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

The Nature of a Corporation.

As in all other inquiries, no satisfactory result will be attained until, as a basis of reasoning, a true definition is reached. What, then, is a corporation? Many definitions have been advanced and accepted, but no one yet advanced has been found to meet the exigencies of all corporate questions; no definition has been given to which the courts in all corporate cases have been able to refer as the basis from which to reason out the questions involved. On the contrary, the courts have usually been compelled to make a definition to suit the particular case in hand, rather than to decide the case according to any accepted definition.

It will be of interest to examine, first, several of the most famous definitions, and we will consider shortly three, each accepted for many purposes. These three are cited not only because they are among the very best ever advanced, but also because they are typical of the three classes into which, probably, all the definitions may be divided. Quoting them in

their chronological order: Mr. Kyd, in his well-known work on corporations, being almost the first English treatise on the subject, at page 13 of the introduction, says: "A corporation, then, or a body politic, or a body incorporate, is a collection of many individuals united in one body, under a special denomination, having perpetual succession under an artificial form, invested by the policy of the law with a capacity of acting in several respects as an individual, particularly of taking and granting property, of contracting obligations, and of suing and being sued, of enjoying privileges and immunities in common, and of exercising a variety of political rights, more or less extensive, according to the design of its institution or the powers conferred upon it, either at the time of its creation or at any subsequent period of its existence."

Chief Justice Marshall, in the *Dartmouth College Case*,[1] defines, or rather characterizes, a corporation as an "artificial being, invisible, intangible and existing only in contemplation of law."

Justice Field, in the case of the *Pembina Mining Company* v. *Pennsylvania*,[2] says with reference to private stock corporations: "Such corporations are merely associations of individuals united for a special purpose and permitted to do business under a particular name, and having a succession of members without dissolution;" thus evidently, in opposition to the definition of Chief Justice Marshall, reverting more or less to the definition first given by Mr. Kyd.

These definitions all contain truth, but a little thought will show that not one of them is satisfactory or complete. A corporation is evidently in one sense, as said by Justice Field, composed of persons, since in a sense it cannot be composed in any other way; but, as evidently, it is something more. A, B and C may compose a corporation, as if, for instance, they are the incorporated trustees of a university; but, as evidently, the university of which they are such trustees is in the law something more than the association of the three, since it is something separate and distinct from each and all of them.

[1] 4 Wheaton, 636 (1819).
[2] 125 U. S. 189 (1887).

This fact is equally plain when we consider corporations less simple in their nature than eleemosynary bodies. Take commercial stock corporation, with reference to which Justice Field gives his definition. Of what persons is it composed? If it is an aggregation of persons, of what persons? Justice Field and the other jurists, who have advanced similar definitions, would, we may assume, answer, "the stockholders." But in such answer hey would disagree, not merely with Chief Justice Marshall, who ably treats of this particular subject in his dissenting opinion in the case of the *United States Bank* v. *Dandrige*,[1] but will also put themselves in opposition to certain corporate facts.

A corporation is only an aggregation of stockholders, in the sense that they are the ultimate owners of its property. The word ultimate is used advisedly, because they possess no actual existing legal interest therein whatever; and even in a case of dissolution, when their actual legal rights first accrue, such rights are not primary, but are entirely subsidiary to the rights of all persons who have claims resulting from the action of the corporation itself. The stockholders are in the position of the heirs, or next of kin, or residuary legatees of a living person. Their legal rights only vest upon dissolution, and then entirely subject to the contracts and obligations of the late corporation. A private stock company, indeed, exists primarily for the benefit of its stockholders, who, therefore, have certain equitable rights to prevent the waste of its assets and, subject to the discretion of the directors, have certain rights to share in its profits, and, upon its dissolution, as already suggested, are in the position of residuary legatees of its assets; but in no other sense can they be said to compose the corporation.

Going a step farther, the absurdity of treating the stockholders as a corporation becomes even more apparent. If they were, for all purposes, the corporation, they would certainly exercise its powers, its functions; but, in fact, they do not, and cannot so do. Such powers are exercised by the directors. When the directors, in their corporate capacity,

[1] 12 Wheaton, 113 (1827).

act, the corporation acts, and not otherwise. In certain cases, to be sure, the stockholders are given, by statute, a certain control or veto power over the action of the directors; but, except under such statutes, for the purpose of using the corporate property, for the purpose of exercising the corporate franchise, in which user the legal title thereto is certainly found, the directors and not the stockholders are the corporation. The stockholders, indeed, usually elect the directors, but such accidental fact cannot affect the question one way or the other.

Apparently, therefore, Chief Justice Marshall was entirely right in the case of *United States Bank* v. *Dandrige*, in the opinion that, in so far as a stock corporation is an aggregation of individuals, it is composed rather of its directors than of its stockholders, since they not only can, but are the only persons who can, use its property, exercise its functions and act in its name—the stockholders being merely the ultimate distributees of its property and profits. If we endeavor to apply Justice Field's definition to other than private stock corporations, of which he was speaking, its inadequacy becomes all the more apparent; and this application should certainly be a fair test, since we all realize that the corporate conception, the corporate idea, which distinguishes corporations from other persons known to the law, exists in all corporations. Public and private corporations differ only in their purposes—otherwise they are identical legal entities, and any true definition necessarily includes them both.

Who, then, according to the definition of Justice Field, would compose a municipal corporation? In one sense in which a private corporation may be said to be composed of its stockholders—that is, in that they are the ultimate owners of its assets—the municipal corporation would be said to be composed of its taxpayers; while in another sense in which a private corporation may be said to be composed of its stockholders—that is, in that they elect the directors—the municipal corporation would be composed of the voters. But in the sense in which a private corporation is more properly said to be composed of its directors—in that they are the

persons who use its property and exercise its functions—a municipal corporation would evidently be composed of the various persons or boards who are authorized by its charter to exercise its various functions. For most purposes it would apparently be composed of the mayor and city council; for others, however, it might be composed simply of the city chamberlain; or for others of special boards, such as water boards, park boards, or the like, provided such boards were authorized to exercise any of the corporate functions in the corporate name. Likewise an eleemosynary corporation, such as a college, if simply an aggregation of persons, would be composed, for various purposes, of aggregations of various persons. For some purposes a college may be said to consist of all persons connected with it, whether students or professors. For most purposes it is usually, under its charter, composed of its trustees; but for others, again, its charter may compose it of its faculty—or even, indeed, of its alumni—if by such charter, as is sometimes the case, such various bodies are authorized to act for various purposes in the name of such corporation. For any particular purpose, indeed, a corporation, in so far as it is an aggregation of persons, is composed of those persons who are authorized to act in its name for such purpose; and hence the confusion resulting from the attempt of various jurists to define a corporation as an aggregation of any special set of persons. Plainly, indeed, therefore, a corporation is more than an aggregation of persons, being a legal entity composed for each special purpose; of various persons, indeed, but of different persons for different purposes; and Chief Justice Marshall was entirely right in his statement that, independent of all natural persons connected with it, a corporation is in itself "an artificial being, invisible, intangible, and existing only in contemplation of law." Yet, at first sight, this characterization conveys to our minds no definite idea, and would seem to be a mere metaphysical subtilty of no particular utility. But further reflection and inquiry will show that this existence of a corporation as a legal entity, as an artificial person, is a practical fact, founded in the very nature of the law itself.

The common law, properly speaking, deals not with persons, but with their rights and duties. A, B and C may, indeed, be living persons, but are not, as such, recognized and known to the law, but only through their right to do, or their obligation to refrain from doing, this or that act. So long as their rights are not infringed, nor they infringe the rights of others, the law takes no note of them; it simply protects their rights and compels the performance of their duties. The law, indeed, may be said to consist of the rights and duties of persons as enforced by the state; or since, as is well known, duties are but complementary to rights—it being the duty of every person to recognize and submit to the rights of others—this definition may be further modified, and the law may be simply said to consist of the rights of persons as enforced by the state.

Such being the nature of the common law, it follows, as already suggested, that individuals exist in the law, not as persons of flesh and blood, but merely as the subject of certain general and special rights, with the corresponding duties and penalties. We say rights general and special, because, with reference to general rights of persons and of property, they are divided into classes—such as men, women, infants and corporations—each class being the subject of certain general rights; while it is with reference to their special rights, which grow out of the exercise or breach of their general rights, that the individual members of these classes are distinguished one from another—as, for instance, the right to purchase and hold property is predicated of all men of legal age, not *non compos mentis*, while the right to purchase or own an individual piece of property is predicated only of a person undertaking to exercise this general right, and then serves to distinguish him from all other persons of his class. In contemplation of law, therefore, a person is but the subject of certain rights, duties and penalties; and, conversely, it follows that t such rights, duties or penalties are predicated of an imaginary being, vested with a name, such imaginary being, by such name, as a subject of such rights, duties or penalties, will immediately exist in contemplation of law as an artificial person.

That this is the true nature of the law, and the true position of persons with regard thereto, is made manifest not merely through the analysis thereof, but also by the consideration of some legal phenomena. We will assume, for example, that Richard Roe, the subject of the general rights of property—and, in addition thereto, the subject of the special rights connected with the ownership of the estate of Black Acre—dies, unknown to anyone at home, in a foreign country. Although he is actually dead, no longer existing in flesh and blood as a natural person, in the absence of all proof to that effect whereby by the action of the law his property rights will devolve upon other persons, he still continues to exist, in contemplation of law, as the subject of such rights. He will still, in contemplation of law, be an existing person, not only as the subject of the general rights of the property predicated of all persons, but also as the subject of the special rights flowing from the ownership of the estate of Black Acre. It may be that on account of his actual death he may not practically be able to exercise all of the property rights predicated of him, but this would equally be the case if he were simply absent and without representation, while he would still be able, although dead, through his agents, to collect the rents from his estate, and to that end, or the purpose of punishing or preventing trespass, or maintaining any other property right connected therewith, to instigate and conduct actions in law and equity; and, as the owner of such estate, he will be held, although dead, liable in the law for the improper or illegal acts of his servants and agents in the administration thereof. Indeed, further than this, if his agents are in the possession of the necessary funds or credits, he will be permitted, in the exercise of his general property rights, to purchase and become the owner of other and additional property, real and personal. As a subject, therefore, of these various rights, duties and penalties, he continues in contemplation of law an existing person, even though in fact dead.

Similarly suggestive is the reverse doctrine known as civil death, almost obsolete, but still illustrative of this peculiar character of our law. According to this doctrine a person

still living, but convicted of certain penal offences, thereupon becomes, in contemplation of law, divested of all his property rights, and, therefore, in the eye of the law, although actually living, dead. This death in the law is not and never has been, in fact, complete, although in old times it used to be assumed so to be, because, while ceasing to exist as a subject of the general property rights, such convicted person still continued to live as the subject of certain personal rights, duties and penalties.

We have also the similar case of a living person, whose property rights, after an unexplained absence of several years, have by the action of the law devolved upon a successor, and who, therefore, although living in fact, becomes dead in the law. Such legal death is evidently not, as is generally assumed, the cause, but is, as a matter of fact, simply the result of the necessity of transferring the property rights of a living person to a successor.

The case of a corporation is analagous to the first illustration above given of a person actually dead, but still existing in the law as the subject under his own name of certain rights, duties and penalties. If certain rights, duties or penalties are predicated of anything, metaphysical or otherwise, or predicated of any or of various persons, but under some special name giving the subject thereof an identity, such thing, such being, such person or aggregation of persons known by such name, becomes and is in contemplation of law, as the subject of such rights, duties or penalties, a person—an artificial person indeed—but, nevertheless, as much a person as any living man. Such artificial person or corporation like the dead person alread cited, not possessing the natural faculties, can, of course, only exercise its rights, perform its duties, through natural agents, that is, through natural persons in the exercise of their legal rights; but its rights are in no sense predicated of these agents or any of the various persons or aggregations of persons who may be said to compose the artificial person, but of it under its own name; the artificial person being under its own name the subject of such rights, duties and penalties, and in truth and fact, just as much a person.

in contemplation of law as they. But, as already suggested, corporations are not the only artificial persons existing in the law. On the contrary, it is evident that whenever the law predicates rights and duties of any thing, being or person, except of a natural person as such under his own name, an artificial person exists. Trustees, executors and receivers are all examples of such artificial persons. They are in no sense agents, exercising the rights of their principals but are, in fact, in the law, distinct persons, distinct, indeed, from their own natural persons, as they exist in the law as the subject of an entirely different set of special rights and duties from those predicated of them under their own names. Natural and artificial persons, to be sure, exercise these rights and perform these duties through the same natural faculties, just as directors of a corporation, whether acting as the corporation, or as partners in a different business would act through the same natural faculties, but natural and artificial persons so acting are in no sense identical except in the unimportant identity of the natural agencies through which they act, and, therefore, only to the same extent as two corporations, with identical boards of directors; or two trustees, filled by one and the same natural person; while they are often almost identical in every important respect with some *other* artificial or natural person. A receiver of a corporation, for instance, is in many respects identical with the original corporation; an executor with his testator; and in almost every respect a trustee, a receiver, or an executor with his predecessor or successor in such position.

Artificial persons are, therefore, just as real in the law as natural persons, and exist as such entirely independent of the natural persons, who must, in the very nature of things, exercise their rights and perform their duties. It would seem at first sight, indeed, as if it might be said that, in contemplation of law, there was not in reality any distinction between artificial and real persons; that a natural person was, in contemplation of law, artificial; and, that a natural and an artificial person were, in contemplation of law, different artificial persons, whose rights were exercised by the same natural

person. But this is not true. An artificial person is a separate and distinct legal conception, as such the person exists but as a subject of property rights, while of the living person the personal rights of life and liberty are also predicated. A trustee, as such, possesses none of the rights of persons and, therefore, for instance, cannot maintain an action for assault; likewise a corporation, although its functions are exercised by natural persons, possesses in itself no rights of persons and, therefore, cannot maintain actions for the breach thereof.

But, to revert to our definition; to characterize a corporation as an artificial person is not, therefore, to deal in metaphysics or in subtile concepts, but is simply to state a legal fact of the greatest practical importance, which fact at once establishes the status of corporations and furnishes a basis upon which, necessarily, all the doctrines of corporation law must stand. But the definition is not yet complete; it yet remains to distinguish corporations from other artificial persons.

We have found a corporation to be an artificial person existing, in contemplation of law, as a subject of certain, as yet undefined, property rights, but that is no more than to say that a corporation is an artificial person, since, as we have already found, all artificial persons exist, in contemplation of law, as the subject of certain property rights. The absence of the rights of persons we have found to distinguish artificial persons from natural persons. Are, then, as would seem to be the intendment of Mr. Kyd's definition, corporations to be distinguished from other artificial persons by the peculiar property rights predicated of them? Of what property rights, then, is a corporation the subject, or, to reverse the question, what property rights cannot be predicated of a corporation? Apparently none. In the absence of special limitations, its absolute rights are but those property rights characteristic of all persons. As a person existing in law, a corporation may sue and be sued, buy and sell real and personal property, make contracts, and, through its failure to observe its complementary duties, may break contracts, commit torts and may be held in the law accountable therefor; as, indeed, may all

artificial persons; in fact, in the absence of special limitations imposed by statute or by public policy, the law simply recognizes artificial persons as the subject of the general property rights, although, of course, such rights have to be exercised in the manner provided by law. A corporation need not possess every property right, but it may possess any property right and, therefore, cannot be distingnished from other artificial or natural persons by any peculiar property rights of which it may be the subject. Mr. Kyd's definition, therefore, is evidently not satisfactory.

Similarly with reference to the purposes for which a corporation may exist. Corporations usually, if not invariably, exist for some defined purpose, but the purpose may be general or special, may be charitable, political or commercial, or, as may well be conceived, a corporation might exist simply as a person, not for any special purpose, but merely to enable certain natural persons to exercise all the rights of property as an artificial person under an assumed name *for any legal and proper purpose.* Such a corporation, it is not believed, has ever existed, but evidently such an artificial person might readily be, by statute, created or authorized, and, if created or authorized, would as evidently be a corporation in every sense of the term. Other artificial persons can apparently be more properly, although not completely, defined with reference to their purposes; as, for instance, a trustee can only exist for the purpose of exercising property rights for the benefit of another or other persons; or, a receiver to conceive property rights in litigation, but a corporation can exist as well for these purposes as for any or all others.

The peculiarity of a corporation, therefore, is evidently not to be found in the purpose or purposes, general or special, for which it may be created or authorized. In what then does its peculiarity consist? Mr. Kyd, in his great work, page 70, expanding his definition, states that three capacities alone are sufficient to the *essence* of a corporation.

1. To have perpetual succession under a special denomination and under an artificial form.

2. To take and grant property, to contract obligations and

to sue and be sued by its corporate name in the same manner as an individual.

3. To receive grants of privileges and immunities and to enjoy them in common.

All will recognize that the possession of these three qualities would constitute a corporation, but these last two qualities or capacities are in nowise peculiar to corporations but are possessed by all persons, natural and artificial. All persons, including corporations, by virtue of their recognition as such, can take and grant property, can receive grants of privileges and immunities, and as for enjoying the latter in common, a corporation no more than any other person does that. These two last qualities, therefore, in no sense distinguish or define a corporation, being simply predicated of it as of all other persons; leaving for its only peculiar quality the first mentioned by Mr. Kyd, viz., the capacity of perpetual succession under a special denomination and under an artificial form, or, as it is more commonly put, the capacity of succession under an assumed name. It is not meant by this that a corporation must have perpetual succession, but merely that it must possess the capacity for such succession if actual persons exist with power to exercise its functions. Any corporation may cease to exist by the death of all persons authorized to so act, but, nevertheless, a corporation is not so bound up with the identity of an actual person that, upon the death of the latter, the former necessarily ceases to exist. The corporation exists under an assumed name which continues to represent its property rights regardless of the succession of persons, who may exercise them or reap the benefit thereof, and, therefore, it, under such assumed name, is capable of, or has the capacity of, succession.

This capacity of succession, indeed, like its general property rights, would seem to flow from, to be but a legal incident of, the legal recognition of a corporation under an assumed name. As an artificial person recognized at law under such assumed name, its existence is evidently independent of the existence of the persons who exercise its powers and therefore solely by virtue of such assumed name it is capable of, although for lack

of means to select successors to its original corporators it may not be actually vested with, perpetual succession.

A comparison between corporations and other artificial persons will make this plain, and will, at the same time, show that it is this one quality alone which distinguishes them from each other. Let us note the differences between a charitable corporation, or an incorporated board of trustees for a charitable purpose and an unincorporated trustee or board of trustees. They resemble each other in many respects—they are both artificial persons existing for the general purpose of holding and administering a trust fund—wherein then do they differ? The trustee exists in the law as the subject of special property rights and duties, not attributed to him as a natural person or as an individual, but yet such trustee being known in the law by the same name as the natural person exercising the trust powers, his conventional legal existence is entirely dependent upon his continued existence as an individual. When the individual dies, the trustee dies also, though the law may immediately resurrect him in the successor in the trust. The death of the former is actual and final; there is no successor to his rights and duties, and he as a subject thereof ceases to exist; the death of the latter is conventional—no sooner dead, than, in his successor, he again lives, a subject of the same rights and duties, differing in nothing except in name; if the courts had seen fit to authorize an individual trustee to act as such under an assumed name, upon his death, evidently the trustee as such would not have died, but would have continued to exist under the same name and with the same legal identity in the successor in the trust. In other words, such conventional trustee, existing in the law under an assumed name and therefore possessing under such name the capacity of succession would, in fact, be a corporation sole. And in the case of an unincorporated board of trustees this is all the more plain. We have but to assume the legislature to confer upon A, B and C, trustees, the right to so act under an assumed name to immediately convert such individual trustees into a corporation, the capacity of succession immediately resulting, if not by the terms of the trust or from the act of legislature,

then from the inherent power of courts of equity to appoint successors in trust. That this capacity of succession under such assumed name is likewise the one unique quality of a private corporation having capital stock, is evident from a comparison with common law joint stock companies. The common law, as is well known, recognized the right of individuals to associate themselves together for the purpose of carrying on an enterprise, commercial or otherwise, with a fixed capital divided into transferable shares and free from any further individual responsibility whatever. But it was simply a matter of contract, if the shares were issued and subscribed for thereunder, the law would enforce it as between parties thereto; but as to others than parties, such contract was, of course, not binding. The law recognized the contracts made in behalf of such association by its agents and the various rights and duties flowing therefrom, but it did not predicate such rights and duties of an artificial person existing under the name of such association, and they could not be enforced in its name. On the contrary, the common law predicated such rights and duties of the various individuals composing the association, by and against whom, therefore, as individuals, all actions springing therefrom had to be brought. The managers of the association were but the agents of its members and, as such, could not make contracts unless properly so empowered, and such contracts, even if legally made, could not be at law enforced except at the proper suit of the various individuals on whose behalf they were entered into. The facts that the agents of the association were, by the contract between its members, in nowise authorized to pledge their personal credit, could not avoid their liability to third parties, unless the latter were also parties to such contract, since such members were, in fact, the principals and the very persons primarily responsible for the acts of their agents, the managers of the association. It was possible, therefore, at common law, for individuals to associate themselves together under a contract in all respects similar to the relation between the members of a stock corporation, and yet such association thus formed had no standing in court. It could neither sue nor be sued, take nor grant

property, except in the name of its members, while the latter, as individuals, remained fully liable for the contracts of their agents, unless such contracts expressly provided to the contrary. As the persons composing such association had no right to act in its name, it in contemplation of law simply did not exist.

But, if we assume the managers of such association to be authorized by the state to act independently under an assumed name, evidently an artificial person will at once exist in contemplation of law under such name, which can sue and be sued, buy and sell property, etc., will, in fact, be in every sense of the word a corporation. It may seem strange that, in creating a corporation, the state should but confer upon certain persons and their successors such an apparently simple right as that to act under an assumed name; but, in fact, this right, simple as it seems to be, is entirely contrary to the very nature and definition of the common law. As already stated, such law consists of the rights of persons as enforced by the state. Duties are but complementary to rights, each right carrying with it its complementary duty, on the part of other persons, to observe it; the breach of which duty again creates the right of redress.

It is this latter right of redress, this right to hold a person committing a breach of duty personally responsible therefor, which is the keystone of the entire system. The original right, indeed, may be said but to exist therein, and, therefore, the common law could not permit any person to evade or avoid such personal responsibility for breach of duty. The recognition in the law of other artificial persons, such as trustees, while seemingly an exception to, is in reality the best illustration of this principle. In a trustee the law does not recognize the right of an individual to avoid his personal responsibility for his acts, but, on the contrary, the trustee results from the recognition and enforcement by courts of equity of the duty of trustees to observe the rights of others. If any person has any right in and to property legally vested in another, to protect this right, and to enforce the duty to observe it on the part of the legal owners of such property, equity raises a trust;

a trust being but the duty imposed upon a person holding property belonging to another to observe the rights of the latter. Except for this element of duty a trust could not exist. But, having thus imposed upon persons special duties, not simply to observe the rights of others, but often to exercise such rights for their benefit, in order to better protect such rights, and, also, as was plainly equitable, to relieve the trustee from his personal common law responsibility for their exercise, equity recognized in him as the subject of such rights, an artificial person.

The doctrine of trusts has been extended to many cases to which it properly has no application, but, nevertheless, it has never been admittedly summoned into court for other than the nominal purpose of enforcing duties, never for the admitted purpose of enabling persons to thereby avoid their personal responsibility for their own voluntary acts.

Plainly, therefore, since it was contrary to the primary principles of the common law to release a person from his individual responsibility for his act, the courts could not recognize the right of a person to act under an assumed name, and, therefore, could not recognize the existence of a corporation except by the expressed or implied authority of the state. Such authority is, therefore, in every case necessary to the existence of a corporation; and, *vice versa*, as we have found in our inquiry, when by such authority persons are authorized to act under an assumed name, a corporation immediately results.

A corporation may then be defined as an artificial person, resulting, in contemplation of law, when one or more persons are expressly or impliedly authorized by the state to act under an assumed name.

Henry Winslow Williams.

Baltimore, October, 1898.