Legal Opinions In Corporate Transactions: The Opinion That Stock Is Duly Authorized, Validly Issued, Fully Paid And Nonassessable

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LEGAL OPINIONS IN CORPORATE TRANSACTIONS: THE OPINION THAT STOCK IS DULY AUTHORIZED, VALIDLY ISSUED, FULLY PAID AND NONASSESSABLE

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Legal opinions are rendered so often, in nearly identical terms from one transaction to the next, that one would suppose that by now they would have settled meanings. That would be a mistake. The standard phraseology, replete with fuzzy adjectives modified by slippery adverbs, is susceptible to a broad range of interpretations. The commentators disagree over even the most basic points,¹ and seeking interpretations from lawyers who regularly render opinions can be a little like consulting Humpty Dumpty.

The authors, a law professor and a practicing lawyer, are writing a book on legal opinions in corporate transactions. This article covers the opinion that stock is duly authorized, validly issued, fully paid and nonassessable.

Although the following analysis proceeds phrase by phrase, the four standard phrases of a corporate stock opinion almost always appear together, in lock-step order, and lawyers view them as interdependent. For example, the phrase "validly issued" almost always appears between the words "duly authorized" and "fully paid," and excising it from its usual spot is not an acceptable way to deal with doubts as to the validity of the steps taken to issue the shares.

I. WHAT THE OPINION MEANS

The standard opinion in an equity financing states that the shares of stock being sold by the corporation "have been duly authorized and are..."
validly issued, fully paid and nonassessable." Sometimes the opinion also

tual obligations of the company and are properly dealt with in another part of the standard opinion.

4. This article does not deal with secondary sales. See FitzGibbon & Glazer, Legal Opinions on Secondary Sales of Stock, (November-December) BOSTON BAR J. (1986).

Lawyers sometimes give opinions about shares to be issued in the future, for example upon exercise of a warrant or conversion of a convertible security. Lawyers commonly give such opinions about the underlying shares when warrants or convertible securities are issued in a public or private financing. Lawyers seldom give opinions about shares underlying employee stock options except when those shares are registered on Form S-8 under the Securities Act of 1933. See Item 20 of Form S-8, reprinted in 2 FED. SEC. L. REP. (CCH) ¶ 7200, at 6328 (requiring compliance with Item 601 of Regulation S-K); Item 601(b)(5)(i) of Regulation S-K, 17 CFR § 229.601(b)(5)(i), reprinted in 6 Fed. Sec. L. REP. (CCH) ¶ 71,071, at 61,978 (requiring as an exhibit an opinion of counsel "as to the legality of the securities being registered, indicating whether they will, when sold, be legally issued, fully paid and non-assessable. . ."). Such opinions normally contain explicit assumptions that the stock will be issued pursuant to the terms of the warrant agreement, stock option plan, bond indenture or the like.

A prospective opinion also is required for stock registered "for the shelf" for future issuance pursuant to Rule 415 under the Securities Act of 1933. See Romeo, SEC Requirements for Tax and Other Opinions in Public Offerings, in PLI, OPINION LETTERS OF COUNSEL 127, 139-40 (R. Rowe, Chairman, 1984) (PLI Corporate Law & Practice Course Handbook Series No. 459):

Offerings made pursuant to Rule 415 under the 1933 Act (so-called 'shelf offerings') present a unique problem for the attorney who must render a legality opinion. Item 601(b)(5) [of Regulation S-K] requires that he indicate in his opinion the legal status of the securities when they are sold. But securities registered under Rule 415 often will not be sold for several months after the registration statement becomes effective, thereby placing the attorney in some jeopardy for events affecting the opinion that may occur between the date of effectiveness and the date the securities are sold.

Many attorneys faced with the above dilemma have refused to render an unqualified opinion at the date of effectiveness, on the ground that they cannot assure the validity of the shares several months into the future. In such cases, the SEC staff permits the attorney to issue an opinion which speaks only as of the effective date, provided there is an understanding that the attorney will provide a definitive opinion prior to the time the securities are taken off the shelf and offered for sale. The definitive opinion can be filed as an exhibit to a Form 8-K under the Securities Exchange Act of 1934 . . . provided the registration statement was filed on a 1933 Act form (such as S-3) which permits the incorporation by reference of 1934 Act reports. In the case of registration statements filed on other 1933 Act forms, the definitive opinion must be filed under the cover of a post-effective amendment to the registration statement.

5. When rendered to the underwriters in a public offering, the corporate stock opinion may state:

The shares of capital stock to be purchased by the underwriters from the issuer have been duly authorized for issuance and sale to the underwriters pursuant to the underwriting agreement and, when issued and delivered by the issuer pursuant to the underwriting agreement against payment of the consideration set forth therein, will be validly issued and fully paid and non-assessable. . .

Wolfson, Opinions of Counsel to the Underwriters in Public Offerings of Securities, in PLI, OPINION LETTERS OF COUNSEL 1985 79, 87-88, 136 (R. Rowe, Chairman, 1985) (PLI Corporate Law & Practice Course Handbook Series No. 506) [hereinafter cited as Wolfson 1985]. Sometimes the opinion also states that the shares are "not subject to preemptive rights." Id. at 88, 136. Cf. Halloran, Rendering Opinions of Law—Opinions in Registered Offerings, in PLI,
states that the certificates representing the shares are "in proper form" or "in due and proper form." The purpose of the opinion is to assure the purchaser that the stock it is acquiring entitles its holder, as a matter of law, to all the rights of a stockholder, including voting rights and an equity interest in the corporation to the full extent provided by its charter and applicable corporate law.

The standard opinion also sometimes covers shares previously issued by the company, stating, for example, that a specified number of shares is issued and outstanding. Purchasers request such opinions because defects in outstanding stock may give rise to disputes over shareholder rights, the validity of shareholder actions, and the accuracy of disclosure documents.

Under the principle of interpretation followed here, the opinion that stock is "duly authorized, validly issued, fully paid and nonassessable" refers to those attributes of stock that are not affected by transfers from shareholder to shareholder. Thus, stock that is "duly authorized, validly issued, fully paid and nonassessable" will continue to have that status until the stock's attributes are changed voluntarily by corporate action or automatically under a charter or by-law provision or by operation of law.

The opinion on the status of a company's stock relates only to corporate law. It does not cover compliance with other applicable laws, such as federal and state securities laws. Nor does it cover fiduciary questions, even though an issue of shares might be challenged as a violation of the board's fiduciary duties. Fiduciary questions turn on factual matters such as the intent and relationship of the parties. To pass on such matters, the lawyer would have to rely on elaborate assumptions and hedges that would reduce, rather than augment, the value of the opinion to the recipient. Of course, if the lawyer renders an opinion that to his knowledge furthers an illegal transaction, he may be guilty of aiding and abetting a violation of law or of breaching his duties under the Code of Professional Responsibility.

A. What It Means to Opine that Stock has been "Duly Authorized"

The opinion that stock has been "duly authorized" has both procedural and substantive aspects. From a procedural standpoint, the opinion means
that the stock has been created in accordance with applicable provisions of corporate law and the corporation’s constituent documents. From a substantive standpoint, the opinion means that the company is a corporation and that the attributes the stock purports to have under the company’s charter are permitted by both applicable corporate law and other portions of the charter. The opinion does not, as one authority states, cover steps by the company to issue the stock; those matters are covered by the “validly issued” portion of the opinion.

1. First, the “duly authorized” opinion confirms that the company is a corporation and that applicable corporate law and the company’s constituent documents permit the attributes the stock purports to have under the charter. The opinion that the company is a corporation ordinarily ought not to be a problem, or at least not a new problem, since a separate, unqualified opinion on the corporate status of the company is a feature of every legal opinion in a financing transaction.

Corporate law seldom imposes important restrictions on the attributes stock may possess. But there are some exceptions, both constitutional and statutory. The Illinois constitution and the North Carolina corporation statute, for example, require that holders of common stock have the right to vote cumulatively under certain circumstances, while the Massachusetts statute has been read to prohibit cumulative voting. The New York statute restricts redeemable stock and prohibits corporations from creating stock with rights to convert “upstream” into more senior securities. The Delaware statute has been read to require all shares of stock of the same series to have the same par value, voting rights, and dividend and liquidation preferences.

6. See California Report, supra note 1, at 1049, which states:

[T]he concept of due authorization means that the corporation had the power under its articles of incorporation and bylaws to issue the shares of capital stock at the time they were issued and that the corporation adopted proper resolutions and otherwise took necessary corporate action to authorize or ratify the issuance of the shares.

7. See FitzGibbon & Glazer, Legal Opinions on Incorporation, Good Standing, and Qualification to Do Business, 41 Bus. Law. 461 (1986).


10. See N.Y. Bus. Corp. Law § 512(b) (McKinney 1986) (providing that with certain exceptions “[a] corporation shall not issue common shares which purport by their terms to grant to any holder thereof the right to compel the corporation to redeem such shares . . . .”).


12. See 1 R. Balotti & J. Finkelstein, The Delaware Law of Corporations and Business Organizations §§ 5.2-5.4 (1986) [hereinafter cited as Balotti & Finkelstein]. See also Revised Model Business Corp. Act § 6.02(a) (1984) (“All shares of a class must have preferences, limitations, and relative rights identical with those of other shares except to the extent otherwise permitted by section 6.02 [relating to series].”). In Asarco Inc. v. Court, 611 F. Supp. 468, 477-78 (D.N.J. 1985), the court held that a similar requirement of New Jersey law was violated by the distribution (as a dividend on common) of blank check preferred stock
Statutes for organizing nonprofit corporations and mutual banks often forbid stock altogether. Stock would not be "duly authorized" if it contravened such provisions.

Stock also would not be "duly authorized" if it violated charter restrictions. Charters often restrict the creation of a new class of preferred stock that is senior to an existing class of preferred.

In practice, the hardest questions often arise with regard to preferred stock and stock created to deter takeovers. Preferred stock charter provisions often run on for many pages, and one of the most difficult tasks for opining counsel is to confirm that all of the rights conferred on the preferred shareholders by the charter satisfy statutory requirements and do not conflict with other charter provisions.

Antitakeover strategies often include the authorization of stock with exotic features. Difficult questions, for example, have been presented by "poison pill" stock, which in the event of a takeover becomes convertible into the stock of the company ("flip in" poison pill stock) or of the acquiring corporation ("flip over" poison pill stock). Stock with variable voting rights also may present opinion problems: for example, stock that carries fewer votes per share when held by an owner of more than ten percent of the stock or has different voting rights depending on who owns it. In Unilever Acquisition Corp. v. Richardson-Vicks, Inc., the United States District Court for the Southern District of New York enjoined the issuance of a dividend of preferred stock that would have had 25 votes per share, unless it was subsequently transferred, in which event it would have had only five votes per share for the ensuing 36 months.

which carried no voting rights when owned by large shareholders. The Southern District of New York used reasoning like that in Asarco to enjoin distribution of poison pill rights in Amalgamated Sugar Co. v. NL Indus., Inc., 1986 FED. SEC. L. REP. (CCH) ¶ 92,857, at 94,173-75 (S.D.N.Y. 1986). But cf. Providence & Worcester Co. v. Baker, 378 A.2d 121, 122-24 (Del. 1977) (upholding a provision under which each common shareholder had one vote for each of his first fifty shares of common stock but only one vote for each block of twenty shares thereafter).

13. E.g., MASS. GEN. LAWS ANN. ch. 180, § 3 (West 1986).
15. See Note, Protecting Shareholders Against Partial and Two-Tier Takeovers: The 'Poison Pill' Preferred, 97 HARV. L. REV. 1964 (1984). Poison pill stock often is "blank check"—that is, created by directors pursuant to very general charter authority. See infra notes 72-81 and accompanying text (discussing opinion problems presented by "blank check" securities). Poison pill stock ordinarily is distributed as a dividend to common stockholders. See also infra notes 112-17 and accompanying text (opinion problems presented by stock dividends).

Poison pill rights and warrants have, in large measure, supplanted poison pill stock as an antitakeover device. Such instruments are not stock; they are contractual in nature. Thus, they (unlike the underlying stock) do not raise the opinion problems dealt with in this article.


18. Id. The decision rests primarily on the conclusion that such stock could not be created
The "duly authorized" opinion does not mean that creation of the stock complies with contracts by which the corporation was bound. Loan agreements sometimes contain restrictions on capital structure designed to protect creditors in the event of a takeover battle. The lawyer could give an unqualified "duly authorized" opinion about stock created in contravention of such requirements, although other portions of the opinion might have to be qualified.19

2. Second, the "duly authorized" opinion confirms that the necessary corporate steps have been taken to create the stock. Under the typical business corporation statute, a company's capitalization is set forth in its charter and may later be changed by charter amendment. The Texas statute, for example, provides:

Each corporation may issue the number of shares stated in its articles of incorporation. Such shares may be divided into one or more classes, any or all of which classes may consist of shares with par value or shares without par value, with such designations, preferences, limitations, and relative rights, including voting rights, as shall be stated in the articles of incorporation.20

Under such a statute, the opinion confirms that the proper steps have been taken under the law then in effect to adopt charter provisions relating to the stock, whether in the charter or a charter amendment, and that such provisions continue in effect.

Where the relevant provisions appear in the original charter, the lawyer must satisfy himself that the charter was duly adopted. Where the relevant provisions were adopted or changed by charter amendment, the lawyer also must satisfy himself as to the due adoption of that amendment: for example, that the shareholders' action complied with procedural requirements relating to call, notice, and quorum and that any necessary director vote recommending the shareholder action was properly and timely adopted. The shareholder vote required to approve a change in authorized stock may vary depending on the type of stock being authorized,21 and may be governed by a supermajority voting provision.22 If shares of more than one class are without shareholder approval. But some portions of the opinion imply that the stock would have been invalid even if the shareholders had authorized it. See id. at 409.

19. However, the lawyer who assisted in a transaction that he knew violated the company's contractual obligations might be liable for aiding and abetting that violation or might himself be guilty of violating the Code of Professional Responsibility.


21. See Mass. Gen. Laws Ann. ch. 156B, §§ 70 and 71 (West 1986). One common error is to overlook a requirement that an amendment be approved by a specific percentage of all the outstanding shares entitled to vote rather than only those shares represented at the meeting.

outstanding, the statute or charter may require a separate vote of each class.\textsuperscript{23} When preferred stock is outstanding, for example, the charter typically gives it a separate class vote on the creation of any more senior securities.

Minor defects in the procedures by which the charter was adopted or amended need not prevent a lawyer from giving the "duly authorized" opinion.\textsuperscript{24} The test should be whether the defect would lead a court to refuse to recognize the existence of the stock or any of the material rights it purports to have under the charter. Similarly, the opinion does not cover the adequacy of proxy materials, even though a disclosure defect might be a basis for a successful challenge to shareholder action.\textsuperscript{25} Often other clauses, prepared in carefully qualified terms, cover those matters.

The opinion does not cover the fairness or disinterestedness of those who approved the creation of the stock. Thus, the lawyer could opine that stock was "duly authorized" even though controlling shareholders created the stock as part of an effort to preserve their control over the corporation. However, when struggles for control are involved, lawsuits are common and courts often closely scrutinize actions affecting the capital structure. Lawyers, as a matter of good practice, may choose to include appropriate warnings in their opinions.

3. Third, the "duly authorized" opinion confirms that the charter sets forth the attributes of the stock to the extent required by applicable corporate law. The Revised Model Business Corporation Act provides that "[i]f more than one class of shares is authorized, the articles of incorporation must prescribe a distinguishing designation for each class, and, prior to the issuance of shares of a class, the preferences, limitations, and relative rights of that class must be described in the articles of incorporation."\textsuperscript{26} The Official Comment to this provision states that "[t]hese descriptions [in the articles] constitute the ‘contract’ of the holders of those classes of shares with respect to

\begin{footnotesize}
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\item[\textsuperscript{23}] The Delaware statute, for example, provides that:

The holders of the outstanding shares of a class shall be entitled to vote as a class upon a proposed amendment, whether or not entitled to vote thereon by the certificate of incorporation, if the amendment would increase or decrease the aggregate number of authorized shares of such class, increase or decrease the par value of the shares of such class, or alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely.


\item[\textsuperscript{24}] \textit{See Kaiser v. Moulton, 631 S.W.2d 44, 47-48 (Mo. App. 1981)} (upholding the validity of shares issued after the shareholders had unanimously approved a charter amendment creating the class of stock but before the Secretary of State had issued a Certificate of Amendment).

\item[\textsuperscript{25}] \textit{See New York Report, supra note 1, at 1910:}

It is the consensus of the members of the Committee that no opinion on misstatements or omissions in proxy statements is to be implied. Of course, if a specific claim is made or litigation is commenced challenging authorization, the opining lawyer should disclose this and either provide an opinion on the question or decline to do so.

\textit{The California Report, supra note 1, at 1049-50 is to the same effect.}

\item[\textsuperscript{26}] \textit{Revised Model Business Corp. Act § 6.01(a) (1984).}
\end{itemize}
\end{footnotesize}
their interest in the corporation and must be set forth in sufficient detail reasonably to define their interest."27

Under Delaware law, the attributes of stock may depend upon facts outside the charter if the manner in which such facts operate is clearly set forth.28

When the charter provisions29 establishing the terms of the stock are incomplete or unclear, the lawyer may be able to give the "duly authorized" opinion anyway if courts under applicable law will, like the Delaware courts, take an approach borrowed from contract law and "give effect to the intent of the parties as revealed by the language of the contract and the surrounding circumstances."30

The lawyer could not give the "duly authorized" opinion if terms of the stock required to be set forth in the charter were not included or were included instead in the by-laws.31 The Massachusetts statute provides that "[t]he articles of organization shall [include] . . . if more than one class of stock is authorized, a description of each class with the preferences, voting powers, qualifications, special or relative rights or privileges as to each class

27. Id. (official text to § 6.01).
29. A similar problem arises when director resolutions establishing the terms of "blank check" stock are unclear. For a discussion of "blank check" stock, see infra notes 72-81 and accompanying text.
A difficult question may be presented where courts would construe the charter to have a meaning different from that apparent on its face. Delaware courts, for example, take the view that "reformation of the certificate of incorporation may be ordered in situations where a contract may be reformed." 1 Balotti & Finkelstein, supra note 12, § 5.3. See In the Matter of Farm Indus., Inc., 41 Del. Ch. 379, 395, 196 A.2d 582, 592 (1963). In Farm Industries the shareholders agreed to the creation of classes of stock with differing voting rights but those rights were not reflected in the charter. The court observed that "[t]his situation, which amounts to mutual mistake, provides, in my opinion a legally sufficient basis for causing the certificate [of incorporation] to be reformed so as to reflect their intentions." Id. Delaware courts also take the view that stock preferences "must be clearly expressed and will not be presumed." See Rothschild Int'l Corp. v. Liggett Group Inc., 474 A.2d 133, 136 (Del. 1984) (holding that in a cash-out merger preferred stockholders were not entitled to receive the liquidation preference payments set forth in the charter). When a lawyer concludes that because of such doctrines courts would treat the stock as having materially different terms from those the opinion recipient would expect from reading the charter, he should disclose that conclusion in his opinion.
31. See Gaskill v. Gladys Belle Oil Co., 9 Del. Ch. 289, 291, 146 A. 337, 338 (1929) (refusing to give effect to liquidation preferences set forth in the by-laws because the statute required them to be contained in the charter).

Delaware permits "blank check" stock, whose attributes are established by the directors or a board committee rather than delineated in the charter. See Del. Code Ann. tit. 8, § 151(a) (1983). The Revised Model Business Corporation Act permits the directors, if the charter so provides, to amend the charter without shareholder approval to establish the terms of blank check stock. Revised Model Business Corp. Act § 6.02 (1984). Opinion questions raised by blank check stock are discussed infra at notes 72-81 and accompanying text.
thereof and any series then established . . . ." 32 If the articles permit a class of stock to be divided into two or more series, the Massachusetts statute provides that:

the different series shall be established and designated, and the variations in the relative rights and preferences as between the different series shall be fixed and determined, by the articles of organization or, to the extent expressly so authorized by the said articles, by the directors; provided, that all shares of the same class shall be identical except that there may be variations so fixed and determined between different series as to right of redemption . . . special and relative rights as to dividends and on liquidation . . . conversion rights and conditions under which the several series shall have separate voting rights or no voting rights. 33

A lawyer opining on stock created under such a statute must decide whether two kinds of stock are separate classes, in which event the charter must spell out their relative rights, or merely separate series, in which event the charter may authorize the directors to fix those rights. Many corporate lawyers avoid what might otherwise be a difficult question by taking the position that there is no meaningful distinction between a class and a series and that whatever label the issuer has used should control. Other lawyers strongly object to relying on labels. They refuse, therefore, to opine on the due authorization of securities established by the directors unless the charter sets forth in detail the powers of the board to establish the rights and privileges of each series.

4. Fourth, when the "duly authorized" opinion relates to shares that have been or are being issued, it confirms that sufficient authorized shares of that class 34 were available at the time of issuance.

The key date is the date the shares were issued. Thus, for example, shares issued upon exercise of a stock option would not be duly authorized if all the authorized shares previously had been issued, even if enough shares had been available when the option was granted. The test is strictly chronological. When shares issued at the same time in the aggregate exceeded the number available, the lawyer would not be able to opine that any of them were "duly authorized." But when shares issued at different times in the aggregate exceeded the number available, the lawyer might be able to give the "duly authorized" opinion about those issued first. 35

The number of authorized shares available for issuance is not reduced when a corporation replaces a lost or destroyed stock certificate. Some

33. Id. § 26.
34. When the charter specifies a quantity limit for each series as well as for the class, the lawyer must perform a similar analysis for the series.
35. Of course, the opinion could not be given as to any outstanding shares if the defective shares could not be identified.
authorities suggest that if replacement certificates have been issued, an opinion qualification might be necessary because of the possibility that a shareholder might falsely claim that his certificate was lost and then fraudulently sell the same shares twice, delivering his original certificate to one purchaser and the replacement certificate to the other. This concern is misplaced because lawyers, as a matter of practical necessity, must rely when giving opinions on the accuracy of representations made to the corporation. Thus, absent knowledge to the contrary, a lawyer can give the "duly authorized" opinion regardless of the existence of replacement certificates.

A harder question is whether unauthorized or invalidly issued stock may be ignored in calculating the number of authorized shares remaining available for future issuance. Suppose, for example, a lawyer is asked to opine that two thousand shares of the common stock of Ajax Corporation will be "duly authorized" when the company issues the stock on December 15, 1986. In checking the corporate records, the lawyer discovers that Ajax had issued all of its authorized stock by the end of 1982, and in 1983, without amending its charter, purported to issue and sell another two thousand shares. Then in 1984, Ajax amended its charter to authorize an additional two thousand shares. The lawyer may be tempted to conclude that since the 1983 shares were not duly authorized, all of the two thousand shares authorized in 1984 remain unissued. However, a court might well view the 1984 amendment as an attempt to ratify or validate the 1983 shares, rather than an effort to create new shares. A court's decision would turn on such matters as the knowledge and intention of the shareholders when they adopted the 1984 amendment. A similar analysis would apply if the previous stock were invalid owing to a defect in issuance. The lawyer may be tempted to ignore the invalidly issued shares but must consider the possibility that a court would regard the defect as cured by the directors' failure to object. Under such circumstances, lawyers rarely will be able to give an unqualified opinion.

Another question arises when a company has reacquired outstanding stock. If the reacquired shares are to be counted as duly authorized, the lawyer should confirm that they have been properly reacquired, that they

36. See California Report, supra note 1, at 1049; Fuld, Legal Opinions, supra note 1, at 932-33; Jacobs, supra note 1, at 3-11. Jacobs states:
If any new stock certificate was issued to replace certificates which were lost, stolen or destroyed . . . add the following to your opinion: 'The foregoing opinions are subject to the qualification that the stock transfer books of the Company indicate that new stock certificates representing shares of [identify the class of stock] were issued to replace certificates which were lost, stolen, or destroyed.'

Id.

37. See Campbell v. Hospitality Motor Inns, Inc., 24 Ohio St.3d 54, 493 N.E.2d 239 (1986) (holding that directors may ratify an employment agreement by acquiescence); Fisher v. First Stamford Bank & Trust Co., 751 F.2d 519, 522 (2d Cir. 1984) (holding that directors ratified a stock option by implication).
were paid for out of legally available funds,\textsuperscript{38} and that any steps necessary to restore them to authorized but unissued status have been taken.\textsuperscript{39} Some statutes require action by the board or the shareholders to restore reacquired shares to authorized but unissued status. The Massachusetts statute, for example, provides:

Shares of stock previously issued which have been reacquired by the corporation, may, unless the articles of organization or by-laws otherwise require, be restored to the status of authorized but unissued shares by vote of the stockholders or by vote of the board of directors, without amendment of the articles of organization.\textsuperscript{40}

Shares that are not so restored, often called "treasury shares," should be regarded as "issued" (but not outstanding). The lawyer, therefore, must subtract them in determining how many authorized shares remain available for issuance.\textsuperscript{41}

B. What It Means to Opine That Stock has been "Validly Issued"

The opinion that stock has been "validly issued" means that the corporation has sold or otherwise transferred the stock in compliance with the corporate law of its state of incorporation and its charter and by-laws, as then in effect, and that the corporation has not taken any step that deprives the stock of its "validly issued" status. The opinion does not cover compliance with other laws nor does it mean that the directors who approved the

\textsuperscript{38} See N.Y. Bus. Corp. L. \S 513(a) (McKinney 1986), which states that "[a] corporation, subject to any restrictions contained in its certificate of incorporation, may purchase its own shares, or redeem its redeemable shares, out of surplus except when currently the corporation is insolvent or would thereby be made insolvent." Subsection (b) contains a more limited provision for such purchases out of stated capital. \textit{Id.} \S 513(b).

If the reacquisition created a capital deficiency, an opinion might nevertheless be given if sufficient consideration is received for the shares upon resale to make up the deficiency.

\textsuperscript{39} See Revised Model Business Corp. Act \S 6.31(a) (1984), which provides that "[a] corporation may acquire its own shares and shares so acquired constitute authorized but unissued shares." See Tex. Bus. Corp. Act Ann. art. 4.10 (Vernon 1980) (to similar effect). Section 6.31(b) of the Revised Model Business Corp. Act provides that "[i]f the articles of incorporation prohibit the reissue of acquired shares, the number of authorized shares is reduced by the number of shares acquired, effective upon amendment of the articles of incorporation."


\textsuperscript{41} Cf. H. Henn \& J. Alexander, \textit{Laws of Corporations and Other Business Enterprises} \S 158 (3d ed. 1983) ("Legally, 'treasury shares' are authorized and issued but not outstanding.") [hereinafter cited as \textit{Henn \& Alexander}]. When reacquired shares have not been restored to authorized but unissued status, and the lawyer is asked to opine on a sale that exceeds the number of authorized but unissued shares, the lawyer may be able to give the opinion if the board resolves that treasury shares shall be sold to the extent necessary to avoid any overissuance. To give the opinion on that basis, the lawyer would have to conclude that the treasury shares themselves had been "duly authorized" and that appropriate steps had been taken to acquire and resell them. For a discussion of opinion questions presented by treasury shares, see \textit{infra} notes 118-23 and accompanying text.
stock issuance complied with their fiduciary obligations. Matters covered by the "validly issued" opinion are as follows:

1. First, the "validly issued" opinion confirms that the sale or transfer complies with applicable corporate law. This requirement sometimes goes beyond the standard limitation that shares be issued only out of authorized and unissued stock. The Delaware statute, for example, provides:

   The Directors may, at any time and from time to time, if all of the shares of capital stock which the corporation is authorized by its certificate of incorporation to issue have not been issued, subscribed for, or otherwise committed to be issued, issue or take subscriptions for additional shares of its capital stock up to the amount authorized in its certificate of incorporation.

Under such a statute, shares that have been committed to be issued for one purpose could not be "validly issued" for another. But what has been "committed to be issued" is not always clear. Are shares "committed to be issued" where they are needed to fulfill the company's obligations under outstanding stock options? Would it matter whether or not the board has voted to reserve those shares for that purpose? What if the options have been authorized but not yet granted or have been granted but are not yet exerciseable? What if the company customarily satisfies its obligations to option holders by repurchasing the options? These questions will arise whenever a corporation has reserved shares for one purpose and later wishes to issue them for another. If the shares are "committed to be issued" within the meaning of the statute as a result of such steps, the lawyer could not give the "validly issued" opinion unless enough other shares were available. Of course, the board could always revoke a reservation of shares unless prevented from doing so, for example by an option agreement or, in the case of convertible debt, a bond indenture.

Corporate law restricts stock issuance in other ways. Some corporation statutes, for example, require that existing shareholders be afforded preemp-

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42. See Mich. Comp. Laws Ann. § 450.1301(1) (West 1986), which provides that "[a] corporation may issue the number of shares authorized in its articles of incorporation."


44. This question also arises when the company has poison pill stock or rights outstanding, since poison pill instruments often are convertible at extravagant ratios in the event of a takeover.

45. See E. Folk, The Delaware General Corporation Law 160 (1972) (indicating that directors could not properly issue for another purpose "shares reserved for issue upon conversion or exchange of outstanding securities convertible into the class of shares affected by the proposed issue").

46. Even when the corporation has not expressly agreed to reserve shares, counsel may be concerned that an issuance which did not leave sufficient shares available to satisfy commitments under outstanding options, warrants or convertible securities might constitute an anticipatory breach of its commitments. In many instances, however, the need for those additional shares may not be imminent and the board later may provide for them by authorizing a repurchase of stock or by calling a shareholders meeting to increase the authorized stock.
tive rights. Stock dividends must be distributed prorata and under some statutes may not be distributed while the corporation is insolvent. Purchasers of the stock of corporations organized under professional corporation statutes must be members of the profession. The "validly issued" opinion also confirms compliance with these requirements. On the other hand, the "validly issued" opinion does not confirm compliance with all requirements of law. A company that issues stock in violation of the Trading with the Enemy Act or the registration requirements of the Securities Act of 1933 would be subject to legal sanction, but those violations would not prevent the stock from being "validly issued."

47. E.g., CONN. GEN. STAT. § 33-343 (1960). Corporations may include in their charters provisions opting out of preemptive rights requirements.

The New York Report, supra note 1, at 1910, states:

The failure to satisfy or obtain a waiver of shareholders' preemptive rights, whether statutory or under the certificate of incorporation, might provide a basis for an issuance of shares to be voided. Such a violation of preemptive rights would prevent the giving of an opinion that the shares were "validly issued."

Sometimes an opinion expressly states that the stock issuance does not violate preemptive rights. Other opinion questions presented by preemptive rights are discussed infra in text accompanying notes 60-61, 82, and 119.


When dividends are paid to members of a single class of shareholders, each shareholder must receive an amount equivalent to that paid to the other members of the class. The corporation statutes of most jurisdictions are not explicit on the subject, and corporate charters do not generally spell out the matter in detail. But, the case law leaves little doubt that, although members of the class may be given a choice, none may be required to accept payment different in form or amount than is offered to the others.

(Citations omitted. The passage is not addressed to stock dividends in particular.) For a description of other legal requirements as to stock dividends see notes 112-17, infra, and accompanying text.

"Poison pill" instruments usually are distributed as dividends and often raise difficult questions under this doctrine. See Minstar Acquiring Corp. v. AMF, Inc., 621 F. Supp. 1252, 1257-59 (S.D.N.Y. 1985), in which the court held that a dividend of nontransferable poison pill warrants impermissibly discriminated against those who purchased the underlying common stock after the record date.

49. See, e.g., TEX. BUS. CORP. ACT ANN. art. 2.38A (Vernon 1980) ("[t]he board of directors of a corporation may, from time to time, declare, and the corporation may pay, dividends on its outstanding shares in cash, in property, or in its own shares, except when the corporation is insolvent or when the payment thereof would render the corporation insolvent. . .").

50. See, e.g., MASS. GEN. LAWS ANN. ch. 156A, § 7 (West 1970).

51. Some statutes require (or at one time required) corporations to file certificates reflecting increases in their capital stock. See, e.g., MASS. GEN. LAWS ANN. ch. 156, § 16 (West 1970). See also id. § 17 (filing after issuance cures defect). Some statutes require a filing prior to the issuance of shares of a series established by the directors. See, e.g., MASS. GEN. LAWS ANN. ch. 156B, § 26 (West 1970). The "validly issued" opinion confirms compliance with such requirements when violation could have material adverse consequences.


Authorities differ as to where the line should be drawn between those legal prohibitions that prevent stock's being "validly issued" and those that do not. A special committee of the New York County Lawyers' Association has taken the position that the opinion does not cover all legal prohibitions, but only those that by statute make the issuance "void or voidable because of a lack of approval of a regulatory authority, whether state or federal, or ... [give] a right to void an issuance to a third party or regulatory authority."54 This test is in one respect too narrow: opinion recipients have a legitimate concern about sanctions other than voidness or voidability, such as damages against the company or the purchasers. In another respect this test is too broad: the opinion ought not to be read to cover all statutes but only those that are part of applicable corporate law. A lawyer is expected to confirm that the Department of Public Utilities has approved a stock issuance by a public utility as required by the statute under which the corporation was organized. But a lawyer should not be expected to pass upon all laws. To the extent an opinion passes on legal compliance in general, it does so in a separate clause and then only in carefully qualified terms.55

The "validly issued" opinion does not mean that the directors and officers, in approving the stock issuance, complied with their fiduciary obligations. Stock sold to insiders, for example, could be "validly issued" even though the sale might be challenged as unfair to the corporation or as improperly perpetuating control.56 The question whether a sale of stock is fair and in compliance with fiduciary requirements turns largely on factual issues that lawyers ought not be required to pass upon. As a matter of

54. New York Report, supra note 1, at 1911. See California Report, supra note 1, at 1050 (taking a similar approach).

55. State securities law furnishes a good example of a problem with the approach of the New York Report. Under the New York Report a validly issued opinion could be given even in the face of a statutory violation that resulted in voidness or voidability unless, inter alia, a third party had the right to void the issue. The authors of the New York Report appear to have thought this limitation relieves the lawyer of most securities law problems. The report states:

There is no reason to decline to give an opinion to a purchaser as to valid issuance merely because a transfer of shares may violate the Securities Act of 1933 or a state blue sky law or takeover law which does not make the issuance void or voidable. Those statutes often give the purchaser a right to rescind. If only the purchaser (as opposed to a third party or regulatory authority) has the right to rescind the purchase of the shares, such right should not affect an opinion as to valid issuance.

New York Report, supra note 1, at 1910-11. This statement overlooks the fact that transactions that violate state securities laws may in some states be set aside upon the petition of a securities administrator. See, e.g., Wis. STAT. ANN. § 551.57 (West Supp. 1986). To avoid including compliance with state securities laws in the validly issued opinion, it is better, as suggested here, to conclude that "validly issued" only covers compliance with corporate law.

Of course, a lawyer who gave an unqualified opinion about a transaction he knew to be illegal might be liable for aiding and abetting an unlawful transaction or guilty of violating the Code of Professional Responsibility.

56. See Bennett v. Breuil Petroleum Corp., 34 Del. Ch. 6, 8-12, 99 A.2d 236, 237-39 (Del. Ch. 1953). Lawyers often include a warning in opinions on antitakeover devices to the effect that such devices frequently are litigated.
practice, experienced lawyers often avoid giving an opinion, or carefully qualify the opinion, when it relates to a stock sale that is subject to challenge on such grounds or that otherwise makes them uncomfortable.\textsuperscript{57}

Several authorities have concluded that the "validly issued" opinion also means that "proper consideration" was given for the stock.\textsuperscript{58} These authorities clearly are correct when under the express terms of the applicable corporation statute, stock may not be issued until the requisite consideration has been paid;\textsuperscript{49} Whether they are correct under other statutes is debatable but not worth debating because the "fully paid and nonassessable" portion of the standard opinion deals with the receipt of lawful consideration.\textsuperscript{60}

2. Second, the "validly issued" opinion confirms that the sale or transfer complies with the corporation's charter and by-laws. Charter provisions establishing the terms of a class of stock sometimes prohibit or limit the issuance of senior securities or restrict dividend payments in terms that may apply to stock dividends. Charters and by-laws also sometimes confer preemptive rights.

The "validly issued" opinion does not mean that the transfer complies with contracts by which the corporation is bound, including contracts conferring preemptive rights, although one important authority is partially to the contrary.\textsuperscript{61} A separate section of the opinion usually confirms that the transaction does not violate specified contracts or, sometimes, any contracts known to counsel.

3. Third, the "validly issued" opinion confirms that the issuance was approved in the manner required by corporate law and the charter and by-laws.

\textsuperscript{57} An opinion in a questionable transaction might expose the lawyer to aider and abettor liability and might involve his violating the Code of Professional Responsibility, although it is difficult to charge lawyers with actual knowledge of fiduciary violations when the underlying facts are elusive, as they often are.

\textsuperscript{58} E.g., California Report, supra note 1, at 1050; New York Report, supra note 1, at 1910; Halloran, supra note 5, at 26. See Babb, Barnes, supra note 1, at 568 (concluding that "receipt of consideration of a permissible type" is an element of the opinion).

\textsuperscript{59} See Tex. Bus. Corp. Act Ann. art. 2,16A (Vernon 1980) ("Shares may not be issued until the full amount of the consideration, fixed as provided by law, has been paid."). The New York statute provides that, with certain exceptions, "certificates for shares may not be issued until the full amount of the consideration therefor has been paid." N.Y. Bus. Corp. Law § 504(h) (McKinney 1986).

\textsuperscript{60} See infra notes 88-129 and accompanying text (discussing the opinion that stock is "fully paid and nonassessable").

\textsuperscript{61} See New York Report, supra note 1, at 1911, which states:
A lawyer considering whether to give a valid issuance opinion must determine whether issuance of shares in violation of an agreement merely gives a right to damages or other relief against the corporation, or whether the effect of the agreement (because of knowledge by the purchaser or otherwise) is to make the issuance of the shares void or voidable.
The corporation statutes of many states, including Delaware,\textsuperscript{62} give the directors the power to approve the issuance of stock. Some states, such as Massachusetts, give that power to the stockholders\textsuperscript{63} unless, as is usually the case, the by-laws or a shareholder vote also confers that power on the directors. Mergers, recapitalizations, and similar transactions involving stock issuances frequently require approval of the board and, also, the holders of each class of stock voting separately and as a group. The lawyer must be satisfied that the requisite approvals have been obtained and that the actions of each corporate body were procedurally correct in all material respects.\textsuperscript{64}

Some statutes, including Delaware's, permit boards to delegate their authority to issue stock.\textsuperscript{65} Other statutes limit such delegation\textsuperscript{66} or do not permit it at all.\textsuperscript{67} Even in states with narrow statutes, boards as a matter of practical necessity regularly grant committees authority to issue stock under employee stock plans and to approve last-minute pricing and other decisions relating to public offerings. In those situations and others when a committee has acted, the lawyer must determine whether the committee's actions were permissible under the applicable statute. Until recently, for example, the Massachusetts statute prohibited boards from delegating the authority to issue stock,\textsuperscript{68} but lawyers regularly gave the "validly issued" opinion when a committee acted within parameters established by the board. In addition to the validity of the delegation, the lawyer must determine whether the members of the committee were duly appointed, whether they acted within

62. \textit{See Del. Code Ann.} tit. 8, § 161 (1983), which provides:
The directors may, at any time and from time to time, if all of the shares of capital stock which the corporation is authorized by its certificate of incorporation to issue have not been issued, subscribed for, or otherwise committed to be issued, issue or take subscriptions for additional shares of its capital stock up to the amount authorized in its certificate of incorporation.

The Revised Model Business Corporation Act gives the board the power to approve the issuance of shares but specifies that the charter may reserve that power to the shareholders. \textit{Revised Model Business Corp. Act} § 6.21 (1984).

Any unissued capital stock from time to time authorized under the articles of organization may be issued by vote of the stockholders, or by vote of the directors under authority of a provision of the by-laws or a vote of the stockholders, which provision or vote may be adopted before or after the stock is authorized.

64. When stock is being issued to insiders or their affiliates, the corporation statute, charter or by-laws may impose special requirements such as disclosure by interested directors of their interest in the transaction and may require a finding by disinterested directors that the transaction is in the best interests of or is fair to the corporation. \textit{See Del. Code Ann.} tit. 8, § 144 (1983).


68. The prohibition was contained in \textit{Mass. Gen. Laws Ann.} ch. 156B, § 55 (West 1970). This is of more than historical interest since the old version of the statute would be relevant to an opinion on stock issued prior to the amendment.
the scope of the board's delegation, and whether they followed correct procedures.\textsuperscript{69}

Whatever body has acted, the lawyer must determine whether the resolutions adopted by that body were still in force at the time the stock was issued. This will not be a problem when, as is often the case, the resolutions were adopted shortly before the transaction. If they were not, however, the lawyer should consider whether they have become stale and require readoption. Some corporations, such as mutual funds, continuously issue stock under resolutions adopted at the time of their initial public offerings. Other corporations issue stock over a period of years under stock option, dividend reinvestment, employee stock purchase or other plans pursuant to resolutions adopted when the plan was established. Such resolutions do not lose their force simply through the passage of time. They are, however, subject to amendment or rescission and may contain limits as to quantity, timing or price. The lawyer, therefore, must confirm that the resolutions continue in effect and that the stock issuance conforms with their terms.

The lawyer also must determine whether the resolutions adequately cover all requisite points. These points generally include the kind of stock, the maximum number of shares to be issued, the minimum price, and the type of consideration to be received.\textsuperscript{70} The resolutions normally need not specify the minimum number of shares, the timing of the transaction or the identity of the purchasers. Whether the exact price must be fixed varies from state

\textsuperscript{69} The considerations that determine whether a procedural defect is too minor to prevent the lawyer's giving an opinion are discussed, in connection with other clauses, in FitzGibbon & Glazer, \textit{Legal Opinions on Incorporation, Good Standing, and Qualification to Do Business}, 41 Bus. Law. 461 (1986).

\textsuperscript{70} See \textit{Del. Code Ann. tit. 8, §§152-153 (1983)}, which provide:

§ 152. Issuance of stock; lawful consideration; fully paid stock.

The consideration, as determined pursuant to subsections (a) and (b) of § 153 of this title, for subscriptions to, or the purchase of, the capital stock to be issued by a corporation shall be paid in such form and in such manner as the board of directors shall determine. In the absence of actual fraud in the transaction, the judgment of the directors as to the value of such consideration shall be conclusive. . . .

§ 153. Consideration for stock.

(a) Shares of stock with par value may be issued for such consideration, having a value not less than the par value thereof, as determined from time to time by the board of directors, or by the stockholders if the certificate of incorporation so provides.

(b) Shares of stock without par value may be issued for such consideration as is determined from time to time by the board of directors, or by the stockholders if the certificate of incorporation so provides.

(c) Treasury shares may be disposed of by the corporation for such consideration as may be determined from time to time by the board of directors, or by the stockholders if the certificate of incorporation so provides.

(d) If the certificate of incorporation reserves to the stockholders the right to determine the consideration for the issue of any shares, the stockholders shall, unless the certificate requires a greater vote, do so by a vote of a majority of the outstanding stock entitled to vote thereon.
Often, lawyers are willing to base their opinions on resolutions establishing a pricing formula or authorizing officers to fix a price within a narrow range.

Blank check stock requires additional board determinations. The Delaware statute, for example, provides:

Every corporation may issue one or more classes of stock or one or more series of stock . . . which classes or series may have such voting powers, full or limited, or no voting powers, and such designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions thereof, as shall be stated and expressed in the certificate of incorporation or of any amendment thereto, or in the resolution or resolutions providing for the issue of such stock adopted by the board of directors pursuant to authority expressly vested in it by the provisions of its certificate of incorporation.

The Delaware statute permits the board to delegate most of these powers to a committee. When the board or a board committee exercises blank check powers, the lawyer must be satisfied not only that corporate law and the corporation’s charter permit the terms of the stock, but also that the directors and the committee acted within the scope of their authority and that the charter’s conferral of power in this respect was consistent with the statute. The lawyer also must confirm that the board’s and the committee’s actions were procedurally correct and that any other steps required to issue blank check stock were taken.

Directors sometimes use blank check authority to create a new class of preferred stock designed to deter or defeat takeover bids. For example, in 1979 the Board of Directors of Outdoor Sports Industries, Inc. (OSI) became worried about acquisitions of the company’s stock by Telvest, Inc. OSI was a Delaware corporation, and pursuant to Section 151(a) of the Delaware statute, quoted above, its charter conferred on the board of directors blank

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71. Cf. Revised Model Business Corp. Act § 6.21(c) (1984) ("[b]efore the corporation issues shares, the board of directors must determine that the consideration received or to be received for shares to be issued is adequate").


74. Id. § 141(c).

75. See supra notes 8-18 and accompanying text.

76. A similar analysis is required when directors establish the terms of a series of stock under statutes such as the Massachusetts statute discussed above. See supra notes 32-33.

77. The Delaware statute, for example, requires the filing of a certificate with the secretary of state when blank check stock is issued. Del. Code Ann. tit. 8, § 151(g) (1983).

78. See Telvest, Inc. v. Olson, No. 5798 (Del. Ch., March 8, 1979) (available on LEXIS, States library, Del file).
check authority to create a new class of preferred stock. The OSI Board, relying on this provision, adopted a resolution creating “First Series Preferred Stock” (to be paid as a dividend to holders of common stock) and requiring the affirmative vote of 80% of the First Series Preferred for the approval of certain mergers and consolidations. In *Telvest, Inc. v. Olson,* a Delaware court forbade the distribution of this stock, observing that:

OSI’s board has attempted to convert the voting rights of those same stockholders who would have had the power to approve or disapprove certain business combinations by majority vote—i.e., the holders of the common stock—into the power, in certain situations, to permit less than a majority of the present common stockholders to vote down a merger, sale of assets, etc.

The court further observed:

It seems ... logical to conclude that where the holders of the common stock are given the right to approve certain transactions by only the majority vote required by the various applicable statutes, that right cannot be changed short of an amendment to the certificate of incorporation ... I am aware of no policy evident in the Delaware Corporation law ... which would empower a board of directors to alter existing voting rights of shareholders ... without permitting the shareholders to be heard on the matter.

The court concluded that the creation of the stock was not within the “blank check” powers conferred by OSI’s charter because the charter expressly limited those powers to preferred stock, and the First Series Preferred Stock at issue was not fully preferred stock, despite its name, because it lacked meaningful preferences as to dividends and distributions on liquidation.

*Telvest* demonstrates that some courts put a narrow construction on blank check powers, at least when they are used to discourage outside bidders

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79. *Id.* The resolution provided:

[Although they shall be entitled to no vote on any other matter, the holders of the First Series Preferred shall be entitled to vote as a class on, among other things, any merger or consolidation of the corporation with or into a ‘Related Person;’ upon any sale, lease, exchange, transfer or other disposition of all or substantially all assets either to or from a ‘Related Person;’ upon the issuance of any securities of the corporation, or any subsidiary, to a ‘Related Person;’ and upon the acquisition by the corporation, or any subsidiary, of securities from a ‘Related Person.’] Furthermore, in any such proposed transaction involving a Related Person wherein the holders of the First Series Preferred become entitled to vote as a class, it is provided that ‘the affirmative vote of the holders of not less than 80% of the outstanding First Series Preferred ... which shall include the affirmative vote of at least 50% of the outstanding shares of First Series Preferred held by stockholders other than a Related Person, shall be required for the approval or authorization of any business combination previously set forth herein in which the Related Person is involved.

*Id.*

80. No. 5798 (Del. Ch., March 8, 1979) (available on LEXIS, States library, Del file).
for corporate control. Bidders and target shareholders frequently challenge
the validity of antitakeover devices, and legal doctrines in the area are
unsettled. An opinion could not be given that stock was validly issued if it
were subject to being struck down on grounds similar to those in Telvest.
Even when a lawyer can give the “validly issued” opinion, however, he may
choose to include in the opinion a paragraph pointing out that antitakeover
devices often are challenged and that a court may invalidate the issuance of
the shares for breach of fiduciary duties or on similar grounds. Such a
paragraph provides the opinion recipient a helpful warning about matters
not covered by the opinion. It also helps protect the lawyer against the
possibility that an unsympathetic court will develop a creative theory, as the
court did in Telvest, on which to invalidate the stock.

4. Fourth, the “validly issued” opinion confirms that the issuance
complies, in all material respects, with any further requirements contained
in the resolutions of the stockholders, directors or board committee. Such

81. The current vitality of Telvest is in question. Section 151 of the Delaware statute was
amended in 1983 to make it clear that the filing of a certificate reflecting director resolutions
creating blank check stock operates as an amendment to the charter. The Telvest court expressed
doubt that such amendment was effected under the prior version of the statute and indicated
that such doubts undermined the validity of blank check stock that purported to alter voting
provisions contained unambiguously in the charter. In National Educ. Corp. v. Bell & Howell
Co., No. 7278 (Del. Ch., Aug. 25, 1983) (available on LEXIS, States library, Del file), the
court refused to grant a preliminary injunction against the issuance of preferred stock that
carried meaningful preferences and was in other ways distinguishable from the stock at issue in
Telvest. The court observed:

[Defendant argues that at least a part of [Telvest] (more properly, I think, an
unfortunate insinuation flowing from perhaps improvident language hastily used in
an unreported decision on an emergency injunction application) was expressly and
purposefully reversed—or cured as the case may be—by action of our General
Assembly, effective July 8, 1983, and that consequently the effect of the Telvest
decision is no more.

Further on in the National Educ. Corp. opinion, however, the Chancellor observed:
I remain of the opinion that the decision [in Telvest] was a proper one on its facts.
The stock that was to be issued there... was clearly a sham insofar as it
purported to be preferred stock. So viewed, it was nothing more than an attempt by
a board of directors, by resolution, to change the existing voting rights of the common
stockholders without their consent so as to make a hostile acquisition of the corpo-
ration more difficult to achieve. Moreover, it was an action taken in direct response
to an ongoing hostile take-over attempt.

The Delaware Supreme Court refused to grant an injunction pending appeal of this decision
and the preferred stock was in fact issued. 1 BALOTTI & FINKELSTEIN, supra note 12, § 6.30
(1986).

Another important case on blank check stock is Asarco Inc. v. Court, 611 F. Supp. 468,
480 (D.N.J. 1985), in which the court enjoined the issuance of a dividend of stock carrying
variable voting rights, on the grounds that the New Jersey statute did not “confer upon the
corporation or its directors the power to issue classes of shares which have differing voting
rights within the same class or which modify previously issued classes of shares so as to confer
different voting rights upon shares within that class.”
resolutions may establish preemptive rights, identify the intended purchasers or condition the issuance of any stock on the receipt of subscriptions for a minimum number of shares. They also may require the execution of a stock purchase and sale agreement or the surrender of stock option certificates or warrants.

5. Fifth, the "validly issued" opinion confirms that the corporation has taken any other steps necessary to vest shareholder status in the recipients of the stock. The usual way to vest shareholder status is to deliver stock certificates. When this is done, the lawyer rendering a "validly issued" opinion normally ascertains that the certificates were in fact delivered, that the appropriate persons executed the certificates, that the certificates represented the correct number of shares, and that the certificates were in the form required by applicable statutory, charter and by-law provisions and shareholder or director resolutions.

82. See Nelms v. Weaver, 681 S.W.2d 547, 549 (Tenn. 1984) (directing rescission of shares issued to an outsider because, inter alia, preemptive rights established by shareholder resolution had not been honored). For other opinion questions presented by preemptive rights, see supra at note 47 and accompanying text, supra at text accompanying notes 60-62, and infra at note 119 and accompanying text.

83. Since directors' resolutions commonly recite the consideration for the shares, the "validly issued" opinion may also cover receipt of that consideration. Cf. REVISED MODEL BUSINESS CORP. ACT § 6.21(c) (1984) ("determination by the board of directors [that the consideration to be received is adequate] is conclusive insofar as the adequacy of consideration for the issuance of shares relates to whether the shares are validly issued, fully paid and nonassessable") (emphasis added). Whether the "validly issued" opinion covers this point has little practical significance since the "fully paid and nonassessable" opinion certainly does. See infra notes 90-129 and accompanying text.

84. Statutes, charters, and by-laws often contain specific requirements as to who must sign stock certificates. The Massachusetts statute, for example, provides that the certificate "shall be signed by the president or a vice president and by the treasurer or an assistant treasurer." MASS. GEN. LAWS ANN. ch. 156B, § 27(a) (West 1970). Section 6.25(d) of the Revised Model Business Corporation Act (1984) provides that "[e]ach share certificate (1) must be signed (either manually or in facsimile) by two officers designated in the bylaws or by the board of directors." The lawyer also should confirm, perhaps through an incumbency certificate, that those signing held the offices in question and, when facsimile signatures are used, that the special statutory requirements relating to such signatures have been satisfied.

Section 8-205 of the Uniform Commercial Code provides that:

[An unauthorized signature placed on a certificated security prior to or in the course of issue . . . is ineffective, but the signature is effective in favor of a purchaser for value of the certificated security . . . if the purchaser is without notice of the lack of authority and the signing has been done by: (a) an authenticating trustee, registrar, transfer agent or other person entrusted by the issuer with the signing of the security [or] of similar securities . . . or [b] an employee of the issuer, or any of the foregoing entrusted with responsible handling of the security . . . .

Section 8-205 does not relieve the lawyer of his obligation to confirm the incumbency of the officers who signed the certificate because the protection of that section depends upon the knowledge of the plaintiff.

85. Lawyers usually rely on a treasurer's certificate for these matters. See also infra notes 133-34 and accompanying text (discussing the opinion that the "certificates are in proper form").
Delivery of stock certificates is not, however, the only way to confer shareholder status. Corporation statutes usually require a corporation to issue stock certificates only when stockholders request them. By long-established practice, mutual funds and companies acting under dividend reinvestment plans have given stockholders statements of account and have issued stock certificates only upon request. When the corporation does not deliver stock certificates, the lawyer must confirm that sufficient steps have been taken to vest full shareholder status. This often requires no more than the examination of a treasurer's certificate attesting that the shareholder paid the purchase price, that the corporation's stock records reflect the issuance, and that the shares are outstanding.

Many state statutes (and Article 8 of the Uniform Commercial Code) contain detailed provisions for uncertificated stock, but these provisions seldom are used. When the opinion relates to uncertificated stock, the lawyer also should confirm that the special statutory requirements for such stock have been satisfied.

86. See F. Christie, The Transfer of Stock § 11 (5th ed. 1975):
The issue of stock, in common understanding, means the issue of certificates. But . . . a stock certificate is not necessary to the ownership of stock, and, as a legal matter, stock may be considered issued prior to the issuance of a certificate. Hence, stock may be considered issued when the certificate has been made out but not actually delivered; or when the certificate has been detached from the stock certificate book. Acceptance of payment for the stock may be considered issuance, regardless of the execution and delivery of a certificate. (Citations omitted). But see New York Report, supra note 1, at 1910. Further authorities are cited in 11 W. Fletcher, Cyclopedia of the Law of Private Corporations § 5159 (rev. perm. ed. 1986).

87. See Revised Model Business Corp. Act § 6.26(a) (1984), for example, which provides that "[u]nless the articles of incorporation or bylaws provide otherwise, the board of directors of a corporation may authorize the issue of some or all of the shares of any or all of its classes or series without certificates." Section 6.25(a) provides that "[u]nless this Act or another statute expressly provides otherwise, the rights and obligations of shareholders are identical whether or not their shares are represented by certificates." Uncertificated stock provisions sometimes require delivery of a statement to the transferee. See, e.g., Del. Code Ann. tit. 8, § 151(f) (1983); Revised Model Business Corp. Act 6.26(b) (1984).

Statutes providing for uncertificated stock often leave it unclear what steps are required to "deliver" such stock or complete its transfer to the holder. Absent a provision of corporate law, charter, or by-law on the point the general commercial law of stock transfer governs the question. See American Bar Association Corporation Section Committee on Corporate Laws, Changes in the Model Business Corporation Act Revising Sections 23, 24 and 81—A Report of Committee on Corporate Laws, 33 Bus. Law. 935, 937 (1978). The Comment to Section 23 of the Model Business Corporation Act states that "[i]t is not contemplated that the foregoing amendment [adding language relating to uncertificated stock] would be enacted without the prior or concurrent enactment of a commercial statute which sets forth in detail rules with respect to the issuance, transfer and registration of uncertificated shares." Id. Section 8-313(1)(b) of the Uniform Commercial Code (1977) provides that "[t]ransfer of a security . . . to a purchaser occurs . . . (b) at the time the transfer . . . of an uncertificated security is registered to him or a person designated by him. . . ." Under such a provision, unless corporate law or the charter documents require a different approach the lawyer could not give the "validly issued" opinion until the transfer of the uncertificated stock is reflected in the stock records of the corporation.
Sixth, the "validly issued" opinion confirms that the corporation has not taken steps that deprive the stock of its "validly issued" status. Shares could cease to be "validly issued," for example, if the corporation reacquired them and restored them to unissued status or if the corporate existence ended through merger or dissolution.

C. What it Means to Opine that Stock is "Fully Paid and Nonassessable"

When the relevant corporation statute defines the term "fully paid and nonassessable," the statutory definition is controlling. The Delaware statute defines the term as follows:

The consideration, as determined pursuant to subsections (a) and (b) of § 153 of this title, for subscriptions to, or the purchase of, the capital stock to be issued by a corporation shall be paid in such form and in such manner as the board of directors shall determine. In the absence of actual fraud in the transaction, the judgment of the directors as to the value of such consideration shall be conclusive. The capital stock so issued shall be deemed to be fully paid and nonassessable stock, if: (1) The entire amount of such consideration has been received by the corporation in the form of cash, services rendered, personal property, real property, leases of real property, or a combination thereof; or (2) not less than the amount of the consideration determined to be capital pursuant to § 154 of this title has been received by the corporation in such form and the corporation has received a binding obligation of the subscriber or purchaser to pay the balance of the subscription or purchase price; provided, however, nothing contained herein shall prevent the board of directors from issuing partly paid shares under § 156 of this title.

The Revised Model Business Corporation Act provides that "[w]hen the corporation receives the consideration for which the board of directors authorized the issuance of shares, the shares issued therefor are fully paid and nonassessable." This section analyzes what "fully paid and nonassessable" means when the relevant statute does not define those terms.

1. What it means to opine that stock is "fully paid."

a. First, the "fully paid" opinion confirms that the corporation has received lawful consideration for the stock. Corporation statutes, state
constitutions, and case law often specify what consideration is lawful and what is not. The Revised Model Business Corporation Act takes a very permissive approach, and provides that a corporation may issue stock for "any tangible or intangible property or benefit to the corporation, including cash, promissory notes, services performed, contracts for services to be performed, or other securities of the corporation."\(^9\) The Official Comment states that "[t]he term 'benefit' should be broadly construed to include, for example, a reduction of liability, a release of a claim, or benefits obtained by a corporation by contribution of its shares to a charitable organization or as a prize in a promotion."\(^92\) However, many jurisdictions are more restrictive. The Texas constitution, for example, provides that "[n]o corporation shall issue stock or bonds except for money paid, labor done or property actually received, and all fictitious increase of stock or indebtedness shall be void."\(^93\) Common examples of unlawful consideration are notes (especially unsecured notes), services rendered prior to incorporation, promises to perform services,\(^94\) and intangible items such as good will and ideas.\(^95\)

Even jurisdictions with fairly restrictive statutes may treat contract rights, patent rights,\(^96\) marketable securities,\(^97\) and releases of claims against the corporation\(^98\) as lawful consideration. One Delaware authority indicates that the restriction on the issuance of stock for notes is successfully avoided when an employee borrows funds from the company and uses the proceeds to pay for the stock.\(^99\)

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Some lawyers take the position that when an amount equal to par value is received in lawful form, the stock is fully paid even if further payments are in the form of notes or other impermissible consideration. See 1 BALOTTI & FINKELSTEIN, supra note 12, § 5.9 (1986) ("Since any amounts received for the stock in excess of those which will make up the capital of the corporation are discretionary, there is no reason why they should be made subject to the [Delaware] constitutional tests.").

The lawyer could not give the "fully paid" opinion about stock issued for unlawful consideration even though a suit to have the stock declared void might fail on some equitable grounds such as estoppel arising from consent by the corporation or the other stockholders. See Frasier v. Trans-Western Land Corp., 210 Neb. 681, 682-92, 316 N.W.2d 612, 615-18 (1982) (holding that plaintiff was estopped from asserting that stock had been issued for unlawful consideration).

91. Section 6.21(b) (1984).
92. Id. (official comment).
93. TEX. CONST. art. XII, § 6. See TEX. BUS. CORP. ACT ANN. art. 2.16A (Vernon 1980) (to similar effect).
94. See TEX. CONST. Art. XII, § 6.
95. HENN & ALEXANDER, supra note 41, § 167.
99. 1 BALOTTI & FINKELSTEIN, supra note 12, § 5.9 (1986): The prescription against the use of a promissory note as consideration for the payment of stock would no longer seem to prevent the issuance of shares to officers and other
b. Second, the "fully paid" opinion confirms that the corporation has received any minimum paid-in capital required by statute or charter and, in the case of par value stock, lawful consideration in an amount not less than par. In some states, receipt of par value is a statutory requirement. The New York statute, for example, provides that "[s]hares with par value may be issued for such consideration, not less than the par value thereof, as fixed from time to time by the board." In other states, the requirement is a matter of judge-made corporate law. As discussed below, special rules apply to stock dividends, stock splits, and issues of treasury stock.

Questions often arise as to the "fully paid" status of shares to be issued under earnout, contingent share, and other contractual arrangements calling for the issuance of additional shares without the payment of any additional employees as an incentive to performance since the General Corporation Law now permits loans to be made to officers and employees where the loan may reasonably be expected to benefit the corporation. The consideration for the shares would be the proceeds of the loan. It is probably advisable to handle such a transaction in two parts: (1) the money is paid to the officer or employee pursuant to a loan agreement, and (2) the money is paid by the officer or employer to the corporation in payment for the shares of stock.

A few state statutes require corporations to receive some minimum amount prior to commencing business or require the charter to include such a provision. The Texas statute, for example, requires articles of organization to include:

A statement that the corporation will not commence business until it has received for the issuance of shares consideration of the value of a stated sum which shall be at least One Thousand Dollars ($1,000), consisting of money, labor done, or property actually received.

TEX. BUS. CORP. ACT ANN. art. 3.02A(7) (Vernon 1980).

100. A few state statutes require corporations to receive some minimum amount prior to commencing business or require the charter to include a provision. The Texas statute, for example, requires articles of organization to include:

A statement that the corporation will not commence business until it has received for the issuance of shares consideration of the value of a stated sum which shall be at least One Thousand Dollars ($1,000), consisting of money, labor done, or property actually received.

TEX. BUS. CORP. ACT ANN. art. 3.02A(7) (Vernon 1980).

101. Unless the law permits payment of a lesser amount, as some jurisdictions do for issuances under exigent corporate circumstances. See 1 BALOTTI & FINKELSTEIN, supra note 12, § 5.9 (1986) ("There is no Delaware decision approving or disapproving the doctrine of Handley v. Stutz, 139 U.S. 417 (1891) which permits sales of newly issued stock below par where capital is impaired and the sale is to raise funds to enable the corporation to recoup and prosecute its business successfully."); BALLANTINE ON CORPORATIONS §§ 200 and 344 (rev. ed. 1947); HENN & ALEXANDER, supra note 41, § 167. Some jurisdictions permit organizing expenses and underwriters' compensation to be deducted from the amount received even if that amount is less than the par after the deduction. See, e.g., N.Y. BUS. CORP. LAW § 507 (McKinney 1986).

When par value has been changed by charter amendment, the lawyer should determine which par value was in effect when the shares were issued. But see JACOBS, supra note 1, at 4-40 (implying that corporation must receive an amount based on the par value in effect on the contract date even if a lower par value was in effect on the date of closing).

The Massachusetts statute permits investors to give notes for stock but not in satisfaction of the par value requirement. It provides:

Capital stock may be issued for cash, tangible or intangible property, services, or for a debt or note. Stock having par value shall not be issued for cash, property, services or expenses worth less than the par value. For the purposes of the second sentence, a debt or note of the purchaser secured or unsecured shall not be considered property.


102. N.Y. BUS. CORP. LAW § 504(c) (McKinney 1986).

103. See 11 FLETCHER, supra note 86, § 5200 and cases cited therein.

104. See infra notes 112-23 and accompanying text.
consideration. When the maximum number of shares is fixed and the consideration to be received under a contract exceeds the aggregate par value of all the shares that may be issued, the contract price satisfies the consideration requirement for all the shares.\textsuperscript{105} But when the maximum number of shares to be issued under the contract is not fixed, and the contract limits the amount of consideration payable, the aggregate par value of the shares issued might exceed the contract price under some circumstances.\textsuperscript{106} One solution is to include in the opinion an assumption that the amount paid under the contract will at least equal the aggregate par value of all the shares issued. Another approach is to rely upon a contractual undertaking between the parties to take whatever action is required to comply with par value requirements.

A similar problem arises with regard to shares that may be issued in the future under an incentive stock option plan permitting the award of options exercisable at not less than market value on the date the options are granted. A common solution is to include in the plan a provision prohibiting the grant of options that are exercisable for less than par value. Another solution is to assume in the opinion that the market price will exceed par value at the time options are granted or simply that the exercise price will not be less than par.

When the consideration paid for par shares is other than cash, many statutes establish a presumption that the board’s valuation of the consideration is conclusive in the absence of fraud.\textsuperscript{107} Case law in many states is to the same effect.\textsuperscript{108} Lawyers are entitled to rely on these presumptions in satisfying themselves that the value of the noncash consideration is at least equal to the aggregate par value of the shares. Such reliance may be inappropriate, however, when the directors issue stock to themselves or are otherwise personally interested.\textsuperscript{109}

\textsuperscript{105} When the shares are to be issued and the consideration received after the date of the opinion, the opinion ordinarily is modified to read as follows: “upon receipt of the consideration required by the Agreement, the shares will be fully paid. . . .”

\textsuperscript{106} This might take place under so-called contingent share contracts, for example, under which an acquiring company commits to deliver enough additional shares of its stock that the total consideration paid has a specified minimum market value as of some later date. If the market price of the stock later declines, so many additional shares might have to be issued that their aggregate par value would exceed the value of the consideration. The problem could also arise under some antidilution clauses where subsequent sales of stock are at a very low price.

\textsuperscript{107} See, e.g., N.Y. Bus. Corp. Law § 504(a) (McKinney 1986), which provides that “[i]n the absence of fraud in the transaction, the judgment of the board or shareholders, as the case may be, as to the value of the consideration received for shares shall be conclusive.”

\textsuperscript{108} See Henne & Alexander, supra note 41, § 167.

\textsuperscript{109} 1 Balotti & Finkelstein, supra note 12, § 5.9 (1986) (“The directors whose judgment as to the value of property is conclusive in the absence of actual fraud must not be personally interested in the transaction, and if they issue the stock to themselves or are otherwise interested, the ‘actual fraud’ provision of Section 152 [of the Delaware statute] does not apply to give any weight to their valuation.”). See Maclary v. Pleasant Hills, Inc., 35 Del. Ch. 39, 46, 109 A.2d 830, 835 (Del. Ch. 1954) (“directors cannot evaluate their own services and determine the amount of stock to be issued therefor.”).
c. Third, the "fully paid" opinion confirms that the purchasers have paid all consideration called for by the corporation's charter and by-laws, resolutions of its shareholders and directors, and any applicable stock purchase agreement or similar contract. Special consideration requirements may be contained in stock options and warrants, employee benefit plans, merger agreements, and the like.

Hard questions can arise when the consideration contemplated by the relevant resolutions or contracts includes future payments such as those required by a note or installment purchase agreement, or when it includes an obligation to perform services, for example under an employment agreement. In many states, such consideration would not be lawful and the stock would not be fully paid until the employee has fully performed the obligation. In states where such consideration is lawful, however, the questions arise whether stock can be "fully paid" before the obligations have been performed and, if so, whether the stock would continue to be "fully paid" following a default. The answer to those questions should be yes on the grounds that the corporation has received all that it bargained for: namely, lawful consideration in the form of a promise by the purchaser and a right to enforce that promise. And once stock has achieved "fully paid" status, it ought not to lose that status as a result of subsequent actions by the initial purchaser such as a default on the note or a failure to perform required services. This conclusion is consistent with the view set forth above that, once given, an opinion as to the "duly authorized, validly issued, and fully paid" status of outstanding shares ought to continue to be true until the corporation merges, dissolves or takes some other action to change the status of those shares or until their status changes automatically under a charter or by-law provision or by operation of law.

d. Stock dividends and stock splits present a special case. In general, shareholders need pay no consideration for shares received in a stock split or as a stock dividend, even for par value stock. In the case of a stock split, the par value per share ordinarily is reduced so that, while the number of authorized shares is increased, the capital account of the corporation remains unchanged.

In the case of a dividend of par value stock, the capital account must, under the corporate law of many states, be increased by the par value of the additional shares, and this is done by transferring from the corporation's surplus account to its capital account an amount at least equal to the par

110. Thus, if the resolutions specified a particular cow as consideration for the stock the lawyer could give an unqualified "fully paid" opinion even if everyone in the company expected to receive a fertile cow but in fact the cow turned out to be sterile. This question will seldom arise, since in the standard opinion counsel expressly relies on a treasurer's certificate stating that the company received for the shares the consideration called for by the authorizing resolution.

111. See supra text accompanying notes 5-6.
value of the new shares. To opine that shares distributed as a stock dividend are fully paid, the lawyer must be satisfied that enough surplus is available to satisfy such a requirement. In many cases he simply can rely upon the corporation’s financial statements for this purpose. However, what is surplus under corporate law is not necessarily an accounting matter, and may involve legal judgments on such questions as whether a paid-in capital account can be used for stock dividends when the corporation has an offsetting retained earnings deficit, or whether surplus on a consolidated balance sheet can be used to support a parent company’s stock dividend. Some states permit a company to use revaluation surplus to pay dividends, thus raising the question whether diminutions in value also must be taken into account. Other difficult questions as to how to calculate surplus sometimes arise when the corporation has reacquired its stock or when conversion rights have been exercised. Even if sufficient surplus is not

112. Such a transfer often is required by statute. Cf. Del. Code Ann. tit. 8, § 173 (1983), which provides:

If [a] dividend is to be paid in shares of the corporation’s theretofore unissued capital stock the board of directors shall, by resolution, direct that there be designated as capital in respect of such shares an amount which is not less than the aggregate par value of par value shares being declared as a dividend and, in the case of shares without par value being declared as a dividend, such amount as shall be determined by the board of directors.

Some statutes make it clear that some such accounting step satisfies the consideration requirement. The Michigan statute, for example, provides that “[t]hat part of the surplus of a corporation transferred to stated capital upon issuance of shares as a share dividend shall be the consideration for issuance of the shares.” Mich. Comp. Laws Ann. § 450.1311(4) (West 1973). See California Report, supra note 1, at 1052 (discussing such issues under California law).

113. A good case for permitting a dividend under these circumstances may be presented under statutes, such as Michigan’s, that distinguish between different types of capital. See Mich. Comp. Laws Ann. §§ 450.1341-450.1381 (West 1973).

114. E.g., Indiana Code Ann. § 23-1-28-4 (Burns Supp. 1986). See Revised Model Business Corp. Act § 6.40(d) (1984). A leading corporate law treatise states that “[i]t may well be that most courts . . . presented with facts indicating that the redetermined values were valid” would adopt a permissive attitude. R. Clark, Corporate Law § 14.3.6 (1986). See Morris v. Standard Gas & Elec. Co., 31 Del. Ch. 20, 36, 63 A.2d 577, 584-85 (1949) (where directors who revalued assets “took great care to obtain data . . . and exercised an informed judgment on the matter . . . this court cannot substitute . . . its own opinion of value for that reached by the directors where there is no charge of fraud or bad faith.”); 1 Balotti & Finkelstein, supra note 12, § 5.17 (1986) (“On occasion the books may reflect a historical cost of assets which is wholly unrealistic in terms of present day actual market value. In such a situation the directors may revalue the assets (upwards or downwards) on the basis of such information as they consider to be reliable, and may even be required to do so, in which event revaluation should be applied to all assets and liabilities and not merely those selected by the directors.”). The Ohio statute permits the use of revaluation surplus for stock dividends but not cash dividends. Ohio Rev. Code Ann. § 1701.33(a) (Baldwin 1982).


available, "nimble dividend" provisions may permit the company to pay the dividend based on recent earnings.\footnote{117. See I BALOTTI & FINKELSTEIN, supra note 12, § 5.22 (Delaware law permits stock dividends under the "nimble dividend" approach).}

\textit{e.} Treasury stock presents another special case. In some states, normal consideration requirements are excused when previously issued stock is transferred out of the treasury.\footnote{118. See, e.g., N.Y. Bus. Corp. Law § 504(e) (McKinney 1986); Highlights for Children, Inc. v. Crown, 43 Del. Ch. 323, 328, 227 A.2d 118, 121 (1966); I BALOTTI & FINKELSTEIN, supra note 12, § 5.9 (under Delaware law, "[t]he consideration for [treasury] stock having already been received upon its original issue, and the repurchase having been made out of surplus rather than capital, the treasury stock may now be sold by the corporation for such prices and upon such terms as may be determined by the directors in a good faith exercise of their business judgment.") (citations omitted); HENN & ALEXANDER, supra note 41, at 422 ("With respect to the realallottment of treasury shares, the usual consideration requirements are ordinarily inapplicable."). But see Public Investment Ltd. v. Bandeirante Corp., 740 F.2d 1222, 1223 (D.C. Cir. 1984) (holding that the District of Columbia's statutory prohibition on the sale of stock for notes applied to a sale of treasury shares).}

Preemptive rights may be inapplicable as well.\footnote{119. Johnson v. Duensing, 340 S.W.2d 758, 766 (Mo. App. 1960); HENN & ALEXANDER, supra note 41, § 174. Even when statutory preemptive rights are inapplicable to treasury shares, directors under some circumstances may have a fiduciary duty to offer shareholders an opportunity to participate in an offering. See Schwartz v. Marren, 43 A.D.2d 307, 307-308, 351 N.Y.S. 2d 216, 217-18 (1974). For other opinion questions presented by preemptive rights, see text accompanying notes 47, 60-61, and 82, supra.}

In passing on a sale of shares that would not qualify for a "validly issued" opinion if the shares were not being sold from the treasury (for example because statutory consideration requirements are not satisfied), the lawyer must determine that the shares were "duly authorized, validly issued, and fully paid" prior to their reacquisition and that the company's charter and by-laws permitted the reacquisition: that it did not, for example, contravene provisions designed to restrict repurchase of shares from a hostile shareholder. The lawyer also must confirm that the reacquisition was duly approved by the appropriate corporate body and effected out of legally available funds\footnote{120. See R. CLARK, CORPORATE LAW § 14.6 (1986). Courts may permit reacquisitions out of revaluation surplus. See Vowteras v. Argo Compressor Serv. Corp., 77 A.D. 2d 945, 946, 431 N.Y.S. 2d 136, 138 (1980), modified, 83 A.D. 2d 834, 441 N.Y.S. 2d 562 (1981).} and that the reacquired shares were not returned to authorized but unissued status.\footnote{121. See supra note 38 and accompanying text.}

Some states limit the use of treasury shares depending on how they were reacquired. Texas, for example, forbids the use of treasury shares for stock dividends unless those shares have been "reacquired out of surplus of the corporation."\footnote{122. TEX. BUS. CORP. ACT ANN. art. 2.38A(2) (Vernon 1980).} Many sales of treasury shares would qualify for a "validly issued" opinion even if the shares were not being sold from the treasury. The lawyer may not have to examine the original issuance of those shares and their reacquisition by the company if under applicable corporate law defects in...
the original issuance or reacquisition of such shares would not affect the rights of the purchasers.

Shares sometimes are reacquired from unfriendly shareholders or as part of a takeover defense. Such transactions may raise questions about the directors' discharge of fiduciary duties, but the lawyer is not passing on such questions when rendering an opinion on the sale of treasury shares.

2. What it means to opine that stock is "nonassessable."

The opinion that stock is "nonassessable" confirms that ownership of the stock does not subject its holder to an obligation to make further payments to the corporation. For example, the opinion confirms that stockholders are not subject to liability under the sort of statute and charter, once common but today not, under which the corporation could require further payments from shareholders to help meet expenses.

The opinion does not mean that shareholders are immune from other types of liability: for example, to the corporation for unlawful dividends or to the corporation's creditors under a "piercing the corporate veil" theory. Similarly, the opinion should not mean that shareholders are immune from liability for unpaid corporate wages when the right to sue belongs to the employees rather than the corporation. Some authorities, however, recommend that lawyers disclose the problem when opining on the stock of corporations organized in states that impose such liability and lawyers often follow this practice.

D. What it Means to Opine on the Number of Shares Outstanding

The standard stock opinion sometimes includes a recitation as to how many shares of a company's stock are "outstanding." When the shares

124. See, e.g., N.Y. BANKING LAW § 114 (McKinney 1971).
125. See Babb, Barnes, supra note 1, at 568. An example of a statute imposing such liability is MASS. GEN. LAWS ANN. Ch. 156B, § 45 (1970).
126. Babb, Barnes, supra note 1, at 568.
127. See N.Y. BUS. CORP. LAW § 630(a) (McKinney 1986) (giving employees a right to recover unpaid wages).
128. E.g., Wolfson 1985, supra note 5, at 88; New York Report, supra note 1, at 1912 ("Although these statutes may not technically be assessment statutes (because liability depends on the identity of the holder), the Committee recommends that such questions must be addressed in the opinion as if assessments were involved."); Fuld, Legal Opinions, supra note 1, at 934; Romeo, supra note 4, at 138.
129. See Davis, Shareholder Liability for Claims by Employees, Wis. L. REV. 741, 759 (1984) ("I spoke with several corporate lawyers both in the large Milwaukee law firms and from around the state. Their strongly preferred practice when dealing with the shares of a Wisconsin corporation is to give the 'fully paid and nonassessable' opinion only in a qualified form" because of the Wisconsin statutory imposition on shareholders of liability for unpaid wages.). See Wis. STAT. § 180.40(6) (1957). Note that Wisconsin's statute provides that shares "shall be deemed to be fully paid and nonassessable by the corporation" when consideration is received. Wis. STAT. § 180.15(1) (1957).
130. One form of words is that "[t]he Company's authorized capital stock consists of
also are described as "duly authorized, validly issued, fully paid and non-assessable," an opinion on the number of "outstanding" shares adds only a factual statement as to the number of shares the corporate records indicate are in the hands of stockholders. Lacking legal content, such a statement more properly belongs in the company's representations, and lawyers are well justified in refusing to include it as part of a standard stock opinion.

Outside the context of the standard stock opinion, a statement that a certain number of shares is "outstanding" has no clear meaning and lawyers ordinarily should avoid it. The term "outstanding" might, for example, be read to cover almost all of the points covered by the standard stock opinion.

E. What it Means to Opine that Stock Certificates are in "Proper Form" or "Due and Proper Form"

The opinion that stock certificates are in "proper form" or in "due and proper form" means that the certificates comply with the requirements as to form set forth in applicable corporate law, the charter, the by-laws, and any resolutions of the shareholders or directors. Statutes often require that stock certificates set forth the name of the corporation, the number of shares, the existence of more than one class or series of stock, and any restrictions on transfer and that they be signed by specified corporate officers. When
facsimile signatures are used, statutes may establish requirements for execution by a transfer agent. Sometimes statutes also require disclosures relating to voting agreements, voting trusts, and the status of shares as partly paid.

Subject to statutory limitations, directors have broad discretion as to the form of stock certificates and soon after the company is organized usually approve, as the corporation's stock certificate, a printed form included in a prepackaged corporate organization kit.

When a company goes public or issues a new class of stock, a new form of certificate typically is required. Counsel should take care that the board of directors duly adopts a resolution approving the new form of certificate.

II. SUPPORTING THE OPINION

Corporate lawyers commonly opine on the status of the stock of corporations organized under the laws of their own state and, unless special problems are presented, under the laws of Delaware. For corporations organized under the laws of other jurisdictions, lawyers commonly rely on opinions of local counsel or offer such opinions in place of their own.

When not relying on local counsel, an opining lawyer should examine:

A. Legal authorities

The lawyer should review the statute under which the corporation was organized¹³⁵ and other relevant corporate law authorities, such as judicial decisions, to confirm that the stock's terms, its issuance, and the consideration received for it were lawful, that no preemptive rights were violated, that procedural requirements were met, and that the stockholders cannot be compelled to make further payments for their shares. The relevant law on most of these points is that in effect when the stock in question was authorized and issued. With older corporations this may present a difficult research problem, since it may be hard to reconstruct the statute as in effect at a particular time.

B. Corporate records relating to the stock in question

The lawyer should review the charter, the by-laws, the stock record book, the stock transfer ledger if there is one,¹³⁶ minutes of shareholders' and directors' meetings relating to the stock and the form of stock certificate¹³⁷

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¹³⁵. Some states apply aspects of their corporate law to foreign corporations that do business in the state. See, e.g., Joncas v. Krueger, 61 Wis.2d 529, 536, 213 N.W.2d 1, 5 (1973) (holding that the Wisconsin statute's imposition on shareholders of liability for unpaid wages applies to holders of stock in foreign corporations doing business in Wisconsin).

¹³⁶. A public company usually retains a stock transfer agent who will furnish a certificate concerning the company's outstanding shares.

¹³⁷. See text at notes 20-25, 62-85, and 110-111, supra. The lawyer also should examine any documents incorporated by reference into the stock certificate. Under the Uniform Commercial Code, even purchasers without notice may be subject to the provisions of such documents. U.C.C. § 8-202(1)(c) (1977).
to confirm that the stockholders, directors and officers have taken all steps necessary for the authorization and issuance of the stock and to determine what conditions they may have imposed on the stock's issuance and sale. Often, the lawyer confirms delivery of the shares by attending the closing. When the stock is issued upon the exercise of stock options, the lawyer should examine the plan and the form of option certificate together, in each case, with the resolutions adopting the plan, authorizing the stock issuance and approving the award of options. When the stock is treasury stock, the lawyer also should examine the records relating to its original authorization and sale and its reacquisition by the company.

If the stock was issued as a dividend, the lawyer should examine the balance sheet of the corporation or an accountant's or officer's certificate to determine whether the necessary surplus was available and was transferred to capital, keeping in mind, of course, that surplus for corporate law and accounting purposes may be different. If the stock was created in a stock split, the lawyer should determine that the par value per share was adjusted appropriately or that the capital account was increased, to the extent necessary, by a transfer from available surplus.

C. Documents relating to other equity securities of the company

The lawyer should examine the minutes of shareholders' and directors' meetings generally and the corporate stock records, with special attention to other transactions by the company in its stock. Such examinations sometimes uncover prior stock sales that have reduced the number of authorized but unissued shares, actions by the directors to reserve authorized shares for a particular purpose, and arrangements involving restrictions on the company's right to create or issue senior securities.

D. Certificates from state officials

The opinion on corporate stock is almost always accompanied by an opinion regarding the company's status as a validly existing corporation. To give the corporate status opinion, counsel usually relies, in part, on certificates from state officials, including a long form legal existence certificate listing all charter documents on file with the secretary of state, certified charter documents, and sometimes bring-down telegrams. The lawyer also should examine these documents as a basis for the corporate stock opinion, to confirm that the charter and charter amendments he has been furnished by the company are, in fact, the ones on file with the secretary of state and that the corporation has not filed any other amendments. When shares are

138. When stock is issued pursuant to a board resolution in states such as Massachusetts that permit directors to issue stock only if so authorized by a charter or by-law provision, the lawyer should confirm the existence of such a provision.
139. See supra notes 118-23 and accompanying text.
140. See supra notes 112-17 and accompanying text.
being issued under a recently approved charter amendment, counsel must take care to confirm that the state secretary has endorsed the amendment or taken any other action required to make the amendment effective. In some jurisdictions, counsel also should examine certificates of increase in capital stock and, under certain circumstances, certificates relating to regulatory approvals, such as certified copies of Department of Public Utility orders.

E. Certificates of company officers

As in the case of the corporate status opinion, counsel should obtain certificates of company officers relating to the corporation’s constituent documents and minutes and attesting to the signatures of officers and to the continued effectiveness at the closing date of any required regulatory approvals. In addition, such certificates should attest to the form of stock certificate, the delivery of the shares in accordance with the authorizing resolutions, and the receipt of the requisite consideration. Where a resolution authorizing the stock issuance was adopted many years previously, lawyers often attach to the certificate a copy of the resolution and have the clerk confirm that it is still in force and has not been amended. Officers’ certificates may relate not only to steps taken at the closing, but also, when the opinion covers previously issued shares, to steps taken many years earlier.

III. Handling Defects

When the lawyer learns of a material defect, he rarely can solve the problem by delivering a reasoned or qualified opinion or omitting any portion of the standard formula that the stock is “duly authorized, validly issued, fully paid and nonassessable.” Instead, the lawyer will try to find a way to correct the defect.

This ordinarily will not be too difficult when the defect relates to stock that is about to be issued. For example, the shareholders can be asked to adopt a charter amendment increasing the number of authorized shares or correcting a preferred stock provision. A meeting of the board can be convened to ratify past actions or to approve amended resolutions, and corporate officers can seek waivers of preemptive rights from existing shareholders.

Curing defects, however, is not always so simple. Sticky problems arise when stock has previously been issued, especially when the issuance violated the corporation’s charter. Suppose, for example, that shareholders at a telephone meeting adopted a key charter amendment increasing the number of authorized shares and that, as is the case in many states, telephone meetings of shareholders (as opposed to directors) are not expressly authorized by the corporation statute. If the company later has used the newly authorized stock to go public, ratification by shareholders may be impractical and, even if it is not, questions might arise as to the validity of a ratification

141. Omitting a statement as to the number of shares outstanding may well be acceptable.
in a state that requires the filing of charter amendments within a specified period after the shareholder vote.\textsuperscript{142} Under some circumstances, the lawyer may be able to conclude that telephone meetings of shareholders are permitted despite the silence of the statute. Alternatively, if one shareholder who participated in the telephone meeting owned sufficient shares, the lawyer might be able to conclude that a valid nontelephone meeting was held at whatever place that shareholder happened to be (in which event waivers of notice would have to be obtained from the other shareholders).

A similar problem would arise when the board of directors issued stock in contravention of a statutory requirement that board authority to issue stock be set forth in the charter, the by-laws or both. If all the outstanding stock suffers from this defect, counsel will often be able to solve the problem by having the incorporator ratify the issuance, at least in states where the incorporator has the powers of the stockholders. If the incorporator has died but was counsel and clerk for the corporation when the stock issuance was attempted, the lawyer may be able to conclude that the incorporator took whatever action was needed to validate the stock issuance. The lawyer could then prepare appropriate records for certification by one of the original officers as temporary clerk, attesting that such action did indeed take place.

To take another example, suppose that shares were issued under a board resolution providing for non-statutory consideration such as future services or cash in an amount less than par value. One approach would be for the directors to adopt a new resolution amending their previous resolution to conform to statutory requirements and for the company then to obtain proper consideration from the purchasers.\textsuperscript{143} Another approach, when the consideration paid was less than par value, would be for the shareholders to reduce the par value by amending the charter and to adopt a resolution ratifying the issuance of the stock.

Defective stock problems can also sometimes be solved by the corporation's repurchasing the defective stock or exchanging new, properly authorized and issued stock for the defective shares. If all else fails, a merger into a new corporation with properly issued securities usually will cure the defect.

When curative steps such as these require shareholder action, the safest course is to treat the holders of the defective stock as shareholders for such purposes as voting and notice, and to obtain shareholder approval by a margin that is large enough whether or not the defective shares are counted.


\textsuperscript{143} When a stock issuance is invalid because the consideration received was a promissory note, an alternative solution would be to have the purchaser discharge the debt. See Area, Inc. v. Stetenfeld, 541 P.2d 755, 757-61 (Alaska, 1975) (concluding, after extensive discussion, that such a cure would be effective).
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