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SIGNIFICANT TRENDS IN MODERN INCORPORATION STATUTES

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The quadrennium of 1887 to 1890 was a red-letter period in the history of governmental regulation of American corporate business. During those four years the American system of government, viewed as an entirety, fairly may be said to have mounted the horse of regulation of corporate enterprise and ridden off in all directions. More accurately stated, the Federal Government mounted one horse and galloped away in one direction, while the state governments climbed upon the back of another and headed him toward exactly the opposite point of the compass.

Executive approval of the Sherman Anti-Trust Act[1] on July 2, 1890, brought to a legislative culmination two decades of popular discussion of trusts and monopolies. While the Act was not limited by its terms to corporations, there is little room for doubt that the basic motivation for its passage was fear of the growth of corporate combinations to gigantic size. Thirty years later the Supreme Court of the United States declared that the statute did not inhibit "mere size."[2] However one may regard this interpretation in the light of the industrial, international and constitutional environment of 1920, he would be naïve or hardy in blindness to the facts and prevailing opinions of national life in the 80's and 90's who would deny the purpose and design of the act to keep business units small. That generation sensed the danger to the prevailing competitive system in permitting the growth and multiplication of corporate dinosaurs.

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1. 26 Stat. 209, c. 647, 15 U. S. C. A. §§ 1-7, 15 (1890).

2. United States v. United States Steel Corporation, 251 U. S. 417, 40 S. Ct. 293, 64 L. ed. 343 (1920).

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Wholly apart from this policy, which is reflected in the language of the Act more by implication than by direct assertion, the statute is significant for an altogether different reason, though one highly pertinent to the underlying policy. It constituted the first major effort of the Federal Government in the direct regulation of the general system of corporate business.[3] A prior step in this direction, but one much more limited in its scope and power, had been taken in 1887, when Congress established the Interstate Commerce Commission[4]. But the Commission was not to achieve full stature until two decades later.[5] In any event, the combined effect of the two statutes was to start the Federal Government off on a long and constantly extending journey in the limitation and regulation of corporate enterprise. This, of course, has reached its latest stopping-point in the New Deal's corporate legislation. Whatever variations from original objectives may have occurred, the net result of this half-century's legislation has been to commit the Federal Government to a practice and a policy of extensive corporate regulation.

Prior to 1890 direct regulation of general corporate business had been left to the states. This function they had exercised primarily through controls provided as integral portions of their general incorporation laws.[6] On the whole, and with only one or two notable exceptions, the states had performed the function of control to the extent of their ability. Practically every general incorporation law in force prior to 1890 contained rigid limitations upon the scope and freedom of corporate activity. These reflected a general and all-pervading attitude of suspicion, if not of fear, toward the corporate institution. "Freedom of incorporation" then meant only freedom to incorporate on rigidly re-

3. The emphasis is upon the word *direct*. It is recognized, of course, that from the very outset the national government has exercised a profound influence upon business activity through tariff and other legislation. But the direct regulation of corporate activity was considered primarily a state function prior to this period.

4. 24 Stat. 379, 49 U. S. C. A. § 1 (1886).

5. With the passage of the Hepburn Act, June 29, 1906, 34 Stat. 584, c. 3591.

6. By this statement it is not intended to minimize the regulatory effect of the so-called "granger" legislation. The purpose is rather to call attention to the much wider scope of application of the regulatory provisions of the general incorporation laws. These extended to the entire incorporated community of the state, not merely to particular and special industries and businesses.

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strictive provisions, not, as it has come to mean lately, freedom from restrictions in incorporation. One may accept Professor Dodd's summary of the philosophy of the Massachusetts general incorporation statutes in force in 1886 as fairly typical. He says:

> "This statute plainly envisages the business corporation as an enterprise of definite scope, capable of obtaining new capital but not, as against the opposition of a single shareholder, of changing its general character, simple in its capital structure, democratically controlled, in theory at least, and reasonably assured of beginning business with funds adequate to enable it to meet its obligations."[7]

He rightly concludes that the corporation was conceived of largely as "a static enterprise" under this statute and others in force at that time. The general incorporation laws of the nineteenth century were designed primarily to extend the privilege of limited liability to what may be termed "incorporated partnerships" and relatively local "joint-stock companies" rather than for the creation of institutions national in the spread of their securities and activities.

But in 1888 the Legislature of New Jersey adopted a little noted amendment to its general incorporation statutes. This was destined eventually not only to reverse the historic policy of the states toward corporations, but to place state policy in dealing with them fundamentally in opposition to that of the Federal Government. The provision referred to is the statute which conferred power upon New Jersey corporations to purchase and hold stock in other corporations.[8] Limitations of space do not permit us to trace the full or even the major effects of this apparently minor amendment of the laws of one small state. Suffice it to say, however, that, whatever its original purpose, this seemingly simple extension of corporate power has become the foundation upon which subsequent generations of financiers and lawyers have erected the present holding company structure of industry and finance.[9] Probably no one completely visualized this possibil-

7. Dodd, Statutory Developments in Business Corporation Law, 1886-1936 (1936) 50 Harv. L. Rev. 27 at 33.

8. New Jersey Laws of 1888, ch. 269, § 1, p. 385, and ch. 295, § 1, p. 445. Later extensions appeared in New Jersey Laws of 1889, ch. 265, § 4, p. 414; New Jersey Laws of 1893, ch. 171, § 1, p. 301.

9. The provision, or one similar, was adopted generally in the other states, and appears in all the recent general incorporation laws. See text

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ity in 1888. Certainly few recognized in 1890 that New Jersey had forged a tool with which business could weaken, if not destroy, the original fundamental policy of the Sherman Act. The brief period from 1888 to 1890, therefore, presents one of the strangest and most profound paradoxes in American legal and industrial history. Just at the time when the Federal Government was coming to the aid of the states' historic policy toward corportions and was adopting strong measures to make that policy effective, the states themselves began to turn in the opposite direction and to throw their ancient policy aside.

Of course such an about-face did not occur instantaneously. New Jersey merely pointed the way. Other states followed her example, spacing their action over several decades.

Nor was the influence of this example limited merely to widespread adoption of this particular provision. It became rather the entering wedge, first for other alterations and amendments of the old incorporation laws, later for wholesale revamping of such laws.[10] Professor Dodd has traced this process in the two states of Massachusetts and Illinois.[11] Contrasting what we may term the "horse-and-buggy" statute of Massachusetts in 1886 with the "thoroughly-up-to-date model" of 1936, he is struck "by the abandonment of any attempt to limit the size of corporations, by the willingness to allow incorporators a very large measure of freedom to determine the character and internal government of their organization, by the relaxation of earlier re-

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at infra, notes 63-68. The specific sections of the statutes are: Civil Code of Calif. § 341, as amended by L. 1933, c. 533, § 44 (11); Idaho Code 1932, § 29-114; Ill. Bus. Corp. Act, § 5; Ind. Gen. Corp. Act, § 3(7); Laws of La. 1928, Act No. 250, § 12(e) and (j); Mich. Pub. Acts 1931, No. 327, § 10(i) as amended by P. A. 1935, No. 194; Laws of Minn. 1933, c. 300, § 9; Ohio Gen. Code, § 8623-8; Pa. P. L. 1933, No. 106, § 302(6); Rem. Rev. Stat. Wash. 1932, § 3803-12.

The statutes in Idaho, Indiana, Louisiana, Michigan, Minnesota, Ohio, Pennsylvania and Washington include specific authority to guarantee the securities of other corporations, though in Louisiana, Minnesota, Pennsylvania and Washington this power is available only when necessary or incidental "to accomplish its purpose or purposes as stated in its articles of incorporation." A like general limitation appears upon the power to purchase in Pennsylvania and Washington. In California and Ohio specific authority to subscribe for stock in other corporations is given.

10. Reference may be made particularly to the veritable deluge of no-par stock legislation in the decade from 1915 to 1925. The climax of the movement has come, of course, in the widespread adoption of new general, and on the whole "liberal," incorporation laws since 1925.

11. Op. cit. supra, note 7.

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strictions on the consideration for which stock may lawfully be issued, by the abandonment of any attempt to discourage the incurring of an indebtedness exceeding the amount of capital, and by the insertion of a number of provisions designed to facilitate corporate growth and change."[11a] Reviewing a similar evolution in Illinois[12] he concludes that the draftsmen of the acts presently in force have "for the most part sought to conform the provisions of the corporation law to the business practices of the present day rather than attempt to bring about any substantial change in those practices."[12a] In other words, to bring his conclusions within the purview of our paradox, during the half-century in which the Federal Government has been extending its control over corporate enterprise, the states have been engaged simultaneously in abrogating their control.

Although Maine and New Jersey were the original leaders of this movement, they subsequently back-tracked,[13] and Delaware assumed the position of leadership. The climax of the movement has come in the comparatively recent adoption of so-called "modern" or "liberal" incorporation laws in such old-time "conservative" states as California, Illinois, Indiana, Idaho, Louisiana, Michigan, Minnesota, Ohio, Pennsylvania, and Washington.[14] Undoubtedly these states constitute merely the vanguard of a procession which will grow longer and longer until perhaps the entire country will be included. At any rate this area of legislation is an active one, and if the history of state corporate

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11a. Id., p. 38.

12. Ill. Rev. Stats. (1887), chap. 32; Gen. Corp. Act, Ill. Laws, 1919, p. 312; Ill. Rev. Stat. (1935), chap. 32, originally Ill. Laws, 1933, p. 308.

12a. Op. cit. supra, note 7, p. 43.

13. New Jersey's conversion came largely in the progressive administration of Governor Woodrow Wilson. New Jersey Laws 1913, cc. 13-19, followed in 1915 by the adoption of Delaware's new General Corporation Law, Del. Rev. Code (1915) c. 65. See Dodd, op. cit. supra, note 7, p. 43, n. 67.

14. Deering's Civil Code of Calif. 1931, Div. 1, Pt. 4, Tit. I, ch. I-XVI, §§ 277-413 (enacted in 1931); Smith-Hurd Rev. Stat. 1935, ch. 32, §§ 157.1-157.167 (enacted in 1933); Burns' Ind. Stat. 1933, Tit. 25, ch. 1, 2, §§ 25-101 to 25-254 (enacted in 1929); Idaho Code 1932, Tit. 29, ch. 1, §§ 29-101 to 29-164 (enacted in 1929); La. Gen. Stat. 1932, Tit. XIV, ch. I, §§ 1030-1154 (enacted in 1929); Mich. Pub. Acts 1931, no. 327; 1935, no. 13,194 (the original act enacted in 1931); Laws of Minn. 1933, ch. 300; as am. by Laws 1935, ch. 117, 212, 230, (enacted in 1933); Throckmorton's Code (Ohio) 1930, Tit. IX, Div. 1, ch. 1, §§ 8623-1 to 8623-167 (enacted in 1929); Laws of Pa. 1933, no. 106, as am. L. 1935, no. 361 (enacted in 1933); Remington's Rev. Stat. (Wash.) 1932, Tit. 25, ch. 1, §§ 3803-3852, as am. by Rem. 1933 and 1936 pocket supp. (enacted in 1933).

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legislation during the past half-century is not to be reversed, numerous accessions to this group may be expected in the near future.[15] The wide geographic distribution of the states which have acted to date indicates that the problem and the trend are not local or sectional in character. While the new acts vary greatly in specific detail, they have many common elements of change. The trend is almost universally in the directions indicated by Professor Dodd.[16] It becomes a matter of really national importance, therefore, to ascertain the significance of these statutes, in so far as the complexity and variety of detail permit.[17]

Perhaps the most outstanding common tendencies of the new statutes involve: the elimination of visitatorial powers and administrative supervision in the incorporative process coupled with the introduction of a very large amount of freedom of contract in drafting the articles of incorporation; the general abolition of the old restrictive provisions in regard to capitalization and the authorization of new types and almost universally unlimited amounts of security issues; the broad scope of the powers of amendment of the articles with consequent restriction, if not elimination, of the fixed contractual and "vested" rights of the shareholder; the delegation of vastly greater power to the corporation in carrying on its business, together with practically complete abandonment of the notions of limited enterprise and *ultra*

15. The general trend of recent legislation may be expected to continue. The history of recent state legislation, especially as reflected in the no-par stock laws and those conferring power to purchase securities whether of the corporation's own issue or another's, seems to indicate that once such a movement is under way its progress becomes irresistible. Two rather improbable contingencies might check or stop the process, namely the enactment by Congress of a Federal incorporation law of broad and compulsory application coupled with decisions by the Supreme Court sustaining the law in its major applications. It is doubtful, however, whether even these events could stop the march of the states in their own legislation. On the other hand, these events, should they occur, undoubtedly would render the effects of the new state laws much more innocuous than they are at present.

16. Supra, notes 7 and 11a.

17. The author recognizes the validity of Professor Dodd's assertion that "the statutory side of corporation law is far too complex to make any comprehensive treatment of it in a single article at all practicable." Op. cit. supra, note 7, p. 27. But while comprehensive treatment within such limitations is impossible, it is believed that sufficient similarity of general tendency may be found among the almost infinite variety of detail to justify the present effort. For obvious reasons, both of space and time, it has been impossible to make exhaustive the citations for particular statements, even among the ten statutes herein considered. The attempt has been to go only so far as is necessary to show a tendency.

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vires action; a correlative increase in the powers of the directors; and the final disappearance of nearly all forms of shareholder's statutory liability except for the payment of the subscription price for shares. Before considering in detail the specific statutory provisions which embody and reflect these tendencies, one or two preliminary comments of a general nature may be made.

Professor Dodd attributes the general tendency of the new statutes to accept the business practices of the present rather than attempt to change them primarily to a desire to "check the tendency to incorporate in other states, particularly in Delaware."[18] Undoubtedly the factor of state competition for corporate fees has been highly influential in bringing about general acceptance of the so-called "liberalizing" trend in the new enactments. On the other hand, it may be doubted whether this has been the major influence rather than the reason assigned for it, in view of the states' unquestioned and formerly almost absolute power to exclude foreign corporations from their intra-state business.[19] If the basic desire underlying the enactment of the recent statutes were merely to keep local business at home for purposes of incorporation, the plain, simple and indicated remedy would be the enactment of much more rigid regulations concerning the entrance of foreign corporations.[20] The fact is, however, that this method has been rejected. In view of this, it is probable that there are much more deeply rooted causes for the general acceptance of the Delaware principle. Among these may be mentioned, perhaps, the growing practice of minority legislation in response to pressure from powerful groups, in this in-

18. Op. cit. supra, note 7, pp. 42 and 43.

19. The qualifying adverb "formerly" would be unnecessary but for the possibilities for extension of the two recent decisions of Colgate v. Harvey, 296 U. S. 404, 56 S. Ct. 252, 80 L. ed. 299 (1936), and Louis K. Liggett Co. v. Baldridge, 278 U. S. 105, 49 S. Ct. 57, 73 L. ed. 204 (1928). While it is too early to contend that the combined effect of these cases has been to overrule the historic policy of Bank of Augusta v. Earle, 13 Pet. 586, 10 L. ed. 274 (1839) and Paul v. Virginia, 8 Wall. 168, 19 L. ed. 357 (1869), the tendency of these cases hardly can be considered as consistent with the relatively unrestricted scope of that policy.

20. While there has been a very considerable amount of statutory regulation of foreign corporations, this on the whole has taken the form of provisions for service of process and to secure the compliance by foreign corporations with requirements concerning filing their papers and making certain reports, rather than with any hearty attempt to exclude them from the state.

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stance the local big business community;[21] the development and general acceptance in an increasingly corporately organized world, of the notion that incorporation is a kind of modern "natural right"[22] rather than a special privilege; and finally, and perhaps most important of all these considerations, the fact that the old types of corporation statute, the 1886 models, though in general suited to their day, have become antiquated and inadequate to the needs of modern high-powered business organized on a mass-production scale.

Whatever the cause or causes of the development, the tendencies of the new statutes all look toward an increase of power and mobility in the corporation and a correlative decrease of fixed right in the shareholder; a reversal of Maine's trend from status to contract. The corporation and its management have acquired greatly increased motive power and adjustability, but the individual stockholder has been placed almost in the position of holding a "pig-in-a-poke". It is paradoxical that this change has been brought about by an expanded use of the contract device.

That these changes have occurred does not involve the conclusion necessarily that they are unnecessary or undesirable. It is conceivable that they have been essential concomitants of the general stage of social evolution and organization through which we are passing. It may be that a society organized as broadly as ours is upon the basis of machines and under the capitalistic system, changing as rapidly as it has done during the last fifty years, can operate only with highly mobile industrial and financial organizations. If this is true, and the tendency certainly seems to have been in this direction, the predilection of Mr. Justice Brandeis and others to the contrary notwithstanding, the power phases of the recent corporate development have been necessary phases of that growth. One could not expect to get satisfactory results on modern highways with a motor car of the

21. It may be said fairly that in every instance the new statutes are "big business" statutes. If their purpose were merely to serve the needs of small, local concerns, it would be hardly necessary to include the vast powers and intricate provisions concerning capitalization and distributions which characterize all of them and are most appropriate for the very large organization.

22. Cf. Brandeis, J., dissenting in Liggett Co. v. Lee, 288 U. S. 517, 53 S. Ct. 481, 77 L. ed. 929 (1933).

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model of 1893. Nor could one expect to build a 1937 model motor car with an engine following the design of 1893. The failure, if any, has been in the provision of adequate brakes for the machine. To carry the motor metaphor further, one would not care to drive a 1937 Packard equipped only with the brakes of a covered wagon. Vast horse power requires correlative braking power. It is possible that the failure of the so-called modern incorporation laws, if any, is in their attempt to provide this power to stop. This requires, of course, the substitution of controls as radically different from the old ones as in the power of the new institution from that of the old.

In order to consider the problem more specifically, let us examine in broad outline what the new acts do.

I.

Before discussing the expansion of power and the creation of new controls, we may consider a few preliminary matters, involving principally the organization of the company.

Under the older statutes there were two general types of procedure for incorporation. One was practically automatic; the other involved a considerable amount of administrative supervision by public officials. In the latter group it was common to require an examination by the Secretary of State, and frequently also by the Attorney General, to determine the legality of the articles as drawn, and in some instances to exercise even broader discretion. Perhaps the most extreme statute of this character is that still existing in Iowa,[23] providing in substance that when the articles are presented to the Secretary of State for filing he is to satisfy himself "that they are in proper form to meet the requirements of law, that their object is a lawful one and not against public policy, and that their plan for doing business, if any be provided for, is honest and lawful."[24] In case of doubt as to the legality of the articles, he is required to submit them to the Attorney General, whose duty it is to examine and return them with an opinion upon the points inquired about. Provision is made, in case of rejection, for an appeal to the Executive Council of the state, which is authorized to determine again whether the articles are "in proper form, of honest purpose, not

23. Code of Iowa 1935, chap. 384, §§ 8344-47.
24. Id., § 8344.

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against public policy, nor otherwise objectionable."[25] This statute has been interpreted to permit a very great amount of administrative supervision of incorporation.[26] But it represents a position which is directly the opposite of the trend of the more modern laws. Nearly all of these follow the automatic procedure. Provision for prescription of forms and approval of the articles by the Secretary of State is made in Illinois, Indiana and in Idaho,[27] but the amount of discretion which he is permitted to assume is relatively small. In Illinois and Indiana, provision is made for judicial review of the Secretary's refusal to issue a certificate.[28] However it is doubtful whether these provisions accomplish much more than would be achieved without them, except by way of simplifying procedure. In an age of rapid growth and development in administrative law, the states apparently have concluded that administrative supervision is unnecessary and undesirable in the formation of private corporations. One reason for this may be that the old forms of supervision proved to be relatively ineffective, principally because the whole matter was dumped into the laps of public officials overburdened with other and more immediately pressing duties. Even in Michigan, where the state has established a corporation commission which performs the functions usually carried out by the Secretary of State in respect to incorporation,[29] there is no general delegation of power comparable to that in Iowa for supervising the process of incorporation.

Nearly all of the new laws permit incorporation by three or more natural persons, and most of them have dropped the old requirements of residence and citizenship.[29a] An interesting variation appears in the Michigan act, which provides that: "*one* or more persons, natural *or corporate,* may incorporate under this act,"[30] a provision which goes further than that of any other state. It has, however, at least the merit of honest recognition

25. Id., § 8347.
26. See Lloyd v. Ramsey, 192 Ia. 103, 183 N. W. 333 (1921).
27. Smith-Hurd Rev. Stat. 1933, ch. 32, § 157.48; Burns' Ind. Stat. 1933, § 25-217; Ida. Code of 1932, § 29-108(1). See also Dart's (La.) Stat. 1932, § 1084; Page's Gen. Code (Ohio) § 8623-6.
28. Laws of Ill. 1933, B. C. A., § 148; Ind. Gen. Corp. Act, § 1, sec. 72.
29. Mich. Pub. Acts 1935, no. 13.
29a. In some states the new acts still require a specified proportion of the incorporators, usually two-thirds, to be citizens of the United States.
30. Mich. Pub. Acts 1931, no. 327, § 3.

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of the facts which underlie and are evidenced by the practice of using "dummy" incorporators. While Iowa permits incorporation by a single individual,[31] it has not extended the privilege specifically to other corporations. Somewhat incongruously, the Michigan statute requires at least three directors,[32] apparently even in the case of incorporation by a single individual.

Except for drafting the articles, the procedure is relatively simple, involving execution and acknowledgement of articles by the incorporators, filing them with a public official, and usually also with the recorder of the county where the principal or registered office is located. Many of the statutes require the issuance of a certificate of incorporation by the Secretary of State or other public official,[33] but this is not universal.[34] All of the statutes, except Minnesota and Pennsylvania, seem to have dispensed with the old rigmarole of publication as a part of the incorporative process.[35]

The new statutes very generally specify a particular point in the procedure at which the corporate existence is stated to begin. In Michigan and California, this is upon filing of the articles in the central public office;[36] in Louisiana upon filing in the office of the parish recorder;[37] in Idaho, Illinois and Indiana, on issuance of the certificate of incorporation after filing of the articles.[38] Undoubtedly these provisions are helpful in eliminating the old problems which arose with reference to alleged failure to comply with the conditions precedent to incorporation. The statutes usually provide also that the certificate of incorporation shall be conclusive evidence of incorporation, generally reserving the state's right to challenge the validity of the organization.[39] Pro-

31. Code of Iowa, 1935, chap. 384, § 8340. The provision extends back to the Code of 1851, sec. 702.

32. Mich. Pub. Acts 1931, no. 327, § 13.

33. Idaho Code 1932, § 29-108; Ind. Gen. Corp. Act, § 18; Laws of Ill. 1933, Bus. Corp. A., § 49; Laws of La. 1928, no. 250, § 5; Laws of Minn. 1933, c. 300, § 5; Pa. Bus. Corp. L. § 206(A) (P. L. 1933, no. 106).

34. There is no provision for such a certificate in Michigan and Ohio.

35. See the Minnesota and Pennsylvania provisions, Laws of Minn. 1933, ch. 300, § 5 (III); Pa. B. C. L., § 205 (P. L. 1933, no. 106).

36. Mich Pub. Acts 1931, no. 327, § 5(2); Deering's Civil Code of Calif. 1931, § 292.

37. La. Gen. Stats. 1932, § 1084(I).

38. Idaho Code 1932, § 29-108(2); Smith-Hurd Rev. Stat. (Ill.) 1935, ch. 32, § 157.49; Burns' Ind. Stat. 1933, § 25-218.

39. See, for example, Idaho Code 1932, § 29-112; Smith-Hurd Rev. Stat. (Ill.) 1935, ch. 32, § 157.49; Burns' Ind. Stat. 1933, § 25-218.

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fessor Ballantine has pointed out, however, that the effect of these provisions in Illinois has been muddled by the retention of the "rather blind and inadequate provision" of the former law as to the assumption of corporate powers by persons unauthorized to do so.[40] In Minnesota, the section establishing the certificate as conclusive evidence of incorporation, somewhat inconsistently goes on to provide, "nothing in this section shall limit the existing rules of law as to corporations *de facto* nor as to corporations by estoppel."[41]

Nearly all of the new acts set up special conditions precedent to engaging in business operations as distinguished from the inception of corporate existence. Where the statutes require the articles to specify a minimum paid in capital, payment of this and some form of proof thereof constitute such conditions. Provisions of this sort are found in Louisiana, Minnesota, and Indiana.[42] In several of the states the condition of filing a duplicate or triplicate of the articles in the office of the county recorder is specified.[43] These provisions usually are given sanction by the imposition of a joint and several liability upon the directors not dissenting, for engaging in transactions or incurring debts, "except such as are incidental to organization or to obtaining subscriptions, or to payment for shares."[44]

The trend seems clearly indicated also to constitute the completion of incorporation by an acceptance of pre-incorporation subscriptions without further action by way of "adoption" by the corporation. This is true, for instance, in Michigan, Idaho, and Louisiana.[45] Rather unusual provisions appear in Idaho and Minnesota. In the former, the subscription is made irrevocable for one year;[46] in the latter it is irrevocable unless otherwise pro-

40. Ballantine, A Critical Survey of the Illinois Corporation Act (1934) 1 U. of Chicago L. Rev. 357, 380, n. 68. The provision in question is sec. 149, Ill. Gen. Corp. Act 1919, retained in Bus. Corp. Act, Cahill's Rev. Stats. 1933, c. 32, § 150.

41. Laws of Minn. 1933, ch. 300, § 7.

42. Burns' Ind. Stat. 1933, § 25-219; Laws of Minn. 1933, ch. 300, § 12; La. Gen. Stat. 1932, § 1089.

43. Civil Code of Calif. § 292, as amended by L. 1933, c. 533, § 4, and § 293 as amended by L. 1933, § 5 (the latter relating only to real estate); Ida. Code 1932, § 29-108; Mich. Pub. Acts 1931, no. 327, § 5 (1).

44. See Idaho Code 1932, § 29-110(2); Burns' Ind. Stat. 1933, § 25-219(c).

45. Mich. Pub. Acts, 1931, no. 327, § 8; Idaho Code 1932, § 29-109(3); La. Gen. Stat. 1932, § 1086.

46. Idaho Code 1932, § 29-109(1)(a); likewise in Louisiana: La. Gen. Stat. 1932, § 1086(I)(a).

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vided in writing until sixty days after issuance of the certificate, but void unless accepted within that time.[47] Many of the statutes save the right to avoid the subscription on grounds which would be sufficient for the rescission of contract.[48] There are frequent provisions also with reference to collection of unpaid subscription price, including the creation of liens on shares for the unpaid balance of the price,[49] and in some instances rather harsh provisions for forfeiture of previous payments in case of default.[50]

While these provisions undoubtedly will create some new problems of interpretation, on the whole their effect will be to clear away causes of litigation and to reduce the volume of court action arising out of irregular or defective incorporation.

II.

In a discussion which must be limited by considerations of space as this must be, any attempt at specific and detailed treatment of the scope of the expansion of corporate and managerial powers must fail. It will be possible only to refer briefly to certain phases of the expansion which are outstanding. First, with reference to the scope of corporate powers.

All of the new statutes seem to abandon the old attempt at enumeration of specific types of businesses open to incorporation. Even the later phrase "for any lawful business," while retained in some of the statutes, has been replaced in others by such phrases as "any lawful purpose,"[51] "for any purpose or purposes, other than carrying on the practice of any profession, for which natural persons lawfully may associate,"[52] "for any lawful business purpose."[53] All specify certain exceptions such as banking,

47. Laws of Minn. 1933, ch. 300, § 16, (II), (a).

48. Idaho Code 1932, § 29-109(2); La. Gen. Stat. 1932 § 1086 (II); Laws of Minn. 1933, ch. 300, § 16 (III).

49. Idaho Code 1932, § 29-127; Burns' Ind. Stat. 1933, § 25-205(d); La. Gen. Stat. 1932, § 1086 (IV); Mich. Pub. Acts 1931, no. 327, § 28; Laws of Minn. 1933, ch. 300, § 16 (VII).

50. See, for example, La. Gen. Stat. 1932, § 1086 (IV); Mich. Pub. Acts 1931, n. 327, § 28. The provision of the latter act, especially, for forfeiture not only of the stock but also of all amounts previously paid "as liquidated damages" without reference to any relation between this amount and the damage actually sustained, seems almost vindictive. Contrast with this the much more reasonable provision in Indiana: Gen. Corp. Act. § 6(d).

51. Smith-Hurd Rev. Stat. (Ill.) 1935, ch. 32, § 157.3.

52. Page's Ohio Gen. Stat. Supp. (1926-1935), § 8623-3.

53. Idaho Code 1932, § 29-102; Burns' Ind. Stat. 1933, § 25-201; Laws of Minn. 1933, ch. 300, § 2.

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insurance, and railroad or other specifically named public utility corporations. Perhaps one significant effect of these new types of statement will be to authorize incorporation for a single venture or transaction rather than for a continuous series of transactions sufficient to make up a "business" in the commonly accepted sense of the term.[54]

All of the statutes require that the articles shall state the purposes and objects of the corporation, thus retaining the language of the old notion of the corporation as a limited enterprise. However, so far as the scope of the limitation is concerned, it is greatly restricted by at least two types of provision. One, which appears in many of the statutes, is as follows: "The filing or recording of the articles of incorporation, or amendments thereto, or of any other papers pursuant to the provisions of this act, is required for the purpose of affording all persons the opportunity of acquiring knowledge of the contents thereof, but no person dealing with the corporation shall be charged *with constructive notice* of the contents of any such articles or papers by reason of such filing or recordation."[55] An interesting variation appears in Michigan, where is it provided that no person dealing with the corporation shall be charged with or be entitled to assert constructive notice of the contents of the articles, except

54. Perhaps also the language is broad enough to permit its meaning to be stretched to the other extreme, illustrated in the certificate of incorporation of the Goldman-Sachs Trading Corporation, containing this clause: "In general, to carry on any business not contrary to the laws of Delaware. . .". See Magill and Hamilton, *Cases on Business Organization*, II (1933) 730. It may be questioned whether the language "*any* lawful business" or "purpose" is intended to mean "any *and all*." The Ohio provision, literally interpreted, seems broad enough to sustain the Goldman-Sachs provision. If the other forms of language are to be given equally broad effect, the new acts have moved a great distance from the old law which held specification of corporate objects to be a mandatory requirement of incorporation, and asserted as the basis of *ultra vires* decisions (1) an interest of each shareholder in having the corporation kept within the limits of the risks assumed by him and (2) an interest in the state and the public in seeing that it does not usurp functions not granted to it. While it still would be possible theoretically for the shareholders (actually the promoter-incorporators) to limit their risks to specified enterprises or businesses by contractual provision in the articles, the well known tendency of promoters to assume all the powers authorized would render this possibility of little practical value. This provision is only one of several which have the combined effect of reducing the formerly prevailing requirement of a limited enterprise to a merely verbal shadow of itself. See text at notes 55 and 57; also notes 79-89.

55. Idaho Code 1932, § 29-113; La. Gen. Stat. 1932, § 1091; Laws of Minn. 1933, ch. 300, § 10; Ohio Gen. Code, § 8623-9.

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shareholders, officers and directors of the corporation, and with one other exception.[56]

The profession rightly may welcome extinction of the doctrine of constructive notice of the articles' contents in application to ordinary, every-day business transactions with outsiders, and perhaps in relation to such transactions with shareholders, as well as some others of an "internal" nature. But at the same time one well may wonder whether this provision will be applied by the courts when the articles contain specific requirements for or prohibitions of action in regard to large matters of unusual or "fundamental" importance, and the question presented is as to such matters. On the whole, the exception as to officers and directors and less certainly that as to shareholders contained in some of the acts seems a desirable limitation. In the writer's view, officers and directors should be expected to know something about their articles and ordinarily should not be permitted to hide behind a shield of ignorance regarding their contents.

Correlative with the provision concerning notice, and undoubtedly intended to operate in the same direction, is the more specific attempt to abrogate or limit the operation of the doctrine of *ultra vires* action. The general provision is that the corporation "shall have the capacity to act possessed by natural persons but authority only as necessary or proper to accomplish purposes as expressed or implied in the articles."[57] Professor Ballantine, and others, have pointed out that this attempt has been only partially successful, due primarily to the failure of the statutes to go further and point out more specifically what the consequences of unauthorized action shall be.[58] The provision of the

56. Mich. Pub. Acts 1931, no. 327, § 9.

57. Idaho Code 1932, § 29-114; Burns' Ind. Stat. 1933, § 25-202; La. Gen. Stat. 1932, § 1092; Ohio G. C. § 8623-8; Pa. B. C. L., § 301 (P. L. 1933, no. 106); Rem. Rev. Stat. Wash. 1932, § 3803-11.

58. Ballantine, A Critical Survey of the Illinois Business Corporation Act (1934) 1 U. of Chicago L. Rev. 357, 381-3. Particular criticism is directed against paragraph (a) of Section 8 of the Illinois Act, and a similar provision in Section 303 (1) of the 1933 Pennsylvania Business Corporation Law. The paragraph permits a shareholder to enjoin the corporation from doing unauthorized acts including performance of executory and partially executed contracts, if the court deems such action "to be equitable." Provision is made, however, for allowing damages (not including anticipated profits) to the corporation or other parties resulting from the court's action in setting aside and enjoining the performance of the contract. See also Ballantine, Questions of Policy in Drafting a Modern Corporation Law (1931) 19 Calif. L. Rev. 465, 473-5.

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California law, presumably drafted by him, specifically does this, abrogating the defense as between the corporation and any shareholder or third person, both as to domestic and foreign corporations.[59] However, it permits a shareholder or the state to enjoin unauthorized business where third parties have not acquired rights thereby, and suits against officers or directors by the corporation or shareholders in a representative suit for violation of their authority. In Illinois the effect of the general provision is limited by specific authorization of an injunction against continued performance of partly executed contracts, with a provision for indemnity to outsiders, or the corporation, if damaged by the injunction.[60] In Michigan the plea is denied to all except to the corporation in an action between it and a director, officer, or person having actual knowledge of the *ultra vires* nature of the act, and except to either party in an action between the shareholders and the corporation.[61] In Indiana there is an unusual provision permitting *ultra vires* acts to be voided in a suit by the prosecuting attorney.[62] While most of these provisions are undoubtedly ambiguous and therefore defective, the tendency to the elimination of *ultra vires* problems has been a healthy one, but it involves necessarily a considerable expansion of corporate power. On the whole, this extension is not objectionable, especially in view of the breadth of corporate objectives which may be assumed, and of the powers of amendment conferred by recent statutes.

The new acts invariably follow the lead of New Jersey and Delaware in granting practically unrestricted authority to purchase and in most instances to guarantee the securities of other corporations, domestic and foreign. A common provision reads as follows: ". . . to acquire, guarantee, hold, own and vote, and to

59. Deering's Civil Code of Calif. 1931, § 345.

60. Smith-Hurd Rev. Stat. 1935, ch. 32, § 157.8; and see note 58, supra.

61. Mich. Pub. Acts 1935, no. 194, § 11; Ohio and Minnesota also make abrogation of the defense dependent upon whether the person dealing with the corporation had actual knowledge of the limitations upon the authority of its representatives: Ohio: Page's Ann. Code (1932 Supp.), § 8623-8; Minn. Laws of 1933, c. 300, § 11.

62. Burns' Ind. Stat. 1933, § 25-253. (Gen. Corp. Act 1929, § 54). As an inducement toward vigilant enforcement, a fee of fifty dollars for the prosecutor is provided, to be taxed as part of the costs of the proceeding. This should overcome some of the lethargy which public officials have displayed heretofore about such matters.

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sell, assign, transfer, mortgage, pledge or otherwise dispose of the capital stock, bonds, securities, or evidences of indebtedness of any other corporation, domestic or foreign."[63] In Illinois this is extended to securities of associations, partnerships, or individuals.[64] In Louisiana it includes special provisions as to guaranteeing principal, interest and *dividends* of, or on securities of, other corporations.[65] In Minnesota it is necessary for the articles to authorize the purchase or other form of acquisition, but strangely without such authority the corporation may guarantee the securities of other companies, though only "when reasonably necessary or incidental to accomplish the purposes stated in its articles."[66] This widespread adoption of the foundation stone of the holding company structure, without limitation or restriction, is at least very questionable. If it is deemed necessary to authorize all types of manufacturing corporations, from the Corner Peanut Wagon, Incorporated, to the American Telephone and Telegraph Company, to have liquid outlet for their surpluses, it would seem that the authority could be conferred with some reasonable restrictions and limitations. It should not be beyond the capacity of legislators or expert advisers and draftsmen to devise limitations which would have at least the tendency to prevent the speculative abuses which such broad authority makes possible. Even less defensible seems the provision for guaranteeing obligations of other corporations. An interesting commentary upon this clause is found in the provision of the Michigan statute which requires: ". . . that any corporation organized or doing business in this state under this act shall not have the power to guarantee or in any wise become surety upon any bond or other undertaking securing the deposit of public moneys."[67] The Michigan statute is one of the few which attempt to put any limitations upon the general power, but these are not significant on the whole as restrictions of speculative activity on the part of the company. And if we are to have holding companies,

63. Burns' Ind. Stat. 1933, § 25-202(7); La. Gen. Stat. 1932, § 1092; Mich. Pub. Acts 1933, no. 194, § 10(1); and see the statutes cited post, n. 64-67. See also supra, note 9, and the particular statutes cited, for variations in language and scope of the provisions.
64. Smith-Hurd Rev. Stat. 1935, ch. 32, § 157.5.
65. La. Gen. Stat. 1932, § 1092(e), (j).
66. Laws of Minn. 1933, ch. 300, § 9.
67. Mich. Pub. Acts 1935, no. 194, § 10(i).

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certainly some further legislation for controlling their possibilities for abuse could be devised.[68]

All of the states have adopted the general principle of permitting the corporation to deal in its own shares, whether by way of purchase or redemption. This, however, is generally hedged about by some general limitations, ranging from the old vague provision that the purchase is permissible provided it does not result in an impairment of capital,[69] to the relatively detailed and specific provisions of such statutes as that in California.[70] This whole subject, of course, is tied up with the general problem of capital distributions, which will be treated at a later point.[71] Probably it is impossible to stem the flow of a legal, as it is that of the natural, Niagara. But the writer is one of at least a considerable minority who agree with Professor Nussbaum and others that this tendency has been carried further in the United States than there is any real need for carrying it, and that a more healthy attitude would be the acceptance of the English and continental view making provision, in accordance with that view, for authority to purchase in specifically excepted cases.[72]

Other broad powers have been conferred with reference to borrowing money and giving security for the obligation so incurred, the later statutes having removed practically all restric-

68. The California Act appears to be the only one which gives appreciable attention to the holding company problem. It does undertake a definition of holding and subsidiary corporations, Cal. Civ. Code (1931) § 278, and makes specific requirements concerning information as to the relations between them, particularly in financial matters. Civil Code, § 358, as amended by L. 1933, c. 533, § 57. There is also a provision limiting to specified purposes the purchase by the subsidiary of the holding company's stock. Civil Code § 342, as amended by L. 1933, c. 533, § 45. See also the provision, which appears in some other states, regulating loans to, and guaranties of the obligations of, directors, officers, and in some instances shareholders by the corporation and its subsidiaries. Calif. Gen. Code, § 366, as amended by L. 1933, c. 533, § 67.

69. See Burns' Ind. Stat. 1933, § 25-202(8); Mich. Pub. Acts 1935, no. 194 § 10(h).

70. Deering's Civil Code 1931, § 342. See also La. Gen. Stat. 1932, § 1103.

71. See post, p. 333ff.

72. See Nussbaum, Acquisition by a Corporation of its Own Stock (1935) 35 Col. L. Rev. 971; Ballantine, Questions of Policy in Drafting a Modern Corporation Law (1931) 19 Calif. L. Rev. 465, 479; Levy, Purchase by a Corporation of Its Own Stock (1930) 15 Minn. L. Rev. 1; Morawetz, *Private Corporations* (2d ed. 1886) §§ 112, 113. Professor Nussbaum comments: "As far as can be discovered, the American majority rule stands alone in the world of comparative law." Op. cit. supra, p. 976.

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tions upon the total amount of indebtedness which the corporation and the directors are permitted to incur. The old requirement, that the total amount of outstanding corporate debts and obligations should have some specific relation to the issued capital stock, had behind it at least the philosophy that the corporate shoe-string should not be too short. The modern statutes, however, not only remove these restrictions but in general take away the limitations which existed in the old requirement that in certain instances, at least involving long term loans, the consent of a majority or some other percentage of the shareholders should be obtained.

Another significant expansion has appeared in the general acceptance of provisions authorizing the corporation to sell and dispose of its entire assets and business in the absence of unanimous consent of the shareholders. The usual provision requires a specified majority of the voting shares, as in California[73] and Michigan[74] where a mere majority suffices, and in Idaho, Indiana and Minnesota[75] where a two-thirds majority is required. In some of the states, as in Minnesota,[76] the additional limitation appears that when the articles so require, a vote by classes in addition to the specified majority is necessary. Some of the statutes dispense entirely with the shareholders' vote when the corporation is unable to meet its obligations as they mature, vesting the power to dispose of the enterprise in the directors.[77]

The general effect of these provisions, whatever the variance in detail, is of course to deprive the individual investor of his

73. Deering's Civil Code, 1931, § 343.

74. Mich. Pub. Acts 1931, no. 327, § 57.

75. Idaho Code 1932, § 29-44; Burns' Ind. Stats. 1933, § 25-239; Laws of Minn. 1933, ch. 300, § 35.

76. Laws of Minn, 1933, ch. 300, § 35; also Smith-Hurd Rev. Stat. Ill. 1935, ch. 32, § 157.72.

77. Idaho Code 1932, § 29-144; La. Gen. Stat. 1932, § 1121. In California and Ohio it is provided specifically that no vote of the shareholders shall be necessary to mortgage or pledge all or part of the corporation's property, unless otherwise provided in the articles. Calif. Civ. Code, § 344; Ohio Gen. Code, §8623-73. Pennsylvania retains the old-time conservatism in the matter of bonded indebtedness. The statute prohibits a corporation to increase its indebtedness (other than that contracted in the regular course of business) except upon adoption by the directors of a resolution and concurrence therein by a majority of the outstanding shares, and also, when any class or classes are entitled to vote thereon as a class, by a majority of each such class. Pa. B. C. L. § 309. Rigid provisions for sixty days' advance notice of the meeting at which the resolution is to be presented to the shareholders for action are made.

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right to the continuance of the enterprise, even in a going concern. On the whole, as to the large corporation, this seems to be a beneficial change. It effectually checks the operations of the shareholder-blackmailer. Assuming also that the voting power is widely distributed among the shareholders, it accords with a generally democratic philosophy. On the other hand, it is, of course, entirely possible that the voting power will be concentrated in a very small segment of the outstanding shares. In this situation possibilities of autocratic termination of the enterprise are great unless the general requirement of consent of voting shares is further checked in some other manner. The effect of the provision upon the dissenting bona fide shareholder is somewhat softened by the provision quite generally adopted permitting him to demand payment for his shares in cash at the fair cash value fixed by an appraisal or by judicial determination.[78]

One of the most important expansions of power has been in the provisions relating to amendment of articles. The outstanding purpose appears to have been to get around the vested rights and contract theories of share ownership. One of the commonest provisions is to authorize amendment "without limitation so long as the articles as amended would have been authorized by this act as original articles." This form of language, following closely the Delaware provision,[79] appears in Indiana and Michigan.[80] Another form of statement appears in Minnesota, namely, ". . . so as to include or omit any provision which it would have been lawful to include in or omit from original articles at the time the amendment is made."[81] In Idaho and Louisiana, the language is, "so as to include any provision authorized by this act."[82]

Though the general purpose has been to eliminate the blocking of an amendment by a single dissenting shareholder or small group of shareholders, the statutes vary considerably in the provisions with respect to the adoption of the amendment. In Indiana and Michigan, for instance, it is required that the amend-

78. Idaho Code 1932, § 29-149; Ill. Bus. Corp. Act 1933 (L. 1933, p. 110) § 73; Ind. Gen. Corp. Act 1929, § 41; Mich. Pub. Acts 1931, no. 327, § 44; Ohio Gen. Code, § 8623-65; Rem. Rev. Stat. Wash. 1932, § 3803-41.
79. Rev. Code of Dela. 1915, ch. 65, § 1940.
80. Burns' Ind. Stats. 1933, § 25-221; Mich. Pub. Acts 1935, no. 194, § 43.
81. Laws of Minn. 1933, ch. 300, § 36(I).
82. Idaho Code 1932, § 29-145(1); La. Gen. Stat. 1932, § 1122(I).

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ment be proposed by resolution of the board and adopted by a majority of the shares entitled to vote thereon.[83] In other states, and more commonly, approval of two-thirds of the holders of voting stock is required, as in Idaho (except for change of the corporate name, which may be adopted by a majority).[84] In Minnesota, however, the articles are permitted to state any desired majority,[85] and in the absence of such a statement, the amendment must receive either the vote of two-thirds of the voting shares or a majority of voting shares coupled with the absence of a negative vote of more than one-fourth of such shares.[86] It is quite generally provided also that when the amendment will adversely affect the interests and relative position of any class of shares, that class shall be entitled to vote as a class and a specified majority of such class, in addition to the majority of the general vote, is required to concur in the amendment.[87] While these provisions offer a very real check upon the power of amendment, they leave open the possibility, even where the class vote is provided for, that the amendment may operate to the detriment of one class and to the benefit of another. When a majority of the shares of the class injured is held by persons who will be benefited as owners of the class benefited by the amendment, even these provisions may be inadequate to prevent unjust juggling of the share structure. In Illinois the statute does not leave open to question the types of amendments upon which a class is entitled to vote. The statute contains a specific enumeration of such amendments.[88] While such an enumeration may not be necessary, it at least constitutes a safeguard with reference to the most important incidents of share ownership which might well be followed in other jurisdictions.

The general effect of these provisions remains to be determined. They resemble very closely the so-called "Henry VIIIth

83. Burns' Ind. Stats. 1933, §§ 25-222, 25-223; Mich. Pub. Acts 1931, no. 327, § 43.

84. Idaho Code 1932, § 29-145; Smith-Hurd Rev. Stat. Ill. 1935, ch. 32, § 157.53; La. Gen. Stat. 1932, § 1122; Laws of Minn. 1933, ch. 300, § 36.

85. Laws of Minn. 1933, ch. 300, § 36(III) (b); also La. Gen. Stat. 1932, § 1122(II).

86. Laws of Minn. 1935, ch. 117, § 6.

87. Idaho Code 1932, § 29-145(4); Burns' Ind. Stat. 1933, § 25-224; La. Gen. Stat. 1932, § 1122(III); Mich. Pub. Acts 1935, no. 194, § 43; Laws of Minn. 1933, ch. 300, § 36.

88. Smith-Hurd Rev. Stat. 1935, ch. 32, § 157.54.

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clause" which has become common in recent English legislation establishing administrative agencies.[89] While it is not certain that the courts will not read some limitations into them, acting under a vested rights theory, no one as yet knows what these limitations will be, if any. While a broad power of amendment seems necessary, it is at least doubtful whether a provision as broad in its possibilities as this is required. Perhaps there should be a few fundamental rights of the shareholder not subject to change by any majority.

Another check is provided in some of the statutes in the form of a provision for a demand for payment in cash by a dissenting shareholder of a class, in effect similar to that provided in the case of sale or disposition of the entire corporate assets.[90]

Another general characteristic of the expansion of corporate powers is a rather large extension of the directors' powers, or of authorization for provisions in the articles for such extension. This may be illustrated by the provisions relating to new security issues. Thus, in California the articles may authorize the board "to fix or alter the dividend rate of the redemption or liquidation price of any class or of any series of any class, or the number of shares constituting any series of any class, or of all or any of them, in respect of shares then unissued."[91] Such a provision, of course, vests in the directors of a prospering corporation almost unlimited power to alter the relative position of issued shares by issuing new securities. In states where amendments are required to be submitted by the directors, they have in substance a veto power on such changes.[91a]

89. See Stamp, Recent Tendencies Towards the Devolution of Legislative Functions to the Administration (1924) 2 J. of Pub. Ad. 23; quot. Frankfurter & Davison, *Cases on Administrative Law* (2d ed. 1935) 219.

90. Idaho Code 1932, § 29-149; La. Gen. Stat. 1932, § 1132; Laws of Minn. 1933, c. 300, § 39 as amended by L. 1935, c. 212, § 1, 2; Rem. Rev. Stat. Wash. 1932, § 3803-41.

91. Deering's Civil Code 1931, § 290(5). See, also, similar provisions (in one or two cases limited to "series") in Ill. B. C. A. (L. 1933, p. 310) § 53(i), (j), (k) and § 15(f); Ind. B. C. A. § 17(6) (b); Laws of Minn. 1933, c. 300, § 3, I(e); Ohio Gen. Code, § 8623-4, 4(b); Pa. B. C. L. § 204(7) and § 804 (series only). In Illinois the directors have the power to make by-laws, unless this is reserved by the articles to the shareholders. B. C. A. § 25. They also have the power to increase the stated capital. Id. § 19.

91a. Ill. B. C. A. § 53; Ind. B. C. A. § 23; Pa. B. C. L. § 802; and in Illinois the veto extends to reduction of stated capital. B. C. A. § 59.

This general expansion of directors' powers occurs even though the statutes usually provide that the directors need not be shareholders, unless the

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Greater liberality is shown also in the provision for delegation of directors' power to executive committees, which it is provided, commonly, the board may designate and vest with their full authority. Such a provision appears in Idaho, Indiana, Michigan and Minnesota.[92] Greater freedom for action is allowed also in the provisions such as those of Michigan and Minnesota authorizing the substitution of several or collective written consent for board meetings.[93] On the other hand, a somewhat larger control of directors' action is provided by the more specific regulations as to removal. There is, however, no general uniformity in these provisions. In some of the states, as in Minnesota, the directors may be removed with or without cause by a majority vote.[94] In Michigan such removal is limited to situations where cause exists.[95] In Idaho, a two-thirds vote is required, as is the case in Louisiana.[96] In the latter state, the board of directors is permitted a limited power of removal for cause.[97] It is generally provided that vacancies may be filled by the remaining directors.

III.

It has been stated above that the principal failure of the modern statutes has been to devise controls adequate for the new powers which they create. Heretofore the individual shareholder's principal protections have been his voting rights, his preëmptive right, his power to institute a representative suit and his rights to information. All of these have been greatly limited in the modern statutes either through direct statutory restrictions or through statutory authorization of provisions in the articles which eliminate or restrict them.

First in relation to voting rights. While all of the statutes make provision for voting, practically all make it possible for

articles provide the contrary: Idaho Code 1932 § 29-138(1); Ill. B. C. A. § 33; Laws of La. 1928, no. 250, § 34 I; Mich. Pub. Acts 1931, no. 327, § 13-1; Laws of Minn. 1933, c. 300, § 27 I; Pa. B. C. L. § 401.

92. Idaho Code 1932, § 29-138(2), (3); Burns' Ind. Stat. 1933, § 25-208; Mich. Pub. Acts 1931, no. 327, § 13(4), (e); Laws of Minn. 1933, ch. 300, § 27(IV), (h). Also in Illinois, Louisiana, Ohio and Pennsylvania: Ill. B. C. A. § 38; Laws of La. 1928, no. 250, § 34 III(e); Ohio Gen. Code, § 8623-60; Pa. B. C. L. § 402.

93. Mich. Pub. Acts 1931, no. 327, § 13(4), (d); Laws of Minn. 1933, ch. 300, § 27(IV), (g).

94. Laws of Minn. 1933, ch. 300, § 28(1).

95. Mich. Pub. Acts 1931, no. 327, § 13(3).

96. Idaho Code 1932, § 29-138(4); La. Gen. Stat. 1932, § 1114(III), (b).

97. La. Gen. Stat. 1932, § 1114(III), (a).

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the voting power to be concentrated in a very small segment of the outstanding share structure.[97a] The exception in Illinois is due to a provision in the state constitution which seems to require at least a limited voting power in all shares.[98] Even the privilege of accumulating the voting power of the minority seems to be on its way out. In same states this is protected by constitutional provisions, but in Minnesota, Michigan, Louisiana and Indiana it may be eliminated by appropriate drafting of the articles.[99] On the other hand California and Idaho protect the right.[100]

None of the statutes discriminates between large and small companies in respect to voting provisions. The idea of voting undoubtedly had its origin in democratic conceptions, particularly appropriate to the non-profit and non-stock corporations, and perhaps not greatly less so in the characteristically small corporations of the first half of the nineteenth century. There is, of course, a vast amount of business which is done today by small corporations operating locally. As to these the voting mechanism may well remain a very valuable incident. The reasons are not apparent, except in cases of the one man company

97a. This statement must be qualified by the fact that many of the new statutes introduce a limited and absolute right to vote, even in stock which is non-voting under the articles; principally by classes when class interests are involved in a manner peculiar to some classes and not to others (Calif. Civ. Code § 362a, as amended by L. 1933, c. 533, § 61; Idaho Code 1932, § 29-145; Ill. B. C. A. § 53; Ind. B. C. A. § 25(a), (b); Laws of La. 1928, no. 250, § 42 III; Mich. Pub. Acts 1931, no. 327, § 44, as amended by Pub. Acts 1935, no. 194; Minn. B. C. A. § 36, III(c), as amended by L. 1935, c. 117, § 7); and also, more rarely, by all of the outstanding stock, voting and non-voting, upon matters of major importance, such as amendments changing the corporate purposes substantially (Laws of La. 1928, no. 250 § 42 IV; Minn. B. C. A. § 36, as amended by L. 1935, c. 117, § 8 III(d)); assessment upon fully paid shares (Calif. Civ. Code § 362a, as amended by L. 1933, c. 533, § 61); merger and consolidation (Calif. Civ. Code, supra, § 59(3); Mich. Pub. Acts 1931, no. 327, § 52); sale of all corporate property (Pa. B. C. L. § 311). This reservation of a limited voting power upon matters of paramount importance regardless of contrary provisions in the articles, represents one of the few "conservative" tendencies of the recent statutes. Its effectiveness as a protection for the small shareholder, particularly, in the large company is qualified, however, by his relatively complete inability to secure adequately detailed information as a basis for guidance in casting his ballot.

98. Ill. Const. 1870, art. XI, § 3; Smith-Hurd Rev. Stat. 1935, ch. 32, § 157.28.

99. Laws of Minn. 1933, ch. 300, § 25 (III); Mich. Pub. Acts 1931, no. 327, § 32; La. Gen. Stat. 1932, § 1112(II); Burns' Ind. Stat. 1922, § 25-207.

100. Deering's Civil Code Calif. 1931, § 320; Idaho Code 1932, § 29-133(2).

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and the closed corporation which is really a partnership in corporate form, for extending to the great body of these local companies the vast amount of freedom which the statutes permit in eliminating the voting power. On the other hand the idea that fifty thousand investors can express an intelligent opinion about the conduct of corporate affairs in a changing business world characterized by rapidly fluctuating price structure is an absurdity except for the rarest instances of emergency action. Even in these circumstances when the shares of the large corporation are fairly widely scattered, resort to any considerable percentage of the shareholders for advice or decision is of the most doubtful value. Realization of this fact, as well as the desire of financial manipulators to free themselves from restrictions, undoubtedly lies behind the gradual abrogation of voting power in the large concerns. One reasonably can doubt that the preservation of voting power in the large companies would constitute anything more than a nominal protection to the shareholder. The provision of contingent voting power in classes of securities normally deprived of them may be valid for use in emergency situations. But one hardly could weep over the disappearance of the widespread and farcial device of proxy voting in the larger corporations. However, the recent statutes quite generally put the stamp of approval upon the proxy system, although most of them have provisions to check the operation of stale proxies.[101] In line with this tendency also is the uniform approval of the voting trust,[102] though this also is hedged about by restrictions here and there concerning the duration of the trust[103] and the occasional provision giving other shareholders the right to enter the trust arrangement on the same terms as those extended to the shareholders originally participating.[104] Minnesota has a provision permitting termination of the trust at any time by a majority

101. See, for example, Idaho Code 1932, § 29-133(3); Burns' Ind. Stat. 1933, § 25-207(e); La. Gen. Stat. 1932, § 1112(III).

102. See Civil Code Calif., § 321a; Idaho Code 1933, § 29-134; La. Gen. Stat. 1932, § 1113; Mich. Pub. Acts 1931, no. 327, § 34, as amended by Extra Session L. 1934, Act No. 34; Laws of Minn. 1933, ch. 300, § 26; Ohio Gen. Code, § 8623-34; Pa. Bus. Corp. L. 1933 (P. L. no. 106) § 511; Rem. Rev. Stat. Wash. 1932 § 3803-29. The Indiana provision seems to approve the device. There is no statutory provision in Illinois.

103. Idaho Code 1932, § 29-134; La. Gen. Stat. 1932, § 1113; Laws of Minn. 1933, ch. 300, § 26.

104. Idaho Code 1932, § 29-134(3); La. Gen. Stat. 1932, § 1113(III).

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vote, unless otherwise specified,[105] and in California this may be done if the sole purpose of the trust is voting.[106]

Were it not for the necessity of finding some means for the selection of management, the writer would be almost ready to suggest the total elimination of the voting scheme in the large company, and the provision of some other check upon unsatisfactory conduct of officers and directors. If, however, such a check or checks can be devised, there will be even less reason to bemoan with Professor Ripley the present and the apparently increasing concentration of voting power in the hands of management.[107]

In a corporation with a simple stock structure, especially if all the shares have voting power, the preëmptive right is a very valuable protection to the shareholder. However, as Professors Frey and Ballantine, among others, have pointed out,[108] the preëmptive right becomes only a source of "insoluble difficulties" in the large company with an intricate share structure. For this reason the courts have labored heavily to devise exceptions to and modifications of the right.[109] In this some were, of course, more successful than others. Nevertheless, the situation became preeminently one for legislation. Following the signs indicated by the courts, the legislatures have moved along the way toward the ultimate disappearance of the preëmptive right. Most of the statutes permit the articles to make any provision desired concerning it.[110] Normally, this is followed with the statement that in the absence of a contrary charter provision, the shareholder shall have no preëmptive right in certain specified types of security issues, including issues of treasury shares, issues to employees,

105. Laws of Minn. 1933, ch. 300, § 26(I).
106. Deering's Civil Code 1931, § 297.
107. Ripley, *Main Street and Wall Street* (1927).
108. Frey, Shareholders' Preëmptive Rights (1929) 38 Yale L. J. 563; Ballantine, Questions of Policy in Drafting a Modern Corporation Law (1931) 19 Calif. L. Rev. 465, 469; Ballantine, A Critical Survey of the Illinois Business Corporation Act (1934) 1 U. of Chicago L. Rev. 357, 362.
109. See the cases cited in Ballantine, *Private Corporations* (1927) p. 421, n. 34, p. 422, n. 36, p. 423, n. 38a, and in general Frey, op. cit. supra, n. 108.
110. Deering's Civil Code of Calif. 1931, § 297; Idaho Code 1932, § 29-119(6); Ill. Bus. Corp. Act (L. 1933 p. 310) § 47(k); Ind. Gen. Corp. Act § 6(i); La. Gen. Stat. 1932, § 1108(I); Mich. Pub. Acts 1931, no. 327, § 31; Laws of Minn. 1933, c. 300, § 3(i); Ohio Gen. Code, § 8623-4(b); Pa. Bus. Corp. Act 1933 (P. L. no. 106), § 204(11).

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etc.[111] In California, the preëmptive right is abrogated unless specific contrary provision is made in the articles.[112] In Louisiana, in the absence of such contrary provision, holders of voting shares are given preëmptive rights in voting shares allotted for cash.[113] Thus another of the shareholder's protections is on its way out. Probably this is justifiable as to the large corporation which finds it necessary in raising capital to make its share structure a complicated one; but again it seems that the freedom of contract allowed by the new statutes is greater than is necessary or desirable in relatively small and local companies.

In the legislative period which covers the history of our greatest corporate expansion perhaps the most sacred right of the shareholder was his right to information. While the voting rights and preëmptive rights were being whittled down by the courts, through their approval of concentrative devices, the legislatures were extending and the courts were enforcing the shareholders' right to information. The limitations of the common law rule were found generally too restrictive, and we witnessed the growth of the so-called absolute right of the shareholder to examine the books of account and the records of the company.[114] These were accompanied by punitive provisions levied now against the company, now against its officials, in case of refusal or neglect to comply with the shareholder's demand, however unreasonable.[115] The result, of course, was a very considerable amount of blackmail, and of unfair competition by shareholder-competitors. This has led to a general return in the modern acts to the common law rule, limiting the right of examination to reasonable times and proper purposes.[116]

However necessary this may have been, a tendency is apparent in some of the statutes to go further than is necessary to

111. See for example, Idaho Code 1932, § 29-119(6); Mich. Pub. Acts 1931, no. 327, § 31.

112. Deering's Civil Code 1937, § 297.

113. La. Gen. Stat. 1932, § 1108(II).

114. See for example, Henry v. Babcock & Wilcox Co., 196 N. Y. 302, 89 N. E. 942 (1909); Venner v. Chicago City Ry. Co., 246 Ill. 170, 92 N. E. 643 (1910); Furst v. Rawleigh Medical Co., 282 Ill. 366, 118 N. E. 763 (1918); Weihenmayer v. Bitner, 88 Md. 325, 42 Atl. 245 (1898), quoted and approved in State v. Bucklin, 83 Wash. 23, 145 Pac. 58 (1914); Cincinnati Volksblatt Co. v. Hoffmeister, 62 Ohio St. 189, 56 N. E. 1033 (1900).

115. See for example, R. S. Mo. 1929, § 4551.

116. Deering's Civil Code of Calif. 1931, § 355; Idaho Code 1932, § 29-143; Burns' Ind. Stat. 1933, § 25-210; Laws of Minn. 1933, ch. 300, § 33.

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protect the corporation from the abuses of the old absolute right. For instance, in Michigan and Louisiana, the shareholder who is entitled to an examination must hold two per cent of all the outstanding stock[117] (or, in Michigan, of any class)[118] for a specified period prior to the date of his demand. In Louisiana, if the shareholder is a business competitor, he must hold twenty-five per cent of the outstanding stock.[119] In Idaho, a shareholder with less than ten per cent of the total capital stock is not permitted to take a list of the names and addresses of shareholders except by special permission of the directors.[120]

Such provisions as these would effectually bar all shareholders in many of our largest corporations, among which abuses of management have been in certain instances most noticeable in recent history.[121] In a period in which the other protections of the individual shareholder are gradually disappearing, it seems that the new statutes should not go farther than is necessary in restricting the shareholder's right to information in order to avoid possible abuses which generally can be controlled in other ways.

The harmful effect of these excessive limitations is offset to some extent by the more modern requirements for the making of annual reports to the shareholders and in some instances to the state;[122] and for entitling the shareholders to demand a certified financial statement and profit and loss statement for the

117. Mich. Pub. Acts 1931, no. 327, § 45; La. Gen. Stat. 1932, § 1118.

118. Mich. Pub. Acts 1931, no. 327, § 45.

119. La. L. 1928, Act No. 250, § 38, as amended by Fourth Extra Session, L. 1935, Act No. 34. The provision extends not only to business competitors, but also to "a person who is interested in a corporation who (which) is a business competitor, or one who holds stock in said competitive business."

120. Idaho Code 1932, § 29-143.

121. Perhaps the situation reflected in Rogers v. Guaranty Trust Co. of New York et al., 288 U. S. 123, 53 S. Ct. 295, 77 L. ed. 652 (1933), is not a typical one, but there is evidence that it is all too common to justify practical abolition of the shareholder's right to information and means of investigation. The difficulties placed in his way by the court in that decision, and even more controlling ones of general application arising from the mere factor of expense render this right tenuous enough at best for the bona fide shareholder. His narrow protection afforded by the right of examination should not be entirely abolished in the attempt to check operations of the so-called blackmailer-shareholder.

122. Civil Code of Calif. § 358 as amended by L. 1933, c. 533, § 57; Idaho Code 1932, § 29-601; Smith-Hurd Rev. Stat. 1935, ch. 32, § 157.95-6; Burns' Ind. Stat. 1933, § 25-244; La. Gen. Stat. 1932, § 1119.

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current or preceding fiscal period.[123] Many of these, however, are woefully inadequate in specifying the detail with which the statement shall be made, and nearly all, with California as a notable exception,[124] fail to require any information concerning subsidiary companies. Nearly all of the statutes make provision for penalties, in some cases excessive in character,[125] in others hardly sufficient to be effective,[126] to be imposed either upon the corporation or upon the officials involved for failure to file the reports specified, or to supply the statements prescribed.

Despite these attempts to secure an adequate substitute for the old absolute right of examination, it is probably true, as Professor Dodd says, that "the only really effective effort to obtain the publication of information sufficiently detailed and comprehensive to be of real value to investors is that made by recent federal statutes."[127]

The one old protection of the shareholder which, on the surface, does not seem to have been greatly attenuated by the modern acts, is his power to institute a representative suit. Even this has been curtailed, perhaps in some cases almost to the point of extinction, by the unnecessarily restrictive provisions concerning examination of the books and records referred to above. It is safe to conclude that this right has not been extended on the whole, but rather has been restricted, as a general result of the recent enactments.

IV.

Space does not permit a detailed treatment of the provisions of the recent acts relating to capitalization.[128] Nearly all of the

123. Civil Code of Calif. § 359, as amended by L. 1933, c. 533, § 58; Mich. Pub. Acts 1931, no. 327, § 45; Laws of Minn. 1933, ch. 300, § 34.

124. Deering's Civil Code 1931, § 358.

125. Mich. Pub. Acts 1931, no. 327, § 91 (forfeiture of charter for failure to file annual report for two successive years); Burns' Ind. Stat. 1933, § 25-250 (as in Michigan).

126. Deering's Civil Code Calif. 1931, § 368, as amended by L. 1933, c. 533, § 68, providing a penalty of $100 plus $10 per day to a maximum of $1,000 imposed upon the corporation for failure to keep the specified books and records or to prepare or submit the required financial statement. See also Civ. Code § 358, as amended by L. 1933, c. 533, § 57 and § 359, as amended by L. 1933, c. 533, § 58. In a situation like that presented in Rogers v. Guaranty Trust Co. of New York, supra n. 121, a maximum fine of $1,000 to be paid by the corporation would be a small price for the management to pay for the privilege of debarring the inquisitive shareholder from the information necessary for his further action.

127. Op. cit. supra, note 7, p. 49.

128. See, however, Ballantine, Corporate Capital and Restrictions upon Dividends under Modern Corporation Laws (1935) 23 Calif. L. Rev. 229;

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statutes have abandoned maximum limitations, but, as in Michigan, Minnesota and Indiana, specify minimum amounts with which business may be begun.[129] All permit the issuance of no-par stock, and all make some attempt to solve the problems of capitalization raised by the introduction of this device. The emergence of the concept of stated capital as an attempt at solution of this problem is a general characteristic, although there is great variety in the detail of particular definitions.[130] Perhaps, the most workmanlike job is that in California[131] which is followed somewhat closely in Minnesota.[132] Accompanying the attempts at definition of stated capital are numerous and diverse provisions concerning the definition of the various types of surplus. Paid-in surplus is being recognized generally[133] and requirements are made for keeping it distinct from earned surplus and surpluses created by capital reduction and by appreciation or revaluation.[134] Many of the statutes, however, are not sufficiently restrictive in differentiating the various types of surplus according to their source.[135] While these attempts undoubtedly constitute advances, in view of the general acceptance of the no-par device, all of them have underlying weaknesses in the provi-

Ballantine, A Critical Survey of the Illinois Business Corporation Act (1934) 1 U. of Chicago L. Rev. 357, 358-362, 364-379; Hills, Model Corporation Act (1935) 48 Harv. L. Rev. 1334.

129. Mich. Pub. Acts 1931, No. 327, § 4(1) ($1,000); Laws of Minn. 1933, ch. 300, § 3(f) ($1,000); Burns' Ind. Stat. 1933, § 25-216(8) ($500). Also La. Gen. Stat. 1933, § 1088 ($1,000); Sess. L. of Wash. 1933, ch. 185, § 7 ($500).

130. See Deering's Civil Code of Calif. 1931, § 300b, as amended by L. 1933, c. 533, § 9; Smith-Hurd Rev. Stat. of Ill. 1935, ch. 32, § 157.2(k); Laws of Minn. 1933, ch. 300, § 1(X), § 61 as amended by L. 1935, c. 117, §§ 10, 11; Throckmorton's Code of Ohio 1930, § 8623-37; Laws of Pa. 1933, no. 106, Art. I. (Bus. Corp. L. § 614). Recent acts which retain the older term "capital stock" are: Idaho Code 1932, § 29-101(10); Burns' Ind. Stat. 1933, § 25-101; La. Gen. Stat. 1932, § 1080X; Mich. Pub. Acts 1931, no. 327, § 82, as amended by P. A. 1935, no. 194, and § 20, as amended by P. A. 1935, no. 194; Laws of Wash. 1933, ch. 185, § 1, X.

131. Deering's Civil Code 1931, § 330b.

132. Laws of Minn. 1933, ch. 300, § 1, X, § 61 as amended by L. 1935, c. 117, §§ 10, 11.

133. Deering's Civil Code Calif. 1931, § 300(b); Idaho Code 1932, § 29-128; Smith-Hurd Rev. Stat. Ill. 1935, ch. 32, § 157.2(1); La. Gen. Stat. 1932, § 1105; Laws of Minn. 1933, ch. 300, § 20; Throckmorton's Code of Ohio 1930, § 8623-23; Laws of Wash. 1933, ch. 185, § 23.

134. Deering's Civil Code of Calif. 1931, § 346; Idaho Code 1932, § 29-129(2); Laws of Minn. 1933, ch. 300, § 20; Laws of Wash. 1933, chap. 185, § 24.

135. Idaho Code 1932, § 29-148; Burns' Ind. Stat. 1933 (no provision); Laws of La. 1928, No. 250, §§ 25, 45; Mich. Pub. Acts 1931, no. 327, § 20.

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sions for valuation of property, services, and other types of consideration authorized to be accepted for shares at the time of original issue.[136] While these limitations are designed primarily as controls of distributions, whether by way of dividends or of retirement of outstanding shares, the broad discretion generally permitted in the initial valuation of assets makes their ultimate effect of extremely doubtful value.[137]

Assuming that reasonable valuations have been made, and that honest and relatively accurate books have been kept, the provisions as to stated capital and the various types of surplus undoubtedly constitute more specific directions concerning distributions than formerly existed. In general, dividends of cash or property are prohibited to be paid from unrealized asset appreciation[138] (with occasional exceptions as to securities having a readily ascertainable market value)[139] and from revaluation of assets.[140] Some of the statutes authorize dividends out of paid-in surplus,[141] but guard this by requiring notice of the source to be given to the shareholder[142] and, in some instances, included in the annual public report[143] and in other instances by limiting such dividends to outstanding shares having either preferential divi-

136. Deering's Civil Code of Calif. 1931, § 300a as amended by L. 1933, c. 533, § 8; Laws of Ill. 1933, p. 310, § 17; Ind. Gen. Corp. Act 1929, § 6(c); La. Gen. Stat. 1932, § 1097; Mich. Pub. Acts 1931, no. 327, § 21; Laws of Minn. 1933, § 14; Ohio Gen. Code, § 8623-16; Rem. Rev. Stat. Wash. 1932, § 3803-17. The usual provision is that the judgment of the directors is conclusive in the absence of fraud or bad faith. Michigan requires them to exercise "reasonable care" and Minnesota requires a "reasonable investigation." In Indiana and Ohio par shares may be issued for cash at less than par in certain conditions. In Louisiana, Washington and Pennsylvania, in some cases, the valuation is made by the shareholders or the incorporators. See, for the latter state, Pa. Bus. Corp. Law, § 603(A).

137. See text at infra, note 152.

138. Civil Code of Calif., § 346, as amended by L. 1933, c. 533, § 49; Idaho Code 1932, § 29-129(4); Ill. Bus. Corp. Act (L. 1933, p. 310) § 41(c); Burns' Ind. Stat. 1933, § 25-211; La. Gen. Stat. 1932, § 1106(I)(b)(2); Mich. Pub. Acts 1931, no. 327, § 22; Laws of Minn. 1933, ch. 300, § 21(I).

139. Idaho Code 1932, § 29-129(5)(c); La. Gen. Stat. 1932, § 1106-(I)(b)(4); Laws of Minn. 1933, ch. 300, § 21(I).

140. Idaho Code 1932, § 29-129(4); Burns' Ind. Stat. 1933, § 25-211; La. Gen. Stat. 1932, § 1106(I)(b)(2).

141. Deering's Civil Code of Calif. 1931, § 346(3); La. Gen. Stat. 1932, § 1106(II); Mich. Pub. Acts 1931, no. 327, § 22; Laws of Minn. 1933, § 21(II)(b).

142. Deering's Civil Code of Calif. 1931, § 346a(2); La. Gen. Stat. 1932, § 1106(II); Mich. Pub. Acts 1931, no. 327, § 22; Laws of Minn. 1933, ch. 300, § 21(II)(b); Throckmorton's Code of Ohio 1930, § 8623-38(d).

143. Mich. Pub. Acts 1931, No. 327, § 22.

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dend rights or liquidation values.[144] In some of the states, dividends may be paid only out of some form of surplus,[145] but in others, as in California, Minnesota and Delaware they may be paid from annual net profits even though capital is impaired prior to the payment.[146] Usually there are provisions against the payment of dividends which will have the effect of impairing capital, but these ordinarily are so vague as to constitute only general guides.[147]

With reference to the purchase and redemption of the corporation's own shares, the more recent statutes vary considerably in detail. The excellent policy of the California[148] and Illinois[149] statutes is directed, as Professor Ballantine states, "to discourage speculation by the corporation in its own shares, by restricting purchases in general to earned surpluses."[150] Certain exceptions, however, even in these statutes offer considerable opportunity for purchases detrimental to creditors and other shareholders, such as those permitting redemption of preferred shares, purchase of the shares of dissenting shareholders in specified instances, and repurchase of shares issued under employees' share participation plans, or purchase for sale to employees, especially, when the latter do not exclude directors and officers. Attempts are made also to control reduction of stated capital in the interest of creditors and other shareholders.[151]

In general one cannot view these attempts with great satisfaction. When one has struggled with these problems as long

144. Civil Code of Calif., § 346, as amended by L. 1933, c. 533, § 49(3); Laws of Minn. 1933, ch. 300, § 21(II)(b); Ohio Gen. Code, § 8623-38; Pa. L. 1933, no. 106, § 701, as amended by L. 1935, Act No. 361; Rem. Rev. Stat. Wash. 1932, § 3803-24.

145. Idaho Code 1932, § 29-129; Burns' Ind. Stat. 1933, § 29-211; Ill. Bus. Corp. Act (L. 1933, p. 310) § 41.

146. Deering's Civil Code of Calif. 1931, § 346(2), as amended by L. 1933, c. 533, § 49(2); Laws of Minn. 1933, ch. 300, § 21(II)(c); Rev. Code of Del. 1915, § 1949. The Michigan act also authorizes dividends "either from earned surplus or net earnings." Pub. Acts 1931, no. 327, § 22, as amended by P. A. 1935, no. 194. See also the carefully drawn Minnesota provision: L. 1933, c. 300, § 21, (II) (c).

147. Ind. Stat. 1933, § 25-211; Mich. Pub. Acts 1931, no. 327, § 10(h).

148. Deering's Civil Code 1931, § 347.

149. Smith-Hurd Rev. Stat. 1935, ch. 32, § 157.58.

150. A Critical Survey of the Illinois Business Corporation Act (1934) 1 U. of Chicago L. Rev. 357, 365.

151. See Deering's Civil Code of Calif. 1931, § 348; Smith-Hurd Rev. Stat. (Ill.) 1935, ch. 32, § 157.59; Throckmorton's Code of Ohio 1930, § 8623-39.

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and as faithfully as has Professor Ballantine, it is at least disheartening to find the result of his labors heading up in consideration of the possibilities of finding substitutes for the present system. He states:

> "No satisfactory substitutes for surplus and profits as tests of statutory limits on permissible dividend distribution have as yet been devised. It might be possible to discard the present stated capital and surplus system entirely, and replace it with a provision that withdrawals must not be made unless after each such withdrawal the fair present value of the assets would be at least equal to, say, one and one-fourth times the debts and liabilities of the corporation. This would prescribe a minimum margin of safety of twenty-five percent over the debts and liabilities. Another possibility would be to require a certain current ratio, that is, a fixed minimum ratio of current assets to current liabilities as indicating a liquid position."[152]

V.

In general summary it may be said that the new incorporation laws follow the lead of Delaware in abrogating the old statutory limitations upon corporate organization and substitute therefore large authorizations for incorporated institutions to create their own types of security structure, powers, and limitations. In general, they are designed to give the maximum freedom to the incorporators, and to adjust the statutory provisions to the requirements of the large scale mass production enterprise. The statutes have been successful, perhaps beyond the dream of the initiators of the present large-scale system, in the creation of motive power. They have created a system which not only is adapted to cope with the rapidly changing conditions of the business environment, but also, and in consequence thereof, is liable to great abuses. The individual shareholder now has largely a "pig-in-a-poke." His old vested rights are gone or are going. He is made more dependent with each new statute upon the desires of the management and the majority which often is only another name for the management. Nevertheless, the power development probably has been a necessary one. Certainly it has been so and will continue to be so if the trend of business organ-

152. Ballantine and Hills, Corporate Capital and Restrictions Upon Dividends Under Modern Corporation Laws (1935) 23 Calif. L. Rev. 229, l. c. 262.

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ization continues in the direction of the large unit. The failure, and it has been a real one, has been in the refusal or inability to devise new types of control, adequate to act as brakes upon the new motive power without destroying its effectiveness. It is believed however that not all the possibilities have been exhausted. One or two will be suggested.

In the first place, it is doubtful, to say the least, whether it has been necessary to extend all of the powers and privileges of the new acts to all corporations. To a philosopher, it would appear incongruous to provide the same mechanism for legal organization of "The Corner Peanut Wagon, Incorporated," and "The United States Steel Corporation." It also borders upon the silly to refuse incorporation to John Doe and yet permit him to achieve the corporate status by using dummies. Even more absurd is the requirement that he and his dummies solemnly resolve themselves into meetings as directors and shareholders in order to carry on his corporate business.[153] So far, in the framing of our general incorporation laws, the state legislatures have refused to recognize that John Doe, Incorporated, The Acme Grocery Corporation, and the Steel Corporation, are essentially different institutions. If it is believed necessary to confer vast powers on gigantic corporations in order to induce them to stay at home, it does not follow that the same powers or the same

153. As implied in Mich. Pub. Acts 1931, No. 327, §§ 3 and 13. It is entirely possible, of course, that the situation presented in Jackson v. Hooper, 76 N. J. Eq. 592, 75 Atl. 368 (1909), will be extended to the one-man corporation. That case involved a true "incorporated partnership," but out of respect for the corporate rigmarole designed to fit a group situation, the court refused to recognize the contract for equal control made by the shareholders substantially interested in the enterprise. A result in the contrary direction was reached in Holsinger v. Herring, 207 Ia. 1218, 224 N. W. 766 (1929). The effect of the decision in the Hooper case was to give the final voice in control of the company to a "dummy" shareholder having no substantial interest in the enterprise. While such a result might be justified in the situation there presented as providing a method of breaking the deadlock between the two real owners, not even this justification exists in the case of the "one-man company." In that situation when the statute requires three directors, as does the Michigan Act, the effect of judicial adherence to the normal statutory scheme of action is to give ultimate control to the two "dummies," in effect giving two men the power to run another business. If it is thought desirable to encourage or permit one-man incorporation, the further step should be taken of authorizing one-man control, so long as no one else is interested in the corporation. The fact that the "real owner" normally has economic or other controls over the "dummy" does not require that the latter should be given such vast opportunity for blackmail or other form of injury to the former.

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restrictions should be given to or imposed upon John Doe and the Acme Grocery Corporation. With reference to John Doe, it would seem high time for the states to recognize, as Michigan and Iowa have done,[154] that he has to compete in an incorporated world, and if he cannot do so honestly and openly, he will do so by subterfuge. In many cases this injures no one, but in others it offers opportunity for all kinds of legal tight-rope walking. Why should not the states then recognize the call of John Doe as they have that of the Steel Company, and provide for him a simple corporate mechanism adapted to his circumstances and needs? This should involve not only direct and simple authority for a single individual to incorporate, but also provision for direct control of the incorporated enterprise by the individual whose business is incorporated. Every laborer knows that John Doe is "boss" of John Doe, Incorporated. The law should not be blind to such an elementary "fact of life" in the corporate world. Nor should it create the opportunity, which occasionally is seized, for a mere "dummy" to decide the future of another man's business in a manner contrary to that man's interests and desires.

As to the Acme Grocery Company again it seems unnecessary to supply this small local concern, capitalized, say, at not more than $100,000.00, and having from twenty to a hundred shareholders, resident in the general locality of the corporation's business, with all of the high-powered devices which are given to the Steel Company. While these small concerns are permitted, by the general freedom of contract which characterizes the latest statutes, to simplify their organization as much as they desire, they are also given the power to change this simple structure over the protest of a considerable minority and without the same necessity for doing so which characterizes the Steel Company. Furthermore, valuable protections formerly surrounding the individual shareholder and the minority, are abrogated.

It would seem that an intelligent approach to the general problem of incorporation would require at least three types of general incorporation laws in each state: One for the single incorporator, another for the small concern, and a third for the extensive business setup, for purposes of mass production.

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154. Supra, notes 30 and 31.

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Normally, it is not the small concern which incorporates away from home. And if it were, the matter could be controlled by sufficiently stringent provisions as to the entrance of foreign corporations of this type. By so differentiating the different types of business institutions in accordance with the realities of their business situation and requirements, many of the old safeguards could be retained, at least partially, without unduly hampering the creation of a modern type of corporate motive power where needed.

As to the large concern the problem would remain of devising new controls. It is the writer's view that all attempts along the lines now being followed by the new state incorporation laws to achieve adequate protections either for creditors or investing shareholders will fail. One alternative, of course, would be the institution of rather rigid administrative controls either through the establishment of state corporation commissions with real visitatorial powers, or the creation of similar controls under the auspices of the Federal Government. The writer does not expect such an attempt by the states. It is possible that the Federal Government will go further than it has done recently in corporate legislation. The proposal of a national incorporation act is intriguing[155] but has its difficulties.[156] The subject is too large for treatment at this point, although it is the writer's view that the proposal has very real possibilities, and probably will turn out to be the ultimate resort of an impatient, if not angry, public.

155. At one time or another the proposal has caught the fancy of Presidents Theodore Roosevelt, Taft and Wilson, former Secretary of Commerce and Labor Charles Nagel, former Solicitor-General Frederick W. Lehman, Senator William E. Borah and other statesmen of national distinction disgusted with the situation in which "the state with lowest standards forces the hand of all the rest." As late as 1934 Frank Altschul, Chairman on Stock List of the New York Stock Exchange, wrote to the Senate Committee on Banking and Currency urging full exploration of the possibilities of Federal incorporation despite the "enormous political difficulties in the way of such legislation." This action was urged as a possible means of checking state "practices which have often given us concern" and as a possible means of providing some real protection for investors. The bill introduced by Senator O'Mahoney in 1935 and his subsequent advocacy of its adoption have aided in reviving discussion of the proposal. Had the World War not interrupted the progressive program of legislation in the Wilson Administration, it is possible that such a statute would have been enacted. Had this been the case, there is little room for doubt that it would have been effective to check materially, if not to prevent, the post-war deluge of holding companies.

156. See Berlack, Federal Incorporation and Securities Regulation (1936) 49 Harv. L. Rev. 396.

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Can any less difficult and perhaps less objectionable controls be devised? In one or two respects the recent statutes have suggestive provisions. One is the so-called "appraisal" statute, by which a dissenting shareholder is permitted to demand payment of the fair cash value of his shares, in case of certain unusual actions such as merger and consolidation, amendment substantially affecting his rights, and sale of the enterprise or its entire assets.[157] This is not primarily a control, but an escape; it offers the dissatisfied investor a way out. To a limited extent the possibility of resort to it by a considerable number of shareholders will operate to prevent action. It is, however, a relatively new device. When the results of its use are better known, perhaps it can be extended to more frequent uses, thus offsetting to some extent the abrogation of the shareholder's former contractual position.

Another provision which characterizes the California act[158] and some others[159] is the requirement that on certain unusual questions every share or every share affected shall be entitled to participate in a class vote, regardless of the general provisions of the articles as to voting rights. This operates to introduce a statutory right of veto in the class but not in the individual. It has the merit of a real check, but of course in the large company where shares are widely distributed even within the class, this procedure can be resorted to effectively only in emergency situations. While the provision undoubtedly is a valuable one, and especially so because it is better designed to fit the modern motive power without unduly checking it than were the old voting provisions, it offers the suggestion of a possible extension which might create a real brake correlative to the modern motor power.

If a class can express a class view upon particular matters of policy, there seems to be no reason why it could not be permitted to set up an agency representative of its interests to stand on

157. Deering's Civil Code of Calif. 1931, § 369; Rev. Code Del. 1915, § 1975; Idaho Code 1932, §§ 29-149, 29-155; Burns' Ind. Stat. 1933, §§ 25-236, 25-240; Smith-Hurd Rev. Stat. (Ill.) 1935, §§ 157.70, 157.73; La. Gen. Stat. 1932, § 1132; Mich. Pub. Acts 1931, no. 327, §§ 44, 54; Laws of Minn. 1933, ch. 300, §§ 39, 43.

158. Deering's Civil Code 1931, §§ 361(3), 362a.

159. Idaho Code 1932, § 29-145(4); Smith-Hurd Rev. Stat. (Ill.) 1935, ch. 32, § 157.54; Burns' Ind. Stat. 1933, § 25-224(b); La. Gen. Stat. 1932, § 1122(III); Mich. Pub. Acts 1931, no. 327, § 43; Sess. L. Minn. 1933, ch. 300, § 36 III(d).

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guard concerning them, and in certain instances to take action to protect them. What is proposed is in substance a "board of directors" or observers for each class of shares. The general managerial power, of course, would continue to be vested in the presently constituted board of directors. The class boards would not be given power to initiate policies, or generally to represent the corporation. They could, however, keep track of the general trend of corporate affairs. They could be given broad powers of inspection of the corporate books and records. They could be invested with the power to institute a suit on behalf of the class, somewhat similar to the present shareholder's suit. A limited power of assessment or a lien on shares of the class to cover expenses of examination, investigation and litigation could be provided. Certain veto powers now conferred upon the class could be conferred upon and exercised by them, at least in the first instance. What the American corporation has lacked always, and what the state incorporation laws have never provided, is an effective critical agency within the corporation itself. The provision for cumulative voting was a step in this direction, but not a long, nor, as it now appears, a permanent one. It would be necessary, of course, to make statutory provisions designed to secure the independence of the class directors from the general directors. It should not be difficult to do this, at least in the company with widely scattered shares.

Such a proposal, of course, will not be looked upon with favor by that portion of the managerial interest in big business, which has sought and seeks almost complete freedom from public and shareholder control. Perhaps the idea is chimerical, but it may contain the possibility of establishing an effective check in behalf of minorities and even of majorities presently almost helpless. It might have the additional merit, from the viewpoint of the advocate of private enterprise, of staving off, if not of ultimately preventing, a very widespread expansion of public administrative control in the interests of the investing, the laboring, and perhaps the consuming public.[160]

160. Since the manuscript of this article was completed, the writer has discovered that the suggestion for a "class board" is not entirely novel. In 1925 the following suggestion was made: "It is therefore suggested that machinery be created whereby representatives can be elected by the different groups of security holders who will advise the security holders, from

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time to time, as to the condition of the corporation, by way of check upon the management. In all corporations of more than a minimum number of security holders, such advisory committees could be elected annually by the respective groups of security holders." Eustace Seligman, Broader Legal Aspects of Customer Stock Ownership (1925) 50 Reports of Amer. Bar Assoc. 851, 853-4, quoted Ballantine, *Private Corporations* (1927) 546 n. 151. The provisions of general vigilance committees under the Mexican Commercial Code and the British Companies Acts (see Ballantine, *op. cit.* supra, p. 546, n. 151 and p. 555, n. 180) offer legislative sanction for the proposal. In the writer's view the provision for class, rather than general committees, would offer the greater protection, and there seems no valid reason for limiting their functions merely to that of securing and divulging information.

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