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# Corporations - Promotion - Discharge of Promoter's Liability as Bidder at a Bankruptcy Sale

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CORPORATIONS—PROMOTION—DISCHARGE OF PROMOTER'S LIABILITY AS BIDDER AT A BANKRUPTCY SALE—On October 1, defendant made the high bid at a bankruptcy sale of hotel properties as "Mr. Ash, trustee." Later that same day a certificate of incorporation was executed for a corporation with Ash as treasurer. On October 4 the proper corporate papers were filed with the secretary of state. On October 4 the receivers receipted for the earnest money deposit, the instrument acknowledging, as interpreted by the court, that the receivers would look to the corporation to complete the contract and would not look to Mr. Ash personally. On October 14, the referee confirmed the sale to "Mr. Ash, trustee." On October 27 the corporation ratified the acts of Mr. Ash. On October 27 the receivers were notified that the transaction would not be completed, the property was shortly thereafter resold, and the receivers brought suit. *Held,* defendant was not personally liable for the loss realized by resale. *Frazier v. Ash,* (5th Cir. 1956) 234 F. (2d) 320.

The court relieved defendant of liability on two separate grounds. Faced with the contention that since defendant acted as agent for a non-existent corporation at the time he made the contract, he was personally liable on the contract,[1] the court first concluded that although this was the general rule, it did not apply where the parties themselves agreed to look to the corporation alone for responsibility and the corporation ratified the contract after it came into being.[2] The court's second ground for relieving defendant of liability is based upon the peculiar aspects of the bankruptcy sale transaction. In effect, the court ruled that the bid was binding on defendant on the date of the auction, but that the contract as made on confirmation was with the corporation and acted to discharge the defendant of his liability on the bid.[3] This would appear to be the better analysis of the problem. That liability is imposed upon the bidder at the time of acceptance of his bid but not on the receivers until the time of confirmation is the favored rule.[4] If the bidder is not a party to the contract as confirmed by the court, he should not be liable on the contract.[5] This second ground makes it apparent that the court in the first part of its opinion unnecessarily entered into the difficult field of promoter's liability on contracts made on behalf of a non-existent corporation.[6] Having done so, however, the court should have based its decision on the time at which the obligations of the parties become fixed under the peculiar aspects of the bankruptcy sale procedure, rather than the supposed intent of the parties. If the contract was formed when the sale was confirmed by the court, then

[1] O'Rorke v. Geary, 207 Pa. 240, 56 A. 541 (1903); Kelner v. Baxter, L.R. 2 C.P. 174 (1866); 1 WILLISTON, CONTRACTS, rev. ed., §306, p. 893 (1936).

[2] Carle v. Corhan, 127 Va. 223, 103 S.E. 669 (1920); Weeks v. San Angelo Nat. Bank, (Tex. Civ. App. 1933) 65 S.W. (2d) 348. See Ehrich and Bunzl, "Promoter's Contracts," 38 YALE L. J. 1011 (1929) and BALLANTINE, CORPORATIONS, rev. ed., §41, p. 115 (1946).

[3] Principal case at 327.

[4] The peculiar arrangement of binding the bidder on his bid while the receivers are not bound until confirmation stems from the Bankruptcy Act which requires that the sale be subject to "approval of the court." 52 Stat. 882 (1938), 11 U.S.C. (1952) §110, sub. f. The general rule binding the purchaser on his bid is expressed in Gordon v. Woods, (1st Cir. 1951) 189 F. (2d) 76, and approved by COLLIER, BANKRUPTCY MANUAL, 2d ed., §70.93 (9), p. 1044 (1956), and 4 MOORE'S COLLIER §70.98, p. 1577 (1942; Supp. 1955). *Contra,* In re Susquehanna Chemical Corp., (W.D. Pa. 1950) 92 F. Supp. 917.

[5] This situation was clearly presented in In re Childs Co., (2d Cir. 1947) 163 F. (2d) 379, a case on which the court in the principal case relied to explain this interchange of liability. There defendant was high bidder at a bankruptcy sale, but the contract as confirmed was with Molly Weingarten, a fictitious person. The receivers asked specific performance against the defendant-bidder. He counterclaimed for the return of his earnest money deposit. Specific performance was denied since defendant was not a party to the contract, but defendant was also denied return of his deposit money since he was bound on the bid.

[6] The language of the court indicates that it employs the concept of ratification to account for the interchange of liability between promoter and corporation. Various theories have been advanced to explain how a corporation becomes bound by an act done before it has come into being, e.g., ratification, adoption, continuing offer, and novation. BALLANTINE, CORPORATIONS, rev. ed., §38, p. 108 (1946). This problem is extensively discussed in annotations in 17 A.L.R. 452 (1922), 49 A.L.R. 673 (1927), and 123 A.L.R. 726 (1939).

clearly the defendant is not liable, for he was acting as agent within the scope of his authority for a corporation known by the receivers to have come into existence several days earlier.[7] If, however, the contract was formed on the date of the bid, the defendant should be personally liable since he was acting as agent for a non-existent corporation.[8] Since the receivers did not know that the corporation did not exist on the day of the bid, they could not have intended to look to an unformed corporation for responsibility. Certainly the case is a difficult one, because both the date of the bid and that of the contract fix separate liabilities in bankruptcy sales. The contract as confirmed, however, was with the corporation itself through its agent, and the promoter should not be liable on it. The problem under either theory is a narrow one of discharge of a bidder's liability at a bankruptcy sale. Although the court offers no analysis as to how this discharge is accomplished, it is apparent that the facts lend themselves readily to the concept of novation. Here the court pointed to the receipt to show the intention of the parties not to bind the bidder personally, i.e., the receipt in effect acted as a novation.[9] The striking and helpful aspect of this case is that, since the contract is formed at confirmation, there is adequate opportunity to spell out the elements of novation at this time. In the instrument that is approved by the court the intention to discharge the bidder can be specifically expressed, and protection for the bidder from personal liability assured. The court's holding rightly gave effect to the intention of the parties, but the parties themselves should have been careful to assure themselves of this result by embodying the elements of a novation in the contract formed at the time of confirmation by the court.

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[7] MECHEM, AGENCY, 4th ed., §296 (1952); BALLANTINE, CORPORATIONS, rev. ed., §49, p. 137 (1946).

[8] Note 1 supra.

[9] From the Childs case, note 5 supra, it is apparent that the novation may be a limited one for it may not restore to the bidder his earnest money.