of the stock certificates to Bob and Dan, it can be inferred from the facts that Muscle Machine retained possession of the stock certificates. That being the case, remedies (1) and (2) are available to Muscle Machine. It could bring suit to enforce full payment pursuant to § (1), but must be ready and willing to deliver the stock certificates to Bob and Dan. Fletcher, *Cyclopedia of the Law of Private Corporations*, § 1830.

Alternatively, Muscle Machines can sell Bob and Dan's shares pursuant to § (2). If Bob's assessment is correct, and the fair market value of the stock is \$50 per share, then Bob and Dan each would still remain liable for the \$5,000 difference (plus interest), provided the sale is made in good faith, in a reasonable manner and upon notice to Bob and Dan. If the stock sells for a higher amount, any excess amount is paid to Bob and Dan.