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## DISSENTING STOCKHOLDERS AND AMENDMENTS TO CORPORATE CHARTERS

### INTRODUCTION.

Few branches of corporation law are in a more confused and unsatisfactory state than that relating to the right of minority stockholders to prevent amendments to the corporate charter, to which they have not given their assent, from becoming operative. The problem arises under three distinct types of charters which differ so widely from one another that they must be dealt with separately. There is in the first place the type of charter, once common, but rare, if not wholly unknown today, which is granted without any provision for amendment being made at the time either in the charter itself or in the general law. Secondly, there is the charter which is granted subject to a power of amendment or repeal reserved by the legislature. Lastly, there is the corporate charter which is granted subject to corporation laws which not only reserve to the legislature the power of amendment or repeal but confer an amending power upon the majority stockholders as well.<sup>1</sup> Each of these types of charter presents difficult problems with regard to the rights of dissenting minority stockholders.

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<sup>1</sup> Theoretically a charter might be granted which conferred an amending power on the majority but reserved no such power to the legislature, but no modern legislature would be likely to grant such a charter.

## MINORITY'S RIGHTS UNDER UNAMENDABLE CHARTERS.

Owing to constitutional restrictions existing in many States forbidding the granting of unamendable charters,<sup>2</sup> and also to a policy against the granting of such charters which has come to control the actions of legislatures in States where no such constitutional restrictions exist, the unamendable charter has become almost extinct. An understanding of the rights which it confers upon the individual stockholder is, however, the necessary basis for any intelligent discussion of the rights of such stockholder under the other types of charters.

Whatever one's views may be as to the substantial or insubstantial character of the distinctions between a business corporation and a partnership, it is universally recognized that the charter or articles of organization of a corporation form, like the articles of a partnership, a contract between the members. In the case of a partnership, it is no less plain that the articles, being thus a contract between each member of the firm and every other member, cannot be amended without unanimous consent.<sup>3</sup> In the case of a corporation, the problem is complicated by the fact that, owing to our conception of the charter as a grant of authority by the state, the charter cannot be amended even by unanimous consent without the state's permission.<sup>4</sup> Assuming however, that the state gives such permission, may that permission be taken advantage of by a majority of the stockholders or must acceptance of the amendment be unanimous?

In view of the doctrine that the charter is a contract between each stockholder and every other stockholder and in view of the constitutional protection of contracts against impairments by state legislation, it would seem at first sight that the answer must necessarily be that unanimous acceptance of the amendment is necessary, and this without regard to the question of the

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<sup>2</sup> See 7 FLETCHER, CYCLOPEDIA CORPORATIONS (1919) § 4300 for a list of such constitutional provisions.

<sup>3</sup> *Natusch v. Irving*, 2 Coop. temp. Cott. 358 (Eng. 1824); Gow, PARTNERSHIP (3rd ed. 1841) Appendix VI, p. 398.

<sup>4</sup> 1 MORAWETZ, PRIVATE CORPORATIONS (2d ed. 1886) § 395. It is difficult to find explicit authority for this proposition, which is, however, a necessary consequence of the accepted theory that incorporation is a legislative grant.

interpretation of the legislative intent as indicated by the statute conferring the permission to amend; for if that statute, properly interpreted, purports to confer the amending power on less than all of the stockholders, it would seem to be unconstitutional as impairing the obligation of the contract between the stockholders. Nevertheless, an examination of the authorities reveals that, although unanimous consent is ordinarily necessary,<sup>5</sup> the rule requiring it is, in most jurisdictions at least, subject to an important qualification.

That qualification is due to the doctrine that a change authorized to be made in a charter contract is not an impairment thereof with regard to dissenting stockholders, provided the alteration can be characterized by some such criticism-disarming adjective as auxiliary, incidental, or non-fundamental.<sup>6</sup> The basis for the general rule that changes in the charter cannot be made without unanimous consent being that the charter is a contract between the members analogous to the articles of a partnership, it is difficult to find a logical justification for permitting even minor alterations of this contract without the consent of all parties thereto.

It may, indeed, be urged that such of the provisions of the

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<sup>5</sup> *Middlesex Turnpike Co. v. Luke*, 8 Mass. 267 (1811); *Union Locks and Canals v. Towne*, 1 N. H. 44 (1817); *Hartford & New Haven R. R. v. Crosswell*, 5 Hill 383 (N. Y. 1843); *Stevens v. Rutland & B. R. Co.*, 29 Vt. 545 (1851). The rule is also recognized in the more recent cases but the actual results in these cases are affected by the fact that they generally deal with charters granted subject to a power of amendment reserved by the legislature.

<sup>6</sup> *Banet v. Alton & Sangamon R. R.*, 13 Ill. 504 (1851), change "beneficial to corporation" and not "radical"; *Kenosha v. Rockport, etc. R. Co.*, 17 Wis. 13 (1863), change "in furtherance of the original undertaking and incidental to it"; *Woodfork v. Union Bank*, 3 Cold. 488, 500 (Tenn. 1866), "auxiliary and not fundamental"; *Mower v. Staples*, 32 Minn. 284, 20 N. W. 225 (1884), "auxiliary." The rule was recognized by the United States Supreme Court in *Clearwater v. Meredith*, 1 Wall. 25 (1864), in which the court said: "But it is not every minute and unimportant change which would work a dissolution of the contract." See also *Nugent v. Supervisors of Putnam County*, 19 Wall. 241 (1873). The rule is frequently referred to in the more recent cases, but nearly all of these relate to corporations whose charters are subject to a legislative power of amendment, and it is generally difficult to determine to what extent the court has been influenced by that fact in its phrasing and application of the rule. There are a few cases taking the position that no change is valid without unanimous consent. See *Zabriskie v. Hackensack, etc. R. R.*, 18 N. J. Eq. 178, 189 (1867). See also 1 MORAWETZ, PRIVATE CORPORATIONS (2d ed. 1886) § 403.

charter as were inserted wholly at the instance of the state and for the protection of the interests of persons other than the incorporators do not form part of the latter's contract *inter se*, and hence that their alteration does not involve any alteration of that contract.<sup>7</sup> Some of the cases dealing with so-called auxiliary amendments may be supported on this ground. Where, for example, a charter of a railroad or turnpike company provides that it is to be forfeited unless the road is constructed by a certain date, it may fairly be said that the amendment extending the time is simply a waiver of the state's right of forfeiture and does not modify the contract between the stockholders.<sup>8</sup> So, too, if restrictions on the power of a public service company to mortgage its property are plainly imposed for the benefit of the public at large rather than for the protection of the stockholders, an amendment removing these restrictions may properly be said not to involve a change in the stockholders' contract.<sup>9</sup> Even where the amendment, instead of removing restrictions, grants additional powers which are merely new means of carrying out the purposes for which the corporation is organized, it is doubtless true in many cases that the change involves no real alteration of the original intent. It may well be that although the incorporators have, perhaps as a result of legislative insistence on definiteness, prescribed in their charter a particular means for accomplishing their purpose which seemed at that time to be satisfactory, their real underlying purpose was to reach the desired end by such methods as experience should from time to time demonstrate to be practicable.

Nevertheless, it is easy to carry this line of reasoning too far, if what we are seeking is the intent of the incorporators. Where their contract in terms provides for a particular method of carrying out the enterprise proposed, and where there is noth-

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<sup>7</sup> See MORAWETZ, *op. cit.* § 400.

<sup>8</sup> *Taggart v. Western Maryland R. R.*, 24 Md. 563 (1866); *Milford & Chillicothe Turnpike Co. v. Brush*, 10 Ohio 111 (1840). Some of the decisions commonly cited for this proposition are based on the existence of the reserved power to amend. See, for example, *Agricultural Branch R. R. v. Winchester*, 13 Allen 29 (Mass. 1866).

<sup>9</sup> *Joy v. Jackson, etc. Plank Road Co.*, 11 Mich. 155 (1863).

ing to indicate that the limitation as to method was imposed on them by the legislature, there is a real possibility that some of them at least regarded the means selected as important and had no intention to permit them to be altered. The statement sometimes made by courts that there is an implied agreement on the part of each stockholder to permit the majority to accept amendments which the law regards as auxiliary or incidental to the original plan is manifestly false, if by implied agreement we mean an agreement implied in fact and based on the intention of the contracting parties as manifested by the language which they have used. The rule of majority control within the original agreement is not a peculiar rule of corporation law but, today at any rate, applies to partnerships as well,<sup>10</sup> and yet it would astonish the bar to be told that one who signs articles of partnership impliedly agrees that the majority of his associates may amend without his consent provided that the amendments are not fundamental in character.

It is plain, therefore, that when we speak of an implied agreement by the minority in the case of corporations to consent to minor changes, we are not speaking of an agreement implied in fact at all but rather of an agreement implied in law, or, in plainer language, of a rule of law devised by the courts in the interests of justice as they see it and imposed on objecting stockholders irrespective of their actual intent. The language of the majority of the cases indicates that there is such a rule, and the results reached in them are difficult to explain unless the existence of such a rule is conceded.

It is submitted that the rule is a desirable one. Granting that a charter is a contract between the stockholders and therefore possesses some similarity to articles of partnership, the differences between the factual situation presented by the articles of ordinary partnership and that presented by the articles of the ordinary corporation are substantial. The normal partnership is composed of a small group of persons and the partnership articles are in a real, and not merely in a theoretical sense,

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<sup>10</sup> BURDICK, PARTNERSHIP (3rd ed. 1917) 228.

the terms on which they have agreed to do business together. The normal corporation is a much larger group and owing to the transferability of its stock its articles are not as a general rule the language of those who ultimately become the owners of the enterprise. In many of the cases in which a minority stockholder seeks to block a change in the method of doing business on the ground that it involves a change in his contract which cannot lawfully be made without his consent, it is probable, if not certain, that the objecting stockholder joined the enterprise with only the vaguest notions as to its scope and with no idea whatever as to whether the comparatively slight change in its business policy to which he now objects could or could not be accomplished under the articles in their original form. Under such circumstances, his insistence on blocking small amendments furnishes ground for the suspicion that his real object is not to keep the enterprise in the ancient grooves but to force the majority to buy him out at an extravagant figure.

Like many another rule of law, the rule that has curbed to some extent the power of the dissenter to act the part of blackmailer has been phrased in the language of fiction, but to demonstrate the unreality of fiction is not by any means to demonstrate the unwisdom of the rule, which, if confined within proper limits, seems better calculated to promote business needs and to do justice between majority and minority than a rule giving the latter an unqualified veto power would do.

It is submitted, however, that inasmuch as the rule grants to the majority in the interests of fairness and of progress a power which there is no evidence that the minority intended to confer on them, it ought to be confined within rather narrow limits. It may be justifiable to allow the majority to accept changes in name,<sup>11</sup> slight changes in routing of railroads,<sup>12</sup> or changes in the number of directors to be chosen.<sup>13</sup> It would seem, however, that some of the cases permitting modi-

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<sup>11</sup> Clark v. Monongahela Navigation Co., 10 Watts 364 (Pa. 1840).

<sup>12</sup> Milford & Chillicothe Turnpike Co. v. Brush, *supra* note 8; Wilson v. Wills Valley R. R., 33 Ga. 466 (1863).

<sup>13</sup> Mower v. Staples, *supra* note 6.

fication of routes have gone rather far,<sup>14</sup> and that the occasional decisions sanctioning consolidations by majority vote,<sup>15</sup> the result of which is that one who has subscribed to stock in the *A* corporation finds himself without his consent a stockholder in the *B* corporation, carry the doctrine to unjustifiable lengths. It may, however, fairly be said that most of the courts which have adopted this doctrine have applied it in conservative fashion. Although it is generally accepted as law today, its practical importance is a matter on which considerable difference of opinion may well exist, for, as we shall see, it is not wholly clear how far recent decisions on majority control are due to it and how far to another doctrine with which we shall shortly have to deal.

So much for the legal situation with regard to state corporations with unamendable charters. The case of a federal corporation with a charter purporting to be unamendable would present an interesting problem inasmuch as Congress is not expressly restrained from impairing contracts but only from depriving persons of property without due process of law. How far a federal charter not expressly made amendable would create in a stockholder vested property rights which could not be altered without his consent is a problem on which the opinions of the courts shed very little light, since in the few cases which have arisen involving federal corporations the charter has contained a clause expressly permitting Congress to amend it. The ques-

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<sup>14</sup> Thus the Illinois courts have treated rather substantial changes in railroad routes as non-fundamental within the meaning of this rule. *Banet v. Alton & Sangamon R. R.*, *supra* note 6; *Peoria & Oquawka R. R. v. Elting*, 17 Ill. 429 (1856); *Rice v. Rock Island & Alton R. R.*, 21 Ill. 93 (1859).

<sup>15</sup> *Hanna v. C. & F. W. R. R.*, 20 Ind. 30 (1863). This case is difficult to reconcile with other Indiana cases, although it purports to be based on special facts. See *McCray v. Junction R. R.*, 9 Ind. 358 (1857); *Shelbyville & R. Turnpike Co. v. Barnes*, 42 Ind. 498 (1873). The case of *Sprague v. Illinois River R. R.*, 19 Ill. 173 (1857), sometimes cited as supporting consolidations by majority vote, seems to relate to a different matter. The amendment authorized the company to abandon part of its projected line and consolidate and connect with another railroad. The connection and abandonment had taken place but apparently the consolidation had not. The weight of authority is to the effect that consolidation is a fundamental change. *Clearwater v. Meredith*, 1 Wall. 25 (1863); *New Orleans J. & G. N. R. R. v. Harris*, 27 Miss. 517 (1854); *Lauman v. Lebanon Valley R. R.*, 30 Pa. 42 (1858).

tion of federal charters will, accordingly, be left for treatment in a later portion of this article in connection with state charters granted subject to a reserved power to amend.

#### THE RESERVED POWER—RIGHTS OF THE CORPORATION AND OF THE STOCKHOLDERS AS A WHOLE.

State charters containing a reservation to the state of the power to amend or repeal were occasionally granted at a very early period.<sup>16</sup> Their general vogue, however, is a result of the famous *Dartmouth College* case,<sup>17</sup> and any attempt to determine their meaning and effect must, therefore, start with a discussion of that case.

That case arose out of the attempt on the part of the legislature of New Hampshire to make radical changes in the charter of Dartmouth College, an eleemosynary educational corporation chartered by the King of England in the days when New Hampshire was a British colony. The validity of the act providing for these changes was attacked by the trustees of the College, on the ground that the charter was a contract the obligation of which was unconstitutionally impaired by the statute.

Since the corporation was a charitable and not a business enterprise, the doctrine formerly referred to, that a charter is based upon a contract between the members, similar to the articles of a partnership, was not applicable. It might, nevertheless, have been possible to treat the charter as embodying a contract between the donors *inter se* or between the donor and the trustees. It was not, however, on any such theory that the case was argued and decided. The United States Supreme Court had previously held that the constitutional clause protects executed as well as executory contracts and that a legislative grant of

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<sup>16</sup> See *Commonwealth v. Bonsall*, 3 Wharton 559 (Pa. 1838), dealing with a charter granted in 1784; *Houston v. Jefferson College*, 63 Pa. 428 (1869), dealing with a charter granted in 1802. The earliest judicial intimation that such a reservation would be effectual to enlarge the power of the legislature over corporations is found in *Wales v. Stetson*, 2 Mass. 143 (1806).

<sup>17</sup> *Dartmouth College v. Woodward*, 4 Wheat. 518, 712 (1819). In his concurring opinion in that case, Mr. Justice Story said that "if the legislature mean to claim such an authority" (to amend the charter) "it must be reserved in the grant."



land is therefore within its scope.<sup>18</sup> Adopting this principle as a premise, Webster's famous argument drew from it the conclusion that the royal charter was a grant from the King to the founder of the College, and hence a contract between the former and the latter.<sup>19</sup> The force of this argument in so far as it applied to the problem of private corporations seems to have been admitted by counsel for the state, who contended that Dartmouth College was an institution founded for public rather than private ends and that the charter of such an institution is not a contract but an ordinary legislative act.<sup>20</sup> Webster's argument was accepted by the court, with the result that the decision established the doctrine that a corporate charter is a contract between the state and the corporation or the incorporators and that this contract is protected by the constitution from impairment by subsequent legislation.

While the doctrine of the *Dartmouth College* case to the effect that the corporate charter is a contract with the state has, as the Supreme Court said in a later case, "become firmly established as a canon of American jurisprudence,"<sup>21</sup> it has not escaped criticism. Whatever may be said in support of it as an early nineteenth century exposition of the meaning of the word "contract" in an eighteenth century constitution,<sup>22</sup> it is not altogether in harmony with modern conceptions of contracts, of corporations, or of the proper scope of legislative power.

The doctrine of the case is a two-fold one: that a legislative grant is a contract, and that a charter is a legislative grant. Each aspect of the doctrine is open to criticism from the standpoint of present day legal theories. Whatever the usage may have been in Marshall's day, we do not now speak of a fully

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<sup>18</sup> *Fletcher v. Peck*, 6 Cranch 87 (1810).

<sup>19</sup> See *Dartmouth College v. Woodward*, *supra* note 17, pp. 589 *et seq.*

<sup>20</sup> See *ibid.* pp. 608 *et seq.*

<sup>21</sup> Brown, J., in *Pearsall v. Gt. Northern Ry.*, 161 U. S. 646, 660 (1896).

<sup>22</sup> Blackstone defines contracts as including "a contract *executed* which differs in nothing from a grant," 2 BL. COMM.\* 443. Both Alexander Hamilton and Robert G. Harper had, prior to the decision in *Fletcher v. Peck*, *supra* note 18, given opinions to the effect that the contract clause forbade a state to revoke its grant. I WARREN, *THE SUPREME COURT IN UNITED STATES HISTORY* (1922) 397. But see the opinion of Mr. Justice Johnson in that case.

executed grant, unaccompanied by warranties or other promises of either party, as a contract, nor of the obligation of a grantor not to attempt to repossess himself of the thing granted as contractual.

The assumption that a charter is a legislative grant is not so clearly inconsistent with current modes of legal thinking as is the idea that the grant is a contract. This notion of the charter as a grant, which long antedates Marshall,<sup>23</sup> has become so deeply embodied in our law by the *Dartmouth College*<sup>24</sup> case and by subsequent cases, that it is probably true that most lawyers even today accept it without question. Nevertheless, many of our most acute judges and legal writers are today extremely critical of the notion.<sup>25</sup>

As long as incorporation was a special privilege granted as an act of legislative grace to certain persons and denied to others, the conception of a charter as a grant or franchise was a natural one. Today, however, our statutes generally provide that the privilege of incorporation for business purposes is open to all, and in many states special favors granted to some corporations only are forbidden by the state constitution. Unless we insist on attaching a large measure of importance to the convenient fiction of corporate personality, we can hardly avoid the conclusion that the right to be a corporation is no more a grant or franchise than is the right to do any of the other things, such as drive an automobile or locomotive, keep a dog, become a limited partner, practice law or medicine, or make a will, which are today permitted only on compliance with certain statutory requirements. According to this view, our corporation laws are

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<sup>23</sup> The legal habit of thinking of a corporation as a grant, concession, or franchise dates back to the middle ages, having its roots both in the common law and in the canonist's view of the corporation as a fictitious person created by an act of sovereign power. See HOLDSWORTH, *A HISTORY OF THE COMMON LAW* (1st ed.) 373.

<sup>24</sup> *Supra* note 17.

<sup>25</sup> Whether we like it or no, the concession theory has notice to quit and may carry the whole fiction theory with it. MAITLAND, *INTRODUCTION TO GIERKE'S POLITICAL THEORIES OF THE MIDDLE AGES* (1900) XXXVIII. "We may assume further, in accordance with a favorite speculation of these days, that philosophically a partnership and a corporation illustrate a single principle"; Holmes J., in *Merchants' Nat. Bank v. Wehrmann*, 202 U. S. 295, 300 (1906).

simply regulations of a certain mode of doing business, and our so-called charters, apart from their aspect as contracts between the incorporators, are simply evidence that the incorporators have complied with the legislative requirements and hence are entitled to do business in that mode. On this theory the repeal or amendment of a charter is merely a change in the law, and the only problems which it raises are whether it amounts to a denial of due process in that it deprives some one of property rights which ought in fairness to be regarded as vested, or whether it impairs the obligation of the contract existing between the members of the corporation.

Of course the *Dartmouth College* case<sup>26</sup> and its successors make it impossible for us to treat the problem of corporate charters altogether from this standpoint. But those of us, whether judges or students of the law, who regard it as the most satisfactory method of viewing the problem of legislative control over corporations find it difficult not to be influenced by it in our attitude toward phases of the problem which are sufficiently removed from the question raised by the *Dartmouth College* case<sup>27</sup> so that their solution is not foreclosed by that decision.

At least one elaborate and well reasoned attempt has been made to view the problem of reserved power to amend and repeal from this angle, namely, that of Chief Justice Doe of New Hampshire. In his opinion of the well known case of *Dow v. Northern R. R.*,<sup>28</sup> and in his notes prepared in connection with that case, which are contained in the sixth volume of the *Harvard Law Review*,<sup>29</sup> Judge Doe contends that the *Dartmouth College* case<sup>30</sup> is erroneous in that it treats a corporate charter as a contract instead of as an exercise of legislative power, and that the effect of a reservation of power to amend or repeal is not to modify the charter contract but to get away from the con-

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<sup>26</sup> *Supra* note 17.

<sup>27</sup> *Ibid.*

<sup>28</sup> 67 N. H. 1, 36 Atl. 510 (1887).

<sup>29</sup> *A New View of the Dartmouth College Case*, 6 Harv. L. Rev. 161 (1893).

<sup>30</sup> *Supra* note 17.

tract theory altogether, and thus to restore the situation which would have existed had the *Dartmouth College* case<sup>31</sup> been decided the other way.<sup>32</sup>

What, then, is this legislative power which is retained by the insertion in the charter of an amendment or repeal clause? It is such power of regulation by law as the legislature would have over the business enterprise if it were unincorporated, and in addition the power to repeal the privilege, which exists only by legislation, of doing business in the corporate form. This power of repeal includes in it the power to repeal conditionally instead of absolutely, thus affording the stockholders the alternative of getting out of business or accepting the modified charter. In that case, however, the modified charter can be accepted only by unanimous consent, for acceptance involves an alteration of the only true contract which exists, the contract of the stockholders *inter se*. Legislative power does not include the power to modify contracts.

On this view the power to amend would appear to mean only the power conditionally to repeal, unless—and Judge Doe

<sup>31</sup> *Ibid.*

<sup>32</sup> A similar view of the effect of the reserved power has occasionally been expressed by other judges. "It (the reservation) places the corporation in the same position it would have been in had the Supreme Court held that charters are not contracts"; Field, J., in *San Mateo County v. Southern Pac. R. R.*, 13 Fed. 722, 755 (1882). This view was reiterated by Judge Field in his dissenting opinion in *Spring Valley Water Works v. Schottler*, 110 U. S. 347, 371 (1883). The same view of the matter is expressed in 2 COOK, CORPORATIONS (8th ed. 1923) § 501, and Mr. Cook's language has been quoted and approved by the Utah court. *Garey v. St. Joe Mining Co.*, 32 Utah 497, 91 Pac. 369 (1907).

On the other hand, the author of a learned article in this Review, although arguing at length in favor of Judge Field's position, admitted that the majority of the cases decided prior to 1905, the date of that article, were not in accord with it; Horace Stern, *The Limitations of the Power of a State Under the Reserved Right to Amend or Repeal Charters of Incorporation*, 53 U. OF PA. L. REV. 1, 27 (1905). In the light of subsequent cases, such as *Polk v. Mutual Reserve Fund L. Ass'n. of N. Y.*, 207 U. S. 310 (1907), it is even clearer today that Judge Field's proposition is not law in the majority of jurisdictions. If the *Dartmouth College* case had been decided the other way and if the legislatures had consequently regarded it as unnecessary to reserve power to amend charters, the courts would hardly have avoided holding that the legislature, although possessing power to repeal charters conditionally or unconditionally and to legislate with regard to corporations for purposes falling within the police power, would have had no power to amend charters. Nevertheless, the majority of the courts insist that the legislature does possess such a power.

is not explicit on this point, which was not involved in the case of *Dow v. Northern R. R.*<sup>33</sup>—there is power to repeal a portion of the corporate privileges without thereby conferring on the minority the right to insist on a dissolution. It would seem that if such power of partial repeal does exist, it must, according to this theory, be confined within narrow limits, as the repeal of any substantial part of the corporate privileges would make the enterprise substantially different from that originally contemplated, and hence modify the contract between the stockholders. The problem, according to Judge Doe's reasoning, would seem to be identical with the problem whether a law which makes it illegal to carry on a substantial portion of the business hitherto conducted by a partnership dissolves the partnership.

Apart from this question of partial repeal, the effect of Judge Doe's view is thus to limit the regulation of corporate affairs, even under charters containing the reserved power, to regulations which would be constitutional if imposed on partnerships and to regulations imposed indirectly by the rather clumsy device of threatening to repeal the charter unless the regulations be accepted,<sup>34</sup> and also regulations in the form of such incidental and beneficial changes in the charter as may be authorized under the doctrine of implied consent previously set forth.<sup>35</sup>

If the question could fairly be regarded as an open one, the writer would be tempted to adopt Judge Doe's solution of the problem. It gets rid for practical purposes—since substantially all charters now existing are subject to amendment—of the rather archaic reasoning of the *Dartmouth College* case<sup>36</sup> and gives us a theory as to the scope of the reserved power which is intelligible and should be comparatively easy to apply. Recent cases have demonstrated that the contract clause does not prevent the legislature from modifying contracts under its police

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<sup>33</sup> *Supra* note 28.

<sup>34</sup> Such regulations can, according to this view, be accepted only by unanimous consent. If one stockholder dissents, the others must induce him to sell his stock or dissolve.

<sup>35</sup> Judge Doe does not accept this latter doctrine, except in a modified form. See *Dow v. Northern Railroad*, *supra* note 28 at 522.

<sup>36</sup> *Supra* note 17.

power when sufficient reasons for so doing exist,<sup>37</sup> and it may be argued that the police power plus the power of repeal and the power to deal with obstructive minority stockholders on the basis of the theory of implied consent to incidental changes give the legislature all the power which public policy requires.<sup>38</sup>

Nevertheless, an examination of the cases, and especially of those in the United States Supreme Court,<sup>39</sup> makes it abundantly clear that Judge Doe's theory has not prevailed in most jurisdictions. It would be surprising indeed if it had. In the first place the theory involves the repudiation of the reasoning of the *Dartmouth College* case<sup>40</sup> to an extent which could hardly be ex-

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<sup>37</sup> The most striking illustrations of the extent to which contracts may be modified under the police power are the New York rent law cases. *Marcus Brown Holding Co. v. Feldman*, 256 U. S. 170 (1921); *Levy Leasing Co. v. Siegel*, 258 U. S. 243 (1922). It has, of course, long been unquestionable that a state cannot contract away its police power, but it does not necessarily follow that private contracts may be modified under the police power, a proposition which was not definitely established until the decision in *Manigault v. Springs*, 199 U. S. 473 (1905).

<sup>38</sup> A liberal interpretation of the police power would have made the reserved power to amend charters unnecessary for the purpose of enabling the legislature to protect the rights of outsiders. The rule giving the minority the right to prevent the majority from accepting substantial amendments does, however, frequently work injustice in that it may compel the majority to pay an exorbitant price for the right to make changes which are plainly beneficial. This difficulty would not have been a serious one had the early corporation statutes contained a provision authorizing the majority to amend. Where, however, as was generally the case until recently, the corporation laws gave the majority no such power, it may fairly be contended that Judge Doe's views, even if modified by the doctrine that the majority may adopt amendments which are "auxiliary" or "incidental" would, unless a very liberal construction had been given to these words, have left a dangerous power of obstruction in the hands of the minority.

<sup>39</sup> See, for example, *Miller v. New York*, 15 Wall. 478 (1873), change in voting rights of stockholders held valid; *Close v. Greenwood Cemetery*, 107 U. S. 465 (1883), amendment of charter of cemetery to give lot owners control held valid (the corporation was chartered by Congress and not by state legislature, but the decision is not rested on that ground); *Looker v. Maynard*, 179 U. S. 46 (1900), amendment permitting cumulative voting held valid; *Polk v. Mutual Reserve Fund L. Ass'n. of New York*, *supra* note 32, law authorizing directors to make radical change in kind of insurance policy to be issued by mutual company held valid. For state cases upholding substantial amendments, see *Cook*, *loc. cit. supra* note 32. Such of these cases as hold the amendment to be valid as against objecting stockholders are plainly inconsistent with Judge Doe's views. Some of the others, where the objection was made by the corporation, might be reconciled with Judge Doe's theory by treating the amendment as a conditional repeal and the failure of the corporation to dissolve as an acceptance of the condition. See, however, note 46 *infra*, with regard to the difficulties involved in such an interpretation of the cases.

<sup>40</sup> *Supra* note 17.

pected to find favor with the courts in view of the fame of that opinion and of its author and of the numerous occasions on which it had been cited with approval during the period which intervened between that decision and the case of *Dow v. Northern R. R.*<sup>41</sup> In the second place, Judge Doe's theory gives so little scope to the word "amend" as distinguished from the word "repeal" that it is not altogether satisfactory as an interpretation of the intent of the legislature in reserving the amending as well as the repealing power. Furthermore, the doctrine that contracts may be amended under the police power is a very recent one,<sup>42</sup> and until this doctrine became established, the tendency to treat the amending power as the basis for justifying the sort of regulation of corporations which was generally conceded to be desirable was almost unavoidable.

It is clear, not only from the language used in many cases but from the results which they reach, that Judge Doe's treatment of the reserved power as a kind of legislative recall of the decision in the *Dartmouth College* case<sup>43</sup> will not do, and that we must, in discussing the reserved power, accept the correctness of Marshall's proposition that a corporate charter is, for constitutional purposes, a contract between the incorporators and the state as well as a contract between the incorporators *inter se*.<sup>44</sup>

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<sup>41</sup> *Ibid.*

<sup>42</sup> See note 37, *supra*.

<sup>43</sup> *Supra* note 17.

<sup>44</sup> It is sometimes said that a corporate charter includes three contracts, one between the state and the corporation, one between the state and the stockholders, and one between the stockholders *inter se*. Cook, *op. cit. supra* note 32, § 492. There is no doubt that an amendment to a charter may produce any one of three different effects: it may affect the corporation and it alone; it may affect all the stockholders equally as in the case of amendments imposing an additional stockholders' liability to creditors; it may modify the relative rights of the stockholders. It is difficult, however, to regard the charter as being at once the instrument which brings the corporation into existence and a contract with it. If we must look upon the transaction as a contract with the state, it would seem that the only contract which the state makes is made with the incorporators as individuals and their successors. The effect of this contract is, however, to confer upon them both individual rights as members of the corporation and collective rights, which are treated in the law as the rights of the corporation as a legal entity. Where subsequent legislation impairs rights of the latter sort, the right to complain of such impairment is treated as a corporate right; where it impairs rights of the former sort, the right to complain is a right of the members as individuals.

What, then, of a charter granted subject to the reserved power of amendment or repeal? Even if an ordinary grant or charter is a contract, it might seem that a repealable grant or charter is not; for the obligation, which Marshall called contractual, not to derogate from one's grant does not exist where the grantor expressly states that his grant is revocable or modifiable. Accordingly, one's natural impulse is to say that a repealable charter cannot be a contract, and that the legislative power which exists over it exists not because the incorporators have consented to the exercise of the repealing power, but because they have no option in the matter. The power of an owner of property to revoke a license is not based on the theory that a license is a contract and that the licensee has consented to revocation, but on the right of an owner to do what he wills with his own. It would seem that a revocable charter is a mere license, and that the reserved power clause is simply a statement by the state as licensor that it is not contracting that its bounty may at any time be revoked or cut down.

Although this reasoning does not, like that of Judge Doe, involve any criticism of the *Dartmouth College* case,<sup>45</sup> the result which it reaches with respect to the power of the legislature is exactly the same as that reached by Judge Doe. If it were not for the reserved power, there would be two contracts, that between the state and corporation, and that between stockholder and stockholders; and the legislature could impair neither. The reserved power, according to this theory, prevents the first contract from coming into existence; it cannot affect the second as the legislature has no constitutional power to do this, except in so far as the legislature may affect contracts under the police power.

If, then, we adopt this view, we must, as under Judge Doe's view, explain the cases upholding amendments as against objection by the corporation on the ground that the legislature in amending the charter is, in effect, saying to the corporation, "accept the amendment or dissolve," and that the corporation, by failing to dissolve, has necessarily accepted despite any protest

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<sup>45</sup> *Supra* note 17.



it may making. It may indeed be possible to explain the cases on this basis, but any such explanation is certainly wholly out of accord with the language of the decisions.<sup>46</sup>

As for the cases upholding amendments as against objection by minority stockholders, it would seem that this view does not, like that of Judge Doe, necessarily require us to disapprove of those cases. It is true that this view, no less than that of Judge Doe, involves the proposition that the legislature is wholly without power to change the contract between the stockholders. It does not, however, necessarily involve the proposition that the majority stockholders are without power to do this. If, as Judge Doe maintains, the reserved power, as between state and corporation, simply wipes out the effect of an erroneous judicial decision, there would seem to be no reason for giving it any additional effect as between stockholder and stockholders. If, on the other hand, the reserved power does give the legislature the power, which it would not otherwise possess, of confronting the corporation with the alternative of dissolving or accepting an amendment, it may be possible to argue that, in joining a corporation whose existence is subject to such a power, a stockholder confers on the majority of his brethren the power to bind him by a determination to adopt the alternative of accepting the amendment rather than dissolving—that the making of such a choice becomes a kind of corporate action, in which as in other cases of corporate action, the majority have power to act on behalf of all. There is language in some of the cases which could be adduced in support of such a view, and the majority of the cases are so wholly without any clear cut theory that it may be argued that they are as easy to reconcile with this theory as with any other.

Nevertheless, it may be doubted whether a theory which denies to the legislature any direct power over the minority stockholder, and seeks to explain the ability which the legislature undoubtedly has in fact to affect his rights on the basis of an

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<sup>46</sup> It is equally out of accord with the language of the statutes and is, furthermore, difficult to harmonize with substance of such statutes as impose a penalty other than dissolution—a fine, for example—for failure to comply with the provisions of the amendment.

implied agreement by him to permit the majority to act for him, is really satisfactory. There is in truth no such agreement. If we imply it, it is only because we think it is sound policy that the rule of majority control should be substituted for the rule of unanimous consent. If the basis of the doctrine is policy, it is preferable to hold that the power is in the legislature, which controls policy, rather than that the power is in the majority stockholders by virtue of a fictitious agreement between them and the minority.

With the exception of a few opinions, of which that of Judge Doe is the most carefully worked out, the cases, in general, tacitly assume and some of them expressly state that a charter which is granted subject to the reserved power of amendment or repeal is a contractual transaction between the state and the incorporators<sup>47</sup> within the broad meaning of the word "contract" as used in the *Dartmouth College* case.<sup>48</sup> The theory implicit in the majority of the decisions would seem to be that in accepting the charter containing such a reservation, the incorporators impliedly agree that the legislature may amend the charter contract with the state despite the fact that the incidental consequence of such an amendment is to alter the contract between the members themselves by permitting the majority to continue to do business under the charter as amended regardless of the wishes of the minority.

It may be contended that it is beyond the legitimate scope of legislative power for the legislature to enter into such an ar-

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<sup>47</sup>The reserved power "is a provision intended to preserve to the state control over its contract with the corporators," *Tomlinson v. Jessup*, 15 Wall. 454, 458 (1873). This statement is by Field, J., whose view of the reserved power, as indicated by the quotation in note 32, *supra*, might easily have led him to the conclusion that a charter which is subject to the reserved power is not a contract at all. In *Stearns v. Minnesota*, 179 U. S. 223, 240 (1900), a charter of a railroad, granted subject to the reserved power, provided for a tax on gross earnings in lieu of all property taxes. The state later sought to impose a property tax in addition. The court held this invalid, saying that "a contractual exemption of the property of the railroad in whole, upon consideration of a certain payment, cannot be changed by the state so as to continue the obligation in full, and at the same time deny to the company, either in whole or in part, the exemption conferred by the contract." This language assumes that such a charter is a contract, which the legislature has a limited power to modify. See also *Duluth & Iron Range R. Co. v. St. Louis County*, 179 U. S. 302 (1900).

<sup>48</sup>*Supra* note 17.

rangement. The power of the legislature is to enact laws. This power includes the power to confer either irrevocable or revocable franchises. It may plausibly be argued, however, that it does not include the power to make agreements with the incorporators to the effect that if they receive a corporate franchise they shall be deemed to agree that the legislature shall have power to make laws with regard to their enterprise which it could not make if there were no contract relation between them and the legislature.<sup>49</sup>

It is submitted that such an argument is unduly restrictive of legislative power. It is doubtless true that the legislature cannot by contract obtain anything but legislative power. It could not, for example, contract for the power to act as judge in controversies between stockholders. Legislative power under our constitution is, however, normally subject to certain restrictions which are not inherent in it but are due to specific limitations contained in the bill of rights. How far some of these may be waived by the parties entitled thereto may be doubtful, but there would seem to be little doubt that the effect of the due process clause on legislation with regard to a particular property right would be radically affected by an agreement on the part of the person having such right that it should not be deemed to be protected against impairment by legislation enacted for what the legislature regarded as the public good, and that the effect of the contracts clause on a particular agreement would be radically altered by the consent on the part of the parties to such contract that it be subject to alteration by such legislation.<sup>50</sup>

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<sup>49</sup> See *Dow v. Northern R. R.*, *supra* note 28, and *Opinion of the Justices*, 66 N. H. 629 (1891). "Certainly the legislature cannot in a charter of incorporation, or in any other law, reserve to itself any greater power of legislation than the constitution itself concedes to it"; Bradley, J., dissenting, in *Sinking Fund Cases*, 99 U. S. 700, 748 (1878).

<sup>50</sup> In footnote 22 of the article by Horace Stern, *supra* note 32, the learned author asks the question: "Can a power which does not exist be reserved?" It is submitted that the question is rather: "Can a power which the legislature does not ordinarily have be obtained by it by an agreement made as a condition of receiving a privilege?" The answer to this question is neither an unqualified "yes" nor an unqualified "no." There are certain powers which are so clearly non-legislative that no agreement by the parties to be affected thereby can authorize the legislature to exercise them. There are constitutional rights which cannot be waived, even by an agreement with the state to waive them.

It is true that the legislature can according to modern decisions modify contracts under the police power. Nevertheless, a reasonable legislature might feel that the public good demands that, if it is to grant the privilege of doing business in the corporate form, it shall retain for itself a greater degree of freedom to modify the contract rights between the persons engaging in such business than the contract clause, even as impliedly modified by the police power, would normally allow. It may fairly be said that in getting the incorporators to agree to permit the legislature such greater freedom with regard to modifying such contracts, the legislature is contracting for the exercise of legislative power unhampered by the existence of what might otherwise be deemed vested rights, rather than contracting for the exercise of power which is not legislative at all.

Whatever limitations there may be on the power of amendment, there would seem to be no doubt that, if the theory just stated be adopted, it follows that, *prima facie* at least, the power embraces all phases of the charter contract with the state. This view necessarily leads to the consideration of the question of what is meant by the charter contract and what is included therein. As stated above, this so-called contract is in reality a grant or license to carry on business in a way in which it could not be carried on without incorporation. For constitutional purposes we treat the legislature as contracting with the incorporators that the grant shall not be revoked or modified unless power to do so is reserved, and thus treat the grant as in effect

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Such, for example, is the right to resort to the federal courts where the federal constitution grants such a right. *Terral v. Burke Construction Co.*, 257 U. S. 529 (1922). On the other hand, there is no doubt that a state which is granting to a foreign corporation permission to do business in the state may exact from the corporation and from its stockholders an express or implied agreement to be bound by regulations which, apart from its power of exclusion, the state would have no power to impose. See *Thomas v. Matthiessen*, 232 U. S. 220 (1914), holding that a state may make it a condition of the entry of a foreign corporation into the state that its stockholders consent to personal liability under the local laws and that such consent will be implied when the stockholder expresses a wish that the corporation do business in that state. Similarly, a state which is granting the privilege of incorporation, may within limits discussed hereafter, exact from the stockholders an agreement that the legislature may have certain powers which it would not possess in the absence of agreement.

a contract between the legislature and the incorporators. Obviously, then, the rights and privileges granted to the incorporators which are of such a nature that the incorporators would not have possessed them had they done business without incorporation are parts of this charter grant or contract. These rights include the privilege of suing and being sued, and of taking and conveying property in the name of the business entity—rights which, apart from recent statutes, could not be secured without incorporation. They also normally include the privilege of doing business without personal liability, and the power, by issuing stock to other persons besides the incorporators, to confer similar privileges on such other persons and on their transferees.

With the exception of these rights, powers, and privileges, the stockholders of a corporation generally acquire no rights which they would not have as a matter of common law if they did business without incorporation. All the so-called powers of a corporation which relate to the kind of business which it can do are generally no broader, though they are frequently narrower, than the powers possessed by natural persons. Such being the case, it has been argued that these powers are no part of the corporate franchise or contract and are not subject to the amending power.<sup>51</sup> The argument, however, finds little or no support in the cases, and it is submitted that it is unsound.

Two views have been and still are taken as to the nature of corporate powers. One view, which has the support of the English and of some important American decisions, is that a corporation obtains not only its life but every one of its powers from the charter, and that it is incapable of doing anything not authorized thereby.<sup>52</sup> If this view, which is generally known as the "special capacity" doctrine, be accepted, it can scarcely be denied that, inasmuch as every power which the corporation possesses is conferred upon it by the charter, the extent of its powers is a portion of its franchise or charter contract.

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<sup>51</sup> See 53 U. OF PA. L. REV. 1, 44 (1905).

<sup>52</sup> *Central Transportation Co. v. Pullman Palace Car Co.*, 139 U. S. 24 (1890); *Ashbury Railway Carriage & Iron Co. v. Riche*, L. R. 7 H. L. 653 (1875).

Of recent years, however, another theory, commonly called the "general capacity" theory, has been gaining ground in this country. According to this theory, a corporation once created has the legal power, as distinguished from the legal privilege, of doing not only those acts which are authorized by the state, but those which are unauthorized, so that what is commonly called an *ultra vires* act is, nevertheless, a corporate act.<sup>53</sup> Thus, the powers do not depend upon the charter, except in the sense that until brought into being by the charter the corporation has no existence and no powers of any sort.

If this view be adopted, the argument that so-called corporate "powers" are not derived from the franchise or charter contract is somewhat more plausible than it is if we accept the special capacity theory. Nevertheless, it is submitted that, even on this view, the argument that such "powers" are not part of the charter contract is unsound in that it is immaterial for our purposes whether the limitations which the charter imposes on corporations are limitations on its powers or only limitations on its privileges. Even according to the general capacity theory, a corporation, if it insists on taking advantage of its legal powers to do acts which it is not privileged to do, incurs a liability to have its charter taken away from it, even though the charter may be an irrevocable one. The limits of its privilege of acting, as distinguished from its power to do so, are fixed by its charter, and there seems to be no good reason to deny that these privileges are part of the charter contract. There is little or no discussion on this question in the cases, but the results reached in them are in accordance with the view here taken.<sup>54</sup>

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<sup>53</sup> George W. Pepper, *Rights Under Unauthorized Corporate Contracts*, 8 YALE L. J. 24 (1898); Albert J. Harno, *Privileges and Powers of a Corporation and the Doctrine of Ultra Vires*, 35 YALE L. J. 13 (1925). See also Comstock, C. J., in *Bissell v. Mich. Sou. & Nor. Ind. R. R.*, 22 N. Y. 258, 266 (1860). "Consciously, or unconsciously, all courts today do treat some unauthorized corporate action as corporate action"; E. H. Warren, *Executed Ultra Vires Transactions*, 23 HARV. L. REV. 495, 497 (1910).

<sup>54</sup> The cases upholding amendments which restrict the ordinary powers of a corporation, as distinct from its special franchises such as the right of eminent domain or its members' freedom from personal liability, are numerous and the cases which uphold amendments imposing additional burdens on the corporation are even more numerous. See, for example, *New York*

A particular corporate charter—speaking now of true charters conferred by a special act as distinguished from so-called charters of corporations created by the act of the incorporators themselves under general laws—in addition to conferring on the corporation the special privileges above referred to and delimiting the purposes for which these privileges can be made use of, also contains a number of provisions as to the internal organization of the corporation, regulating such matters as the voting rights of the members, the number and powers of the directors, the relative rights of the various classes of stockholders, and the like. These provisions seem rather to be conditions on which the corporate franchise may be exercised than provisions of the corporate franchise itself. Nevertheless, as such conditions, they should be regarded as parts of the charter contract. That they are not necessarily in all cases beyond the scope of the reserved power of amendment is shown by the decisions of the United States Supreme Court and of a majority of the state courts.<sup>55</sup>

It is submitted, therefore, that, where the corporation is formed by special act, the charter contract with the state is one of broad scope, embracing not only the privileges and immunities of the corporation but its internal organization; and that,

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Ry. v. Bristol, 155 U. S. 556 (1893); St. Louis Iron Mt. & St. Paul Ry. v. Paul, 173 U. S. 404 (1899); Fair Haven R. R. v. New Haven, 203 U. S. 379 (1906); Berea College v. Kentucky, 211 U. S. 45 (1908); *Opinion of the Justices*, 97 Me. 590, 55 Atl. 828 (1903); New York Central & H. R. R. v. Williams, 199 N. Y. 116, 92 N. E. 404 (1910). Some of these decisions might, it is true, have been based upon the police power rather than on the reserved power of amendment.

There are also many decisions upholding the amendment granting increased powers. Such amendments are, however, in general not compulsory but confer a new power on the majority, if they choose to exercise it. The effect of such amendments on the minority's rights is a disputed question which will be discussed at a later point in this article.

<sup>55</sup> For compulsory amendments see *Miller v. New York*, 15 Wall. 478 (1873), increasing voting rights of city as stockholder; *Jackson v. Walsh*, 75 Md. 304, 23 Atl. 778 (1892), increasing number of trustees of college and providing that certain of them be state officials. The acceptance of such amendments is more commonly made dependent on their acceptance by a majority or some other percentage of the stockholders. For cases dealing with such amendments, see *infra* notes 69 and 70.

subject to certain limitations to be discussed hereafter, all portions of this contract are subject to the amending power.<sup>56</sup>

Modern corporations are not, however, as a general rule, incorporated by special legislative act, but by action of the incorporators taken in accordance with the provisions of a general law. Although these general laws limit in some degree the privileges and purposes and form of organization which a corporation may have, much of the detail as to the scope of its activities and as to its internal structure is regulated not by law but by the agreement of the incorporators as embodied in the articles of incorporation which they draw up. In many states where such general laws exist, the constitution or statutes, instead of reserving the power to repeal or amend charters, reserve the power to repeal or amend the corporation laws.<sup>57</sup>

Suppose that in one of these states the corporation laws say nothing about the number of directors and that the incorporators have fixed this number at five. If the legislature should thereafter provide that all corporations, including those pre-

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<sup>56</sup> It is suggested in a note in 7 *COL. L. REV.* 598 (1907), that the contract with the state, even if given the widest possible scope, does not include all the provisions of the contract between the stockholders. Some of the distinctions attempted to be made, as, for example, that a change in corporate powers affects the contract with the state, but that an authorization of a consolidation affects only the contract between the members, seem to the present writer to be neither sound theoretically nor desirable practically. It is true, however, that there are certain provisions of the charter which are intended purely for the protection of the stockholders and could be waived by unanimous consent without any alteration of the charter. Thus there would seem to be no doubt that stockholders could, by unanimous consent, authorize an assessment on fully paid stock. It may be argued with considerable plausibility that if the legislature purports to authorize such an assessment, it is attempting to change the contract between the members rather than that between the corporation and the state. Nevertheless, it is submitted that any such distinction is insubstantial. As is pointed out subsequently, the rule requiring unanimous consent to amendments is a rule of corporation law and hence may fairly be regarded as part of the charter contract with the state. An amendment doing away with this rule as to a particular change is therefore an alteration of the contract with the state without regard to the kind of change to which it relates.

<sup>57</sup> See for example Kansas Const., Art. XII, § 1; Michigan Const., Art. XV, § 1; Nebraska Const., Art. XIII, § 1; New Jersey Const., Art. IV, § 7, par. 11; New York Const., Art. VIII, § 1. On the other hand, some states and constitutions still speak of amending or repealing corporate charters rather than corporation laws. See Pennsylvania Const., Art. XVI, § 10; Rhode Island Gen. Laws (1923) ch. 248, § 79. Others give the legislature power to amend or repeal both charters and corporations laws. See New Hampshire Pub. Laws (1926) ch. 225, § 74.



viously formed, shall have seven directors, the act would doubtless be an amendment to the corporation laws, and, unless invalid for reasons hereafter to be dealt with, would be within the power of amendment which had been reserved. It is not equally clear that a special act providing that the corporation in question should have seven directors would be authorized by the power which had been reserved of amending not the articles of particular corporations but the general corporation laws.

The problem is not, however, of much practical importance. Many modern legislatures are, as we have seen, forbidden by the constitutions of their states either to create corporations or to amend their charters except by general laws, and, even where no such constitutional provision exists, a legislature would be unlikely to pass special acts regulating the internal affairs of a particular corporation which had been organized under the general laws. The question is referred to here chiefly because it illustrates the point that the conception of a corporate charter as a contract with the legislature and of subsequent legislative acts as modifications of that contract is an idea which does not altogether fit the present system of organizing corporations under general laws. The view of a charter as a contract has, however, been carried over from the special act situation to that in which incorporation is obtained through compliance with general laws. We must accordingly deal with it as an established doctrine and endeavor to work out some satisfactory rule for determining its scope.

Apart from this possibility of distinguishing between amendments to the charter and amendment of the laws in cases of incorporation under general laws, how far, if at all, does our doctrine of the broad scope of the charter contract and of the amending power leave room for any limitations on the latter power? We have seen that the corporation cannot lawfully do any act not authorized by its charter, so that all of its privileges are properly regarded as portions of that charter. In exercising such privileges, the corporation will, however, obtain rights which, although obtained through the exercise of powers conferred by the legislature, are not themselves derived from the

charter contract but from dealings with private individuals. Of such a nature, for example, is the tangible property of the corporation, which is derived either from subscriptions to its stock or from purchases made by the corporation from outsiders. If the legislature were to repeal the corporate charter, it is well settled that, under modern rules of corporation law, this property would not escheat to the state, but would, after payment of debts, be distributed among the stockholders. It is reasonable and just, therefore, to hold, as the courts have held, that the corporation and its stockholders cannot be deprived of such property by any action taken under the guise of amending the charter.<sup>58</sup>

The decisions are not, however, entirely harmonious in the reasons that they give for so holding. It has sometimes been suggested that to use the amending power for the purpose of depriving the corporation of its property would be unconstitutional as amounting to a taking without due process of law.<sup>59</sup> Provided, however, that the reserved power of amendment is, as a matter of construction, plainly broad enough to cover the taking of the corporation's property, this argument as to the applicability of the due process clause is a little difficult to maintain. It is doubtless true that the legislature cannot obtain by contract the right to pass laws which are plainly confiscatory, but there may well be cases where corporate rights which would normally be regarded as vested are not vested because the corporation has agreed that they shall not be so treated. Where such is the case,

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<sup>58</sup> *Commonwealth v. Essex Co.*, 13 Gray 239 (Mass. 1859), is the leading case for this proposition. See also *Superior Water, Light & Power Co. v. Superior*, 263 U. S. 125 (1923). The decision in *Holyoke Water Power Co. v. Lyman*, 15 Wall. 500 (1873) is opposed to that in *Commonwealth v. Essex Co.*, *supra*, but the difference in decision appears to be due to a different view of the facts rather than of the scope of the reserved power. "It may be admitted that it (the reserved power) cannot be exercised to take away or destroy rights acquired by virtue of such a charter and which by a legitimate use of the powers granted have become vested in the corporation." *Miller v. New York*, 15 Wall. 478, 498 (1873).

<sup>59</sup> "The state cannot impose the condition that they (corporations) . . . shall ask no indemnity if their lands be seized for public use, or be taken without due process of law"; *Field, J.*, in *County of San Mateo v. So. Pac. R. R. Co.*, 13 Fed. 722, 754 (1882). See also *Lake Shore & Mich. Sou. R. R. v. Smith*, 173 U. S. 684, 698 (1899); *Chicago, M. & St. P. R. R. v. Wisconsin*, 238 U. S. 491, 501 (1915).

depriving the corporation of such rights would not be confiscation.<sup>60</sup>

It is submitted, therefore, that the real question in every case is as to what the reserved power should, in the light of its purposes and of our general notions of what is fair and reasonable, be construed to mean. So interpreted, it should, if couched merely in the general language ordinarily used, not be construed as including the right to take property not acquired from the state, and, accordingly, that property would still be protected by the Fourteenth Amendment. If, on the other hand, the legislature should by express language reserve the right to take such property for public purposes<sup>61</sup> without compensation, it is difficult to see how any constitutional rights could be infringed by such a taking.

In addition to the vested rights of the corporation in its property, which thus cannot be taken under the amending power,<sup>62</sup> the cases tell us that the stockholders also have vested rights which cannot be so taken. Here again, it is submitted that the basis for the limitation should be the proposition that the amending power ought in the interests of fairness not to be construed as including the power to take away these rights, rather than that it could not constitutionally be so construed.

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<sup>60</sup> In *Superior Water, Light & Power Co. v. Superior*, *supra* note 58 at 136, the Supreme Court held that the reserved power does not authorize a legislature to deprive a corporation of a franchise which it had obtained from a city. In so holding the court emphasized the fact that none of the decisions of the state court prior to the date when the franchise was accepted "construes the reservation in the state constitution as having the extraordinary scope accorded to it below." The natural inference from this language is that if the earlier decisions of the state court had been the other way, the franchise would have been revocable despite the fact that it contained no language making it so.

<sup>61</sup> A taking for private purposes would not be within the scope of legislative power. Hence it would be immaterial whether the corporation had agreed to it or not.

<sup>62</sup> Rights obtained from third parties are not the only rights which the courts have regarded as vested. There are also implied limitations on the power of the legislature, under guise of amending the charter, to deprive the corporation of rights obtained from the legislature itself or to impose on the corporation unreasonable restrictions on its business freedom. *Duluth & Iron Range R. R. v. St. Louis County*, *supra* note 47; *Lake Shore & Mich. Sou. R. R. Co. v. Smith*, *supra* note 59; *Chicago, M. & St. P. R. R. v. Wisconsin*, *supra* note 59.

Just what these vested rights are is not wholly clear. Stock is created under authority of the charter so that the charter is the origin of all of the stockholder's rights. In addition to that, many of his specific rights, such as his right to vote, are usually set forth in the charter or in the corporation laws, which are regarded as integral parts of the charters of corporations formed under general laws. The stockholder does not, however, obtain his stock by grant from the state but by subscription to the capital of the corporation or by purchase. His stock is property which has been duly paid for, and so to amend the charter as wholly or in large measure to deprive his property of its value is certainly unjust, at any rate where the amending power has been reserved in general terms which the ordinary stockholder would not regard as indicating an intent on the part of the legislature to reserve the right to destroy the value of his property.<sup>63</sup>

It would likewise strike most of us as unjust to construe the amending power in such a way as to enable the legislature to change the nature of the corporate business so radically that the stockholders would find themselves embarked in a radically different enterprise from that in which they originally invested their money. No one buying stock in a railroad corporation would, even if aware of the fact that the company's charter was subject to amendment, imagine that the legislature might later transform the business of his company into that of gold mining or candy making.<sup>64</sup> In fairness to the stockholders, therefore, the amending power should be construed so as to permit only such amendments as are, in the language of the Supreme Court, "consistent with the scope and object of the act of incorporation."<sup>65</sup>

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<sup>63</sup> Most of the cases deal with amendments which require the assent of the majority of the stockholders in order to be effective. For such a case see *Lord v. Equitable Life Assurance Society*, 194 N. Y. 212, 87 N. E. 443 (1909), in which the court, while upholding the amendment in question, recognized the limits of the amending power where property rights of the stockholders are involved.

<sup>64</sup> Here again the amendments which have been the subject of litigation have required the consent of the majority for their adoption. The actual cases do not involve such radical changes as those suggested. But see the consolidation cases cited in notes 95 and 96, *infra*.

<sup>65</sup> *Shields v. Ohio*, 95 U. S. 319, 324 (1877).

It may be, however, that, as suggested later, the amending power ought to be given a broader construction in this connection in cases where the majority stockholders as well as the legislature desire to change the business and the majority are willing or can be compelled to purchase the stock of dissenters at its fair value.

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(To be concluded in the June issue.)