

# THE AMERICAN LAW REGISTER

FOUNDED 1852.

UNIVERSITY OF PENNSYLVANIA

DEPARTMENT OF LAW

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VOL. { 47 O. S. }  
      { 38 N. S. }

FEBRUARY, 1899.

No. 2.

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## AN INQUIRY INTO THE NATURE AND LAW OF CORPORATIONS—PART II.

*The Relation of the State to the Corporation and the Persons  
Composing it.*

As an artificial person existing in the law as the subject of property rights and in its essence differing only from a natural person in that personal rights cannot be predicated of it, a corporation cannot be deprived of its rights, properties or immunities without due process of law; nor can any State pass any law impairing the obligation of its contracts. These constitutional restrictions do not, as is well known, apply to the general rights of property, such as the general rights to contract, to sue, to buy and sell lands, etc., and such rights, therefore, so far as such special provisions are concerned, continue subject to the control of the State; but these provisions do apply, not only to the right of a person to property vested in him, but also to the right to freely use such property, as it is in such right of user that the ownership of the property is found. A corporation, therefore, can no more be arbitrarily deprived of the right to sell its real estate than

of the real estate itself, as in either case it would be deprived of a vested property right without due process of law; although, so far as these special provisions are concerned, it can be deprived by law of the general right to deal in real estate, excepting such real estate as to which its property rights had become vested. Similarly, with regard to its contractual rights, not only cannot its actual contracts be impaired by any State law, but it cannot be deprived by law of its right to make contracts for the use of the property belonging to it, since such latter right is an incident to the ownership of the property and vests upon its acquirement. An incorporated livery stable company, for instance, can no more be deprived of its right to hire or sell its horses, than of the horses themselves, without due process of law, since the ownership of such horses really consists in the right of the corporation to use, to hire and to sell them. It would hardly seem necessary to deal with this question, but that it is apparently often assumed that, by the very act of incorporation, the state acquires some right to regulate the exercise by a corporation of its special—that is—vested property rights. That the State does often possess such right with regard to special corporations is true, but such right in such cases flows not from the artificial character of the corporation, but from the public character of the franchise it enjoys. The State always possesses the right to regulate the use of a public franchise, whether such franchises be vested in a natural or an artificial person, and it is this right to regulate business of a public character usually, if not invariably, conducted by corporations, which is confused with the right to regulate the business of a corporation as such. A railway as a public carrier is subject in the exercise of its public franchise to the reasonable control of the State, but so also would be a natural person vested with a like privilege and duty. Irrespective, however, of any such privilege or duty, the *vested* property rights of a corporation should evidently be governed by the legal doctrines applicable to the property rights of all persons. But a moment's consideration will show that the *general* property rights of a corporation are on a different basis. A corporation is created

when any persons are authorized to act under an assumed name; and, in the absence of any special limitation, we find that such persons are thereby authorized to exercise all the property rights under such name, but it is plainly within the power of the State, upon creating such corporation, to fix or limit such property rights and, as a necessary consequence, to subsequently alter such rights by proper amendment of the corporate charter, for a corporation cannot, as we shall see, be said to possess any vested right therein.

A corporation we have found to be merely the result of the action of the state in conferring upon various persons the right to act under an assumed name; if, therefore, this right thus conferred were abrogated, the corporation would itself cease to exist; or, if such right were modified, would continue to exist, if at all, under changed conditions. And, plainly, this right of such persons to act under the corporate name cannot be maintained by the corporation itself, for such corporation, being but the result of such right, cannot in any way maintain that upon which it depends for its very existence. The inviolability of a corporate charter, therefore, if a fact, must be found in the relations by such charter established, not between the state and the corporation, but between the state and the parties to whom such charter is granted, to wit, the persons composing the corporation. What, then, are such relations? The essence of a corporate charter is the bare right to act under an assumed name. Certainly, in the absence of any other factors or considerations, this right is but a privilege voluntarily conferred by the state, and, therefore, revocable at will. A special power not a common right either of person or of property, but a power entirely artificial and conventional, conferred simply in the execution of a State policy, should certainly remain subject to State control. The power to act under an assumed name thus conferred by the State is not a common right, but is, on the contrary, a special privilege conferred by the state in derogation of the common rights of all other persons and, *a priori*, public policy, as common reason would seem to require, that if the State should subsequently determine the exercise of such right to be contrary

to public policy, that it should be able to withdraw it and thereby dissolve the corporation.

It is, of course, not suggested that a corporate charter may not contain a contract, but what is meant and what would seem too plain for argument, is that the essence of a corporate charter, the bare power conferred by the State upon various individuals to act under an assumed name, is not in itself and cannot be construed into a contract. Many charters, especially charters of quasi public corporations, in addition to creating a corporation, go further and impose upon the resulting corporation special duties, and in consideration thereof grant to it special privileges, which latter may well be said to lie in contract; but what is to be noted is that such a contract, even if found in a charter, is not of its essence but is merely incident thereto. If such a contract be found in the charter creating the corporation, such charter should be to such extent protected from repeal or amendment under the Constitution of the United States; but as is well said by Justice Field, in *Stein v. Mississippi*,<sup>1</sup> in discussing the Dartmouth College case: "In this connection it is to be kept in mind that it is not the charter which is protected, but only any contract the charter may contain; if there is no contract, there is nothing in the grant upon which the Constitution can act." The erroneous doctrine that all corporate charters, without regard to any special contract, are protected as contracts under the Constitution of the United States, which doctrine is generally assumed to be established by the Dartmouth College case, is founded partly upon a misconception of the true nature of corporations, and partly upon the failure to distinguish between ancient and modern charters. It is true that the old English charters, like the charter of Dartmouth College, were in form grants, but the reason for this is to be found not in the peculiar character of the corporation or in any contractual relation which the state intended to establish therewith, but in the fact that the old English charters were in their very nature grants, not simply for the purpose of creating artificial persons to conduct commonplace enterprises,

<sup>1</sup> 101 U. S., p. 16.

but were grants of political privileges which the corporators either purchased or wrested from the crown. These charters took the form of grants, not because the corporators had a vested right to act under an assumed name, but because the object and purpose of such charters, of which the creation of the corporation was but an incident, was to protect the members of the corporation, in the exercise of certain privileges, from the tyrannical interference of not the state but the crown.

Historically, corporations were chartered for public or, more properly speaking, political purposes. It is not meant that they were public corporations in the present technical sense of such term, that is mere agencies of the state; on the contrary, there were few, if any, such. But such charters were primarily grants of political privileges, the corporations existing merely as incident thereto. Naturally, therefore, these charters, being in the nature of charters of liberties, took their solemn form and were vigorously maintained against the encroachments of the crown. But, it is to be remembered, that it was the political privileges and liberties conferred and not the mere right to act under an assumed name that were thus maintained. A glance at the old English corporations will bring this fact out. The first English corporations were probably the guilds. These were associations of tradesmen primarily for mutual advantage, but who, in consideration of certain public duties to be by them performed, had obtained from the crown special political powers and privileges, often of such broad character as to practically embrace the government of a municipality. Historically speaking, indeed, municipalities, as the outgrowth of such guilds, were not as now mere political agents of the state, but were associations of persons who, by charter, had acquired the right, in certain respects, to govern themselves. The charters were, indeed, in many respects, similar to those of the great universities—to that of Dartmouth College; but it is not to be argued from this that these latter charters were, in any sense, contracts. On the contrary, the only deduction, if any, to be drawn, is that these latter corporations are like municipalities, of a political char-

acter, and, therefore, according to our modern doctrine, subject to state control.

The charter of foreign colonies were of the same character. To encourage the establishment of such a colony, a charter would be granted the adventurers, carrying with it various political rights and privileges. Many of the American colonies were thus established; their charters were in form compacts, and the proprietors and colonists, therefore, properly maintained them to be guarantees of political liberties. Going a step further, charters were then granted to companies of merchants conferring certain trade privileges of a political character. But so far stock companies were unknown; and the members of corporations merely enjoyed the political privileges conferred. In the year 1600, however, the first joint stock company, the East India Company, was chartered by the crown. This charter, also, was in form a compact. In consideration of their undertaking certain annual ventures in the Indies, the corporators and their successors, under the name of the East India Company, were granted certain trade and political privileges. Thus far this charter was similar to others previously granted, but in addition this company was authorized to issue stock and to carry on its enterprise in the corporate name for the benefit of the stockholders. Heretofore the members of corporations had enjoyed their political privileges as individuals, the corporation merely existing for the purpose of protecting and maintaining them, but by this charter, as with modern stock companies, all such privileges were vested in the corporation itself, the members thereof having only the right to elect the governing board and to share the profits.

As the East India Company may be said to usher in the modern stock company, it may be well to stop for a moment to compare the old with the new corporation. Both are artificial persons resulting from the right conferred by the state upon various persons to act under an assumed name, but otherwise there is little or no similarity between them. Their charters are essentially different. As seen, the old charters were charters of privileges and liberties of a more or

less political character, of which the act of incorporation in itself was a mere incident, while modern charters are, as a rule, mere acts of incorporation, their sole purpose and intent being to create artificial persons. Old English charters were considered by the people, although not in law, inviolable by the crown, because they were of a public character and carried with them or guaranteed political privileges and liberties, and not because of any legal doctrine or belief that there was anything in the simple act of creating an artificial person binding upon the state; the present legal doctrine, therefore, of the inviolability of corporate charters can find no support in the old English law or sentiment. On the contrary, the very characteristic of the old corporations, its political character, that protected it from the interference of the crown would, under our present doctrine of public corporations, render like corporations subject to state control. The doctrine of the Dartmouth College case, therefore, that charters, as grants or executed contracts, can be neither repealed or amended by the State, cannot be supported either historically or theoretically. Yet, very possibly, the decision itself was correct. It is to be noted that the legislature of New Hampshire did not undertake to repeal the charter in question, but merely amended it so as to change the administration of the College—a very different thing. And the Supreme Court of New Hampshire, in sustaining such act, based its opinion upon its finding that such College was a public and not a private corporation. But, assuming the Supreme Court of the United States to be correct in its finding that such College was a private corporation, a very different case is presented. The State having granted certain individuals and their successors the right to administer a private fund committed to them for a private purpose, under an assumed name, might have deprived such persons, by the repeal of such act, of such special privilege and thereby remitted them their common law rights and duties; but it does not follow that the State possessed the right to transfer this privilege of administering such private property to certain other persons selected by itself. The question of the public or private character of this College was

a fundamental question upon which the State and the United States courts disagreed; the Supreme Court of New Hampshire sustaining the act in question simply as an exercise of the recognized right of the State to regulate and control public corporations. With this divergence of finding, however, we need not concern ourselves further, except to note the rather curious fact that, if the Supreme Court of the United States had but followed the New Hampshire court in holding an educational corporation to be of a public character (as it probably would have done if the case had arisen within the last few years), it would have been compelled to affirm the State decision, and the unfortunate doctrine of the case would probably never have been established. We say unfortunate, for that such doctrine is unfortunate, is, outside of any *a priori* reasoning upon the subject, established by the fact that every State in the Union has been compelled, as a matter of self-preservation, to override such decision by constitutional or legislative provision.

But let us return to the right of the State to amend, without repealing, the charter of a private corporation. In so far as a corporation charter merely confers upon certain persons the right to exercise certain property rights under an assumed name, what has been said with reference to the right of the State to repeal such act and thereby deprive such persons of every right so conferred, applies as well to the right of the State by the amendment of such act, to limit and restrict such persons in the further exercise of such special rights so conferred, so long as such amendment does not interfere with any vested property right of the corporation itself. For instance, a manufacturing corporation could, by proper amendment of its charter, be deprived of its general power to buy and sell lands, provided such amendment did not in any way affect its right to sell such lands as it might have already acquired or contracted to acquire, as only in such latter case would the corporation, as a continuing existing person, be deprived of a vested property right without due process of law. It may seem strange, at first sight, that such an act, applicable to the property belonging to a corporation, would be invalid if the

corporation continued to exist, and yet an act repealing the entire charter and, therefore, necessarily having the same result, would be valid. The distinction, however, is plain. In the latter case, the land belonging to the dissolved corporation would become immediately the property of the directors, receivers or the stockholders of the corporation, as the case might be, with full power of sale vested in them; while, in the former case, it would still remain the property of the corporation, but with the power of sale divested, and it is in this divesting of the power of sale that the invalidity of the act is found. Likewise an act amending a corporate charter, so as to deprive it absolutely of its right to make contracts, would also be void, since that would be to deprive it, while still an existing person and recognized as such in the law, of a vested right with regard to all property belonging to it; and an amendment regulating the exercise of such contractual rights in certain cases would also be, for the same reason, void, unless it could be sustained as a reasonable exercise of the right of the State to regulate the use of a public franchise. It is on this ground, of course, that acts such as those fixing railway charges are sustained, while, for the general reasons heretofore stated, they are void, if unreasonable, as depriving persons of property without due process of law.

It may be generally stated, therefore, that acts repealing corporate charters are valid, as also all acts to amend such charters by limiting the powers originally conferred thereby, provided such amendments are not applicable to vested property rights. It is often suggested, however, that such acts, either of repeal or of amendment, should be held invalid with reference to stock companies as impairing the obligation of the contract between the stockholders, irrespective of any contract between the State and the corporation or any vested right of the corporation as an existing person. This supposed contract among the stockholders is very commonly referred to by text-writers and jurists as an indisputable fact and one of the chief characteristics of a stock company, but, under the analysis of a corporation here given, there seems to be no place for such a contract.

A corporation is but an artificial person existing as the result of the right conferred by the State upon various persons to act under an assumed name; the stockholders are but the donors of the corporate property. Where, then, or in what, is the contract among such stockholders? There may be, and often is, a contract among promoters (who may afterwards become stockholders) with reference to the formation of the corporation, but upon the formation of the corporation such contract ceases. There is, also, often a contract of subscription between the stockholders and the corporation, but upon the full payment for and issue of the stock subscribed for, such contract is fulfilled, or, in any case, and even before so fulfilled, it is a contract between the corporation and its stockholders as individuals and not in any way a contract among the stockholders themselves. A person may become a stockholder of a corporation in two different ways: first, by contract of subscription with the corporation, above referred to, and second, by the purchase of the stock from third persons. In the latter case he evidently enters into no contract with either the corporation or any of the stockholders, but merely a contract or purchase and sale with the former stockholder. In either of the above instances it seems impossible to find a basis for any contract among the stockholders themselves, and in fact none such exists.

The rights and duties of stockholders, indeed, are fixed and determined, but evidently not by any contract among themselves, for they need not have any dealings with each other, but, by law, the fact being that such rights and duties cannot in any way be affected by any contract among themselves. The position of a stockholder in the corporation is evidently one of status and not of contract, and this becomes especially evident when we consider other corporations than those of a commercial character. Take, for instance, the citizens of a municipal corporation, who occupy in many respects a position with regard to the corporation and with regard to each other similar to the position occupied by stockholders. Certainly, it would be absurd even to suggest that any contractual relation exists between such citizens, and yet there is nothing in the

status of a stockholder which serves to distinguish him in this respect from the taxpayer and voter of a municipal corporation. In accepting the charter, or in incorporating the company, the stockholders do, indeed, fix the status of themselves and their successors, but they enter into no contract with each other. They one and all submit themselves necessarily to the law controlling the stockholders of a corporation, but enter into no contract which could be by law impaired, unless it be the contract of subscription with the corporation just referred to and which we will now consider. This subscription contract is based upon the charter. The subscriber to stock agrees thereby to pay the corporation, or, under our definition, the persons authorized to act as such, a certain sum of money to be held and administered by them in their corporate capacity for the corporate purposes as set forth in the charter and, therefore, of course, when such money is paid, it is taken by such corporation or by such persons in such corporate capacity under the resulting contract or trust, as it may be put, that it should be held and used by them in such corporate capacity for such corporate purposes. There, therefore, remains in such stockholders and their successors a vested right in such property to have it managed by such persons and no others, acting in such corporate capacity, applied to such purposes, which vested right, of course, is protected by the various constitutional provisions heretofore referred to.

The State, therefore, cannot, under the guise of amending the charter of a corporation, divert such funds from the charter to other purposes or transfer its administration from the persons to whom, under the original charter, it was committed, to other and different persons, for such an act would both impair the obligation of the implied contract between the corporation and its stockholders, and deprive the stockholders of a vested right in the corporate property without due process of law.

It is interesting to again note here that, assuming Dartmouth College to have been a private corporation, this doctrine sustains the decision of the Supreme Court in such case, since

the statute there in question purported to actually transfer the property of such College from one set of trustees to another.

The only other contracts that might be effected by acts repealing or amending charters are the contracts of the corporations with third persons; plainly, an amendment would be invalid which impaired the obligation of such contract, but a repeal would never impair the obligation thereof, since the dissolution of a corporation as is well determined by the Supreme Court, in *Greenwood v. Union Freight Ry.*,<sup>1</sup> is in the law, but the death of a person and such contracts survive against the corporate successors.

As already suggested, however, a corporate charter is protected from repeal or amendment, to the extent that it contains a special contract or vests property rights. If, for example, a street railway is constructed relying upon the franchise to operate the same upon public highways, granted by the corporate charter, then such franchise is absolutely necessary to the user of such railway property, and in connection therewith should be held a vested property right; or to take the case of a contract, if a railway is constructed relying upon a tax exemption, granted by the charter, then such exemption becomes a contract executed on the part of the railroad and, therefore, binding on the State in the absence of a specially reserved power of amendment or repeal. This power, however, is now almost universally reserved to the State, and, therefore, all charters are now subject to repeal and to such amendment as does not, as heretofore shown, impair any existing contract or divest the corporation of any vested property right.

The status, however, of corporations formed under the general law would seem to be quite different. In such case the State has evidently conferred no special license, in its nature revocable, upon special individuals, but, on the contrary, has granted to all persons alike a general right which it would, therefore, seem it could not abrogate with regard to special individuals. The State, therefore, should not have the power to repeal or amend the charter of such a corporation by a special law,

<sup>1</sup> 105 U. S. 13.

since that would be to deprive the persons constituting such a corporation of a right common to all other citizens. Of course, however, such corporations are not beyond the control of the State, but, being formed under general laws, they should be reached by amendments thereof or by other general laws applicable to all corporations of their class. What has been heretofore said with reference to the amendments of special charters by special laws applies equally to the amendment of the charters of such corporations by general law, and any such general law which impairs the obligation of existing contracts or deprives any corporation of a vested property right will be invalid, although, as heretofore shown, a general law dissolving such corporations would be perfectly legal.

*Henry Winslow Williams.*

Baltimore, October, 1898.

(To be concluded.)