Michigan Law Review

Volume 50 | Issue 8

1952

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ANY discussion of trends and developments in modern corporation legislation must assume some understanding of the historical antecedents of that legislation and the judicial approach to its interpretation. As a practical matter the outline of modern legislation has emerged within the memory of living men, but "in order to know what it is, we must know what it has been, and what it tends to become."[1] The state is less concerned today than long ago about the corporation becoming a state within the state and usurping political power, although such concern could and does evidence itself from time to time.[2] The state now is solicitous of minority shareholder interests in ways formerly unknown. Corporate legislation is in the ascendant relative to judge-made corporate law. It no longer presents a bare outline for organization, but prescribes the detail and fills in the gaps, with the result that large segments of decision law are becoming obsolete. The large unincorporated association is passing from the scene. The reasons for such trends lie deep in our economic, political and legal development.

The history of corporate organization does not present a consistent pattern, at least not in quite the same sense as the history of negotiable instruments. Corporate law has had no Lord Mansfield. The corporate idea in English law is reported to have originated with Pope Innocent IV, with *persona ficta* in the organization of the church, and the system of control erected over the borough and the gild to preserve the King's peace and assure his revenue.[3] From Bracton's day the history of corporate law is full of new beginnings and sharp turns in developmental pattern. For us the New Jersey statute of 1896 marks the last turn.[4]

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[1] HOLMES, THE COMMON LAW 1 (1881).

[2] Attorney General v. Railroad Companies, 35 Wis. 425 at 568 (1874), where Chief Justice Ryan, speaking of the Dartmouth College decision, stated: "It deprives the states of a large measure of their sovereign prerogative, and establishes great corporations as independent powers within the states, a sort of *imperia in imperiis*, baffling state order, state economy, state policy." See 9 HOLDSWORTH, HISTORY OF ENGLISH LAW 47 (1926): "In fact, creation by and subordination to the state are the only terms upon which the existence of large associations of men can be safely allowed to lead an active life." BERLE AND MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 357 (1933).

[3] 1 POLLOCK AND MAITLAND, HISTORY OF ENGLISH LAW, 2d ed., 494, 501, 503. 669-670 (1898).

[4] N.J. Laws, Revision of 1896, c. 185.

During the early period of English commercial expansion, the corporate idea was used to develop and control foreign trade in the interest of the state.[5] The earliest form of commercial organization was the regulated company, organized on the lines of the medieval gild. It used periodic contributions from merchant members, together with crown subsidy, to maintain and garrison forts and fleets at strategic points in the trade areas. The members traded on their own, or pooled their resources to finance individual voyages, all subject to the regulations of the company.[6] It was later that some companies began to finance commercial operations through a permanent capital contributed by the holders of a joint stock. Toward the end of the seventeenth century the joint stock companies became quite distinct from regulated companies,[7] and these joint stock companies were the remote ancestors of the present day business corporation.

Apparently there was little or no statute or decision law with respect to these joint stock companies, and the lawyers and parliament were puzzled and confused by contemporary trading and speculation in the shares of such companies. It is remarkable that the joint stock companies operated freely with or without corporate or chartered status, did not consider themselves bound in their business activity by the purposes and powers defined in crown charters when they had them, and the charters were freely traded to companies desirous of corporate status.[8] The concept of permanent enterprise capital had not developed, and payment of dividends from invested capital carried no odious connotation. The growth of joint stock companies received added impetus from the practice of loaning to the government in exchange for commercial privileges, an idea first exploited in the incorporation of the Bank of England in 1694.[9] Incorporation of the South Sea Company on this principle in 1711 was followed by a period of wild speculation in joint stock company shares which culminated in the first great financial crash of modern times, the bursting of the South Sea Bubble in 1720.[10]

It is at this point that the origin of present day corporate legislation might have been anticipated by almost two hundred years. Parliament might have provided for free incorporation of business organization

[5] 8 HOLDSWORTH, HISTORY OF ENGLISH LAW 200-202 (1926).
[6] Id. at 206-210.
[7] Id. at 206.
[8] Id. at 215-216; 9 id., 60; 1 SCOTT, CONSTITUTION AND FINANCE OF ENGLISH, SCOTTISH AND IRISH JOINT-STOCK COMPANIES TO 1720, 337, 338 (1910-1912).
[9] 8 HOLDSWORTH, HISTORY OF ENGLISH LAW 211 (1926).
[10] Id. at 218.

through a general law, supplemented by affirmative regulation of promotion and security flotation to safeguard the interests of investors and creditors.[11] Instead, Parliament seized upon the free and unregulated company organization which had existed for a generation as the scapegoat for the crash and passed the Bubble Act of 1720, a turn in the opposite direction. The Bubble Act declared illegal the "presuming to act as a corporate body," and the issue of transferable shares of stock, except under authority of an Act of Parliament or a charter granted by the Crown.[12] It declared illegal any activity by a chartered company beyond the powers and business purposes stated in its charter. Here was the beginning of the special act business corporation as we have known it, and the beginning of ultra vires. Thereafter, until the repeal of the Bubble Act in 1825, corporate charters were difficult and expensive to obtain, the fruit of special privilege, and unincorporated joint stock companies conducted business outside the recognition and protection of the law.[13]

Such a system discouraged and stifled development of any body of statute and decision law adequate on the one hand to fix the responsibilities of management and safeguard the interests of creditors and investors, and on the other to provide the organizational laissez faire and flexibility increasingly demanded by a civilization moving through commercial expansion and exploitation into the industrial age. The stifling effect of the Bubble Act may help to explain the organizational inflexibility, and the inadequate, confused provisions with respect to managerial and financial matters which characterized the first general incorporation statutes in America. After all, the draftsmen of these statutes had little legislative background upon which to draw.

The United States inherited this system after the Revolution.[14] Under the Constitution, the Parliament's power over business incorporation passed to the state legislatures. Williston says that only one business corporation was incorporated in America prior to the Revolu-

[11] See the suggestion in 8 HOLDSWORTH, HISTORY OF ENGLISH LAW 219-220 (1926).

[12] 6 Geo. I, c. 18 (1719).

[13] DU BOIS, THE ENGLISH BUSINESS COMPANY AFTER THE BUBBLE ACT, 1720-1800, c. 1 (1938); 1 SCOTT, JOINT STOCK COMPANIES 438 (1912); HUNT, THE DEVELOPMENT OF THE BUSINESS CORPORATION IN ENGLAND 1800-1867 (1936); In re Agriculturist Cattle Insurance Co., L.R. 5 Ch. App. 725 at 734 (1870): "But there were large societies on which the sun of royal or legislative favor did not shine, and as to whom the whole desire of the associates, and the whole aim of the ablest legal assistants they could obtain, was to make them as nearly a corporation as possible. . . ."

[14] The Bubble Act was extended to the American colonies in 1741. 14 Geo. 2, c. 37. For a last trace of it see Spotswood v. Morris, 12 Idaho 360, 85 P. 1094 (1906).

tion.[15] Incorporation by special act was the rule until the middle of the nineteenth century. Increasing economic activity pointed up the cumbersome aspects of the special charter system and led to widespread corruption in the obtaining of special charters. Beginning about 1848, most of the states junked the special act system and enacted general incorporation statutes under which anyone could organize business corporations by preparing and filing articles subscribed by a prescribed number of incorporators.[16]

The first general incorporation statutes reflected the distrust of unrestricted corporate organization inherited from England. This distrust perhaps was deepened by colonial experience with chartered companies controlled from England but uncontrolled in America, and by later experience with railroad development which demanded capital accumulation and large scale corporate organization to an extent previously unknown. The first statutes conceived of an incorporated business as a static economic unit, in which growth or change was not to be expected.[17] Limits were placed upon total stock investment, upon the power to borrow money, and the power to own land.[18] The scope of the corporate enterprise could be altered or enlarged only by unanimous shareholder consent.[19] The courts shared legislative distrust and pursued a restrictive approach to construction of corporate statutes which in the present day controls the draftsman of corporate legislation. If the corporate statutes did not speak expressly, particularly with respect to procedures which (1) undermined the judicial concept of democratic stockholder control, or (2) opened the door to expansion of the size and scope of corporate organization, such procedures were declared illegal and not available to corporate organizers.[20] For instance, each shareholder has one vote regardless of the number of shares held, unless the

[15] Williston, "The History of the Law of Business Corporations Before 1800," 3 SELECT ESSAYS IN ANGLO-AMERICAN LEGAL HISTORY 195 at 234 (1909).

[16] New York Const., art. VIII, §1 (1846); Michigan Const., art. XV, §§1 and 2 (1850); Wisconsin Const., art. XI, §§1, 4 and 5 (1848). The first general act was earlier, in New York, New York Laws (1811) c. 67.

[17] See Dodd, "Statutory Developments in Business Corporation Law," 50 HARV. L. REV. 27 (1936).

[18] Mass. Pub. Stat. (1882) c. 106, §§7, 60; see Louis K. Liggett Co. v. Lee, 288 U.S. 517 at 550, 554, 53 S.Ct. 481 (1933).

[19] Mass. Pub. Stat. (1882) c. 106, §§34, 51; 2 COOK, CORPORATIONS, 6th ed., §§667-669, 680 (1908).

[20] 1 COOK, CORPORATIONS, 6th ed., §4 (1908): "The law is clear that the articles of association of a corporation . . . are allowed to contain only those matters and statements which are required by the statute itself. . . . If . . . additional provisions and regulations are inserted they are void."

statute expressly gives a vote for each share.[21] Proxy voting is allowed only to the extent expressly authorized by statute,[22] and a corporation may not own and hold stock in another corporation unless the statute expressly grants the power.[23] It was against public policy to separate control from ownership of shares through transfer of shares to a voting trustee,[24] and combination through transfer of controlling shares in several corporations to a voting trustee was held illegal.[25] Democracy means majority control, and cumulative voting for directors is not permitted unless authority for it is spelled out in the statute.[26] Stock issued beyond the authorization contained in the articles is void.[27] Without express authority the corporation cannot dispose of all its assets for stock in another corporation, or even for cash unless the "exigencies of the business" justify the step.[28] Merger with another corporation not expressly authorized cannot be accomplished indirectly through sale of assets for stock and dissolution of the selling corporation.[29]

This restrictive approach to the interpretation of corporate statutes has been an effective instrument for judicial control of corporate activity. A realization of its significance in the history of corporate law is essential to an understanding of the corporation codes of the past twenty-five years. It cannot be explained away by the statement that the corporation is a creature of statute, because if the courts had been less distrustful of free business organization they could have construed the statutes to permit most organization procedures and devices to the extent not expressly restricted or prohibited by statute. This judicial

[21] 2 COOK, CORPORATIONS, 6th ed., §609 (1908); Taylor v. Griswold, 14 N.J.L. 222 at 238 (1834).

[22] Taylor v. Griswold, 14 N.J.L. 222 (1834); People v. Crossley, 69 Ill. 195 (1873).

[23] Even where the statute grants the power, it may not be used to acquire control of corporations with different business purposes, State v. Atlantic Railway, 77 N.J.L. 465, 72 A. 111 (1909).

[24] Warren v. Pim, 66 N.J. Eq. 353, 59 A. 773 (1904); Luthy v. Ream, 270 Ill. 170, 110 N.E. 373 (1915). Uncertainty persists despite cases supporting nonstatutory voting trusts, Mackin v. Nicollet Hotel, Inc., (8th Cir. 1928) 25 F. (2d) 783; Alderman v. Alderman, 178 S.C. 9, 181 S.E. 897 (1935).

[25] People v. North River Sugar Refining Co., 121 N.Y. 582, 24 N.E. 834 (1890); State v. Standard Oil Co., 49 Ohio St. 137, 30 N.E. 279 (1892).

[26] State ex rel. Baumgardner v. Stockley, 45 Ohio St. 304 at 308, 13 N.E. 279 (1887): "If the legislature had intended to . . . establish the cumulative system of voting, it easily could, and doubtless would, have done so in plain and unambiguous language."

[27] Scoville v. Thayer, 105 U.S. 143, 26 L.Ed. 968 (1881).

[28] Abbot v. American Hard Rubber Co., 33 Barb. (N.Y.) 578 (1861); Geddes v. Anaconda Copper Mining Co., 254 U.S. 590, 41 S.Ct. 209 (1921); comment, 35 MICH. L. REV. 626 (1937).

[29] In re Doe Run Lead Co. v. Maynard, 283 Mo. 646, 223 S.W. 600 (1920); Riker & Son Co. v. United Drug Co., 79 N.J. Eq. 580, 82 A. 930 (1912).

approach would have left the job of prohibition and restriction to the legislature, and corporation statutes would have followed a negative course, limiting or restricting procedures and practices considered unsound or unfair to minority interests. But the judicial approach has been negative, and corporate legislation of necessity has developed along distinctly affirmative lines, expressly spelling out authorized procedures and devices in considerable detail.

With respect to the scope of business activity of the single corporate unit, the courts allowed a degree of flexibility through the doctrine of implied powers.[30] But it was an uncertain and unpredictable measure and lawyers began the practice, incomprehensible to laymen, of exhausting the verb and adjective vocabulary of the English language in the purpose clauses of corporate articles and concluding by stating that the corporation should have power to do anything else that hadn't occurred to the draftsman. This practice persists today. Such clauses do not define the scope of enterprise activity in the interest of state control, nor do they inform and guide creditors, investors or management. It is suggested that any statutory reform intended to render such clauses obsolete will be an improvement.

The legislatures were slow to undertake the affirmative job of defining permissible procedures for corporate management and organization. The New Jersey Corporation Act of 1896 was the first real attempt in this direction; and it marks one of those abrupt turns in the history of corporate legislation. Beginning with this statute the restrictive concept of a corporate enabling statute as an instrument of direct control over the size, scope, and management of business organization was placed in the background, and the enabling statute was re-designed to serve the interest of corporation promoters and managers in flexible and efficient corporate organization. Specifically the movement took form in reduction of minimum starting capital requirements, elimination of restrictions upon total stock investment and the power to borrow, authority to hold stock in other corporations, authority to issue more than one class of stock, and to change the scope and size of the enterprise through amendment of the articles by majority instead of unanimous vote of shareholders.[31] Proxy voting was expressly authorized,

[30] People ex rel. Moloney v. Pullman's Palace Car Co., 175 Ill. 125, 51 N.E. 664 (1898).

[31] See discussion of Massachusetts statute of 1903 in Dodd, "Statutory Developments in Business Corporation Law, 1886-1936," 50 HARV. L. REV. 27 at 35-39 (1936).

as was director authority to mortgage assets, and majority stockholder authority to eliminate pre-emptive rights, sell or lease all the assets, and dissolve the corporation.[32]

This change of direction in corporate legislation was forced by the rapid expansion and centralization of control in industry which was occurring in the 1890's. New Jersey was soon followed by legislatures in other commercial states, and what became known as the "race of laxity" has continued to this day. This "race of laxity" has been blamed for evils and abuses which have accompanied separation of management from ownership of corporate enterprise.[33] An apathetic and frustrated investing public has been pictured as at the mercy of management not overly concerned with the stockholders' interest. It is suggested that the amounts of capital required for the conduct of industrial business organization made increasing separation of management and ownership inevitable, and retention of the restrictions upon corporate organization which were swept away in the "race of laxity" could not have halted the process. If the corporation enabling act had not been redesigned, then surely industrial business organizers would have turned to the unincorporated association as English trade organizers did in the century following the Bubble Act. The same evils and abuses would have developed, and the legislative problem would have been just as real and probably more difficult of solution. The legislative failure has not been removal of restriction and authorization of flexible organization procedure, but rather a failure to define the authority and duties, and clearly to fix the responsibility of management and majority shareholders.

Against this background the objectives of modern corporate legislation can be classified into (1) those to be achieved through the corporation enabling statute, and (2) those which require continuous affirmative regulation for their realization, as distinguished from negative enforcement by provision for a remedy in court to interested parties.

The statutes providing affirmative regulation of public utilities, insurance and investment companies, and statutes regulating the issue, sale of and dealing in corporate securities, as well as tax statutes which have an important part in corporate business decisions today, are beyond the scope of this paper. This leaves for discussion the corporation enabling statute and its judicial interpretation.

[32] In Delaware authority to limit or deny pre-emptive rights in the articles was enacted in 1927, Del. Gen. Corp. Law, §5-10; and majority shareholder authority to sell all the assets for stock was enacted in 1917, Del. Gen. Corp. Law, §65.

[33] Louis K. Liggett Co. v. Lee, 288 U.S. 517 at 557-567, 53 S.Ct. 481 (1933).

General incorporation statutes from their beginning were inadequate, confused or entirely lacking with respect to many essential matters, for instance: (1) definition of shareholders' obligation to contribute to corporate assets; (2) definition of financial standards for control of distributions to shareholders; (3) extent and incidence of responsibility of management to shareholders, and of both to creditors; (4) definition of procedures for recapitalization, reorganization, dissolution and orderly liquidation of corporations; and (5) rights and remedies of shareholders who dissent against corporate action which substantially alters the character of their investment.

Legislative omission and confusion in these matters naturally forced the courts to clarify and fill in with the judicial concept of what the legislature would have provided had it considered the matter. For instance, courts searched the statutes in vain for any expression of a stockholder obligation to pay the par amount for shares which would invalidate shareholder contracts with the corporation to pay less. In actions by creditors courts concluded that provision for a par figure must mean something, and through tortuous presumptions of fraud and questionable analogies to trust law they imposed upon stockholders an obligation to pay par to the extent necessary to satisfy certain creditors.[34] Beginning in 1912 the legislatures provided half an answer to this problem with a new invention—shares without par value.[35] But they failed to foresee or provide for the problems raised by no par shares with respect to financial standards for control of distributions to shareholders.

Confused legislative definition of standards for control of distributions to shareholders was characteristic. The statutes vaguely expressed an idea that dividends should not be paid out of capital or capital stock, or other than out of net profits or surplus.[36] There was no common understanding as to the meaning of this language, and the courts were free to apply their own ideas as to whether distributions to shareholders should be permitted when the balance sheet showed a deficit, provided the income statement showed earnings for the current accounting period,[37] and as to whether "capital" meant the par value of

[34] Sawyer v. Hoag, 17 Wall. (84 U.S.) 610, 21 L. Ed. 731 (1873); Hospes v. Northwestern Mfg. & Car Co., 48 Minn. 174, 50 N.W. 1117 (1892).

[35] The first statute to authorize no par shares was New York Laws 1912, c. 351.

[36] The New Jersey statute of 1896, §30, read: "No corporation shall make dividends, except from the surplus or net profits arising from its business, nor divide, withdraw, or in any way pay to the stockholders, or any of them, any part of its capital stock, or reduce its capital stock, except according to this act. . . ."

[37] Goodnow v. American Writing Paper Co., 73 N.J. Eq. 692, 69 A. 1014 (1908).

stock subscribed or the cost value of property contributed.[38] Court decisions furnished the only real guide to director conduct and responsibility in this area. Uncertainty encouraged lax and unsound practice, such as charging dividends against invested surplus, and surplus created by revaluation of assets, without revealing the facts to investors and creditors in financial statements or otherwise. One accountant has said: ". . . the primary encouragement for a breaking down of a simple and useful classification of net worth is found in our lax and confusing legal situation."[39]

Citation of further examples would unduly prolong this paper. The point is that until twenty years ago in all states, and yet today in many, decision law furnished the only guide in many areas of corporate practice where statutory direction and clarification were sorely needed. The restrictive judicial approach to corporate statutes still rendered uncertain or prevented the use of many useful procedural devices concerned with internal management, stockholder control, corporate expansion and reorganization. Some common examples are the voting trust, cumulative voting, sale of all corporate assets in exchange for stock, and statutory merger and consolidation.[40] The restrictive judicial approach conveniently insures maintenance of legislative control over corporate organization. Without it the task of the legislative draftsman would be negative and much more difficult. But it must be supplemented by clear cut affirmative legislation with respect to necessary or desirable procedural devices. All of this is not too surprising because history shows corporate legislation to have been in its infancy.

In 1928 the National Conference of Commissioners on Uniform State Laws approved a Uniform Business Corporation Act,[41] and since that time there has been a general movement toward codification and improvement of corporation enabling statutes. In the past twenty-five years new corporation codes have been enacted in Idaho, Ohio, Indiana, Illinois, California, Louisiana, Michigan, Minnesota, Washington and Pennsylvania.[42] In 1946 the Committee on Business Corporations of

[38] Peters v. United States Mortg. Co., 13 Del. Ch. 11, 114 A. 598 (1921).

[39] Paton, "Various Kinds of Surplus: A Symposium," 65 J. ACCOUNTANCY 281 at 286 (1938).

[40] See Wis. Stat. §182.011(2) (1951) and Gottschalk v. Avalon Realty Co., 249 Wis. 78, 23 N.W. (2d) 606 (1946); 15 FLETCHER, CYC. CORP. §7048 (1938).

[41] Since designated a Model Act. This act has been adopted in part in Idaho (1929), Kentucky (1946), Louisiana (1928), Washington (1933), Minnesota (1933), and Tennessee (1929).

[42] Ohio (1927-1929), California (1929-1933), Michigan (1931), Illinois (1933), and Pennsylvania (1933).

the American Bar Association published its Model Business Corporation Act, issued in revised form in 1950. The draftsmen of this statute attempted to include the best from the recent corporation codes, and to present for state use a model statute suitable for adaptation to the particular requirements of any state. It was not intended as a uniform law.

The first code based upon the Model Business Corporation Act to be enacted into law is contained in Chapter 180, Wisconsin Statutes, enacted by the 1951 Wisconsin legislature.[43] This statute is the product of several years work by members of a joint committee of the Wisconsin and Milwaukee Bar Associations. The committee was sponsored by the Judiciary Committee of the Wisconsin Legislative Council under authority of a Joint Resolution passed by the Wisconsin legislature in the 1949 session.[44] Assistance was received from the corporation division of the Wisconsin Department of State, and from the Wisconsin Department of Securities. The new Wisconsin Business Corporation Law follows the basic structure and outline of the Model Act, but significant changes in theory and phraseology have been made. For practical reasons the new law does not become effective as to existing Wisconsin business corporations until July 1, 1953, although such corporations may become subject to it by amendment to their articles before that time.[45] In the interim new corporations may be organized under the new law or under the previous enabling statute.

This discussion of the role of legislation in modern corporate law will use the Wisconsin Business Corporation Law as a point of reference, with comparisons to the Delaware Act and other corporation codes effective within the past twenty-five years. This approach has been adopted because (1) it is practically impossible to consider all of the corporation statutes in forty-eight and more jurisdictions in any detail in a single article; (2) the Wisconsin law is the most recent; and (3) the writer is more familiar with its detail and the background of its development into law than he is with respect to any other code.

The discussion will consider first, statutory provisions which concern the organization, management, and dissolution of the corporation, and procedures for financial readjustment and organic change; and second, statutory provisions which concern the interests of creditors, shareholders and the state.

[43] Chapter 731, Laws of 1951. Of the prior codes the Model Act more closely resembles the Illinois Business Corporation Law (1933) than any other.

[44] Joint Resolution 16S (1949).

[45] Wisconsin Laws 1951, c. 731, §8; Wis. Stat. §180.97 (1951).

I

CORPORATE ORGANIZATION, MANAGEMENT, DISSOLUTION AND REORGANIZATION

In this area modern corporation legislation is committed (1) to minimum restriction upon and maximum convenience and simplicity in procedures for the formation and organization of the corporation, (2) to flexible management procedure, and (3) to authorization for such adjustments in relative shareholder interests and organizational structure as financing requirements and the need for business expansion or contraction may fairly demand. Restrictive judicial interpretation renders essential clear and detailed statutory provision with respect to such procedure and authorization, almost to the point required in the drafting of tax legislation.

As the price for the freedom of action accorded management, the Wisconsin law and others of recent date (1) broaden the scope of inquiry allowed shareholders into corporate affairs and records, (2) permit, and in numerous instances require, shareholder participation in decisions affecting relative shareholder interests, and (3) impose upon management a degree of responsibility for the conduct of corporate affairs previously unknown to statute law, and imposed only vaguely and to uncertain extent in decision law.

A. *Formation and Organization of the Corporation*

The Wisconsin law requires only one incorporator.[46] It should save the lawyer with one stenographer the trouble of running down the hall. Reference has been made to the ridiculous practice of exhausting the English vocabulary in the purpose clauses of corporate articles, to the point where confusion is confounded. The Wisconsin law provides: "It shall be . . . sufficient . . . to state, either alone or with other purposes, that the corporation may engage in any lawful activity within the purposes for which corporations may be organized under this chapter, and all such lawful activities shall by such statement be deemed within the purposes of the corporation, subject to expressed limitations, if any."[47]

The Wisconsin law departs from the Model Act in prescribing in one section a uniform procedure for filing and recording all corporate

[46] Wis. Stat. §180.44 (1951).

[47] Wis. Stat. §180.45(1)(c) (1951). See Nev. Gen. Corp. Law of 1925, §1603-3, added by Nevada Laws 1949, c. 121.

documents, and the time for the beginning of corporate existence is fixed at the *leaving* of a duplicate original of the articles for record at the office of the county recorder.[48] Several of the codes attempt to minimize litigation involving the confusing de facto corporation decisions through provision that issue by the Secretary of State of a certificate of incorporation "shall be conclusive evidence that all conditions precedent required to be performed by the incorporators have been complied with and that the corporation has been incorporated under this chapter, except as against this state in a proceeding to cancel or revoke the certificate of incorporation."[49] This provision is coupled with a requirement that the Secretary of State find corporate articles and other documents to conform to law as a condition to filing.[50] Private litigation involving what incorporating steps amount to substantial compliance, what amounts to a good faith effort to comply, and to user of corporate privileges, can occur only where no certificate of incorporation has issued.

The human tendency to back out of pre-incorporation subscriptions to shares has been another source of unnecessary litigation. It can be minimized by provision that pre-incorporation subscriptions shall be irrevocable for some period of time unless expressly conditioned or all subscribers consent to revocation.[51] Further provision that such subscriptions shall be paid in full upon call is necessary to prevent litigation over whether the liability for breach is for the subscription price or for damages.[52]

Removal of all statutory restriction upon the location of the business office and place of directors and shareholders meetings should be unobjectionable if the corporation is required to maintain a registered office and agent within the state,[53] and if visitorial power is given to the courts of the state to order production of books and records under pain of involuntary dissolution.[54]

Restrictions upon selection of a corporate name are consistent with the modern law of fair competition, and confusion during the period of

[48] Wis. Stat. §180.86 (1951).

[49] Wis. Stat. §180.47 (1951); Uniform (Model) Business Corporation Act, §9 (1928), 9 U.L.A. 70; Calif. Gen. Corp. Law, §313 (1947).

[50] Wis. Stat. §180.86 (1951). An adverse decision is subject to review in a special action de novo in the Circuit Court of Dane County, Wis. Stat. §180.92 (1951).

[51] Wis. Stat. §180.13(1) (1951); see Uniform (Model) Business Corporation Act, §6 (1928), 9 U.L.A. 65; Ill. Bus. Corp. Act, §16 (1933).

[52] Wis. Stat. §180.13(2) (1947).

[53] Wis. Stat. §§180.23(1), 180.37(1), 180.09 (1951); Ill. Bus. Corp. Act §§11, 12 (1933).

[54] Wis. Stat. §180.43(6) (1951); Ill. Bus. Corp. Act, §45 (1933).

organization can be avoided through a clearly defined procedure for reservation of the right to use a name for a fixed period during which incorporation can be completed.[55]

Only commercial engraving firms and those who enjoy reading through magnifying glasses will decry abolishing legal necessity for the minutely printed statement on the backs of modern stock certificates setting forth all of the designations, preferences, limitations, and relative rights of each authorized class of shares. Some statutes seek to relieve the burden of this requirement by authorizing the statement either in full or in the form of a summary.[56] But lawyers are understandably afraid of the legal consequences of paraphrasing and summaries, and usually have the statement printed in full on the certificate. The Wisconsin law makes a bold departure by providing: "in lieu of such statement the certificate may state upon the face or back thereof the designation of each class of shares having preferences . . . such other information concerning such shares as may be desired," and that the corporation upon request will furnish to any shareholder free of charge readable copies of the portions of the articles pertaining to shares.[57]

Unnecessary inconvenience results when a corporation over the years has acquired numerous amendments to its articles of incorporation. Reference to the articles becomes difficult and sometimes uncertain, and when it is necessary to file the articles with an official of another state to qualify as a foreign corporation or for other purposes, all amendments must be attached although many may have become obsolete. Wisconsin and a few other states authorize adoption through the amending procedure of restated articles of incorporation, consisting of the articles as amended to date, in one document. When filed and recorded this document supersedes and takes the place of the original articles and all amendments.[58]

The modern enabling act allows almost complete freedom in the writing of the shareholder contract and the classification of shares. Express authority is granted to limit or deny voting power and pre-emptive rights, and to include desired provisions with respect to preferences,

[55] Wis. Stat. §180.08 (1951); Ohio Gen. Corp. Act, §8623-5-3 (1927).

[56] Model Business Corporation Act, §21; Ohio Gen. Corp. Act, §8623-31 (1927); Ill. Bus. Corp. Act, §21 (1933).

[57] Wis. Stat. §180.18(2) (1951).

[58] Wis. Stat. §180.55 (1951); see Ind. Gen. Corp. Act, Burns Stat. Ann. §25-225 (1933), added by amendment, Ind. Acts 1949, c. 194; Calif. Laws 1951, c. 1377, Calif. Gen. Corp. Law, §3802.

and for redemption and conversion of shares.[59] Practically the only remaining statutory restrictions relate to voting rights, which often cannot be withheld with respect to amendments to articles, and sometimes merger and consolidation, where the action will affect adversely the relative position of a class of shares as to dividends, voting rights, and rights on liquidation. In such cases the class of shares affected is often given the power to defeat the amendment, merger or consolidation by an adverse vote of the class.[60] Such action as sale of all assets, merger and consolidation, and any amendment to articles, requires a vote larger than a majority of a quorum, usually at least a majority and often two-thirds of shares outstanding, which can be increased but not reduced by article provision.[61] These restrictions as to the content of the shareholder contract with respect to voting power, together with the statutory right of the shareholder dissenting against sale, lease or exchange of all the assets, consolidation or merger, to appraisal of and payment for his shares, constitute the principal remaining statutory insistence upon a substantive distinction between debt and equity securities. At least one state requires that all equity securities carry unrestricted voting power.[62] Several enabling statutes authorize giving voting power to bonds and other creditor securities.[63] The law generally, for instance the law of remedies, assumes the existence of a distinction between creditor and equity interests in business organization. If preferred stock can be issued with no voting power at all, then perhaps it should be called a debenture or some other name more appropriate to an extremely junior creditor interest, with respect to which the right to payment of interest and principal is by contract subject to shareholder amending power. This is more than a quibble over labels. Why should an amendment to articles with perhaps a vote by classes be necessary to raise money through such a junior creditor security when it is not necessary to

[59] Wis. Stat. §§180.21, 180.12 (1951); Ohio Gen. Corp. Act, §8623-4-4(b) (1927); Ind. Gen. Corp. Act, Burns Stat. Ann. §25-205 (1933).

[60] Wis. Stat. §180.64(2) (1951), merger or consolidation; Wis. Stat. §180.52 (1951), amendment; Ohio Gen. Corp. Act, §8623-15(4) (1927), amendment but not merger or consolidation, §8623-67-I-(B); Ind. Gen. Corp. Act, Burns Stat. Ann. §25-224, amendment but not merger or consolidation, §§25-231(c), 25-232(c) (1933).

[61] Wis. Stat. §180.71(2) (1951), sale of assets; Wis. Stat. §180.64(2) (1951), merger or consolidation; Wis. Stat. §180.51 (1951), amendment; Ind. Gen. Corp. Act, Burns Stat. Ann. §§25-231(b), 25-223 (1933); Ohio Gen. Corp. Act, §§8623-15(3), 8623-67-I-(B) (1927).

[62] Ill. Const., art. XI, §3; People v. Emmerson, 302 Ill. 300, 134 N.E. 707 (1922); Ill. Bus. Corp. Act, §28 (1933).

[63] Del. Gen. Corp. Law, §29 (1935); Michigan Gen. Corp. Act, §450.36 (1931).

authorize bonds secured by first mortgage on the property? An altogether different set of conditions apply to the mortgage, and it can be authorized by the directors unless it is of substantially all the property and not in the usual course of business. The retention of restrictions upon the extent to which voting power can be denied in the shareholder contract must find its justification in a conviction that recognition of a real line of distinction based upon proprietory participation is conducive to order in corporate organization, and that elimination of the distinction would promote confusion. It appears also that if the distinction is to be preserved at all, it must be done in the corporate enabling statute through insistence there that any security labelled stock must have the right to participate at least in major corporate decisions.

Some recent statutes authorize subdivision of a class of shares into different series, and provide for delegation through article provision of authority to directors to designate the series and make variations in the content of the shareholder contract as between series. To the extent the directors are allowed to write the contract the shareholders are deprived of opportunity to vote on the specific terms of issue, and some of the statutes are so broad as to permit the directors to write the whole contract.[64] This appears unnecessary in view of the reason given for such procedure, which is to permit rapid adjustment of the terms of issue to meet current security market requirements with respect to such matters as the dividend rate, and redemption, liquidation, sinking fund and conversion rights. The Model Act and the Wisconsin law limit the authority which can be delegated to directors to matters which lie within the reason for the delegation. They provide that all series within one class must be identical except for dividend rate, amount payable on liquidation, sinking fund terms, and the conditions of redemption or conversion.[65]

B. *Management Procedure*

The modern corporation code means to give to directors the authority necessary for convenient and efficient operation of the business, and to majority shareholders the authority necessary to make such changes in organization and capitalization as the fortunes of corporate existence

[64] Del. Corp. Law, §13 (1935), authorizes delegation to directors through article provision of complete power over share authorization, with respect to classes of shares as well as series within a class; also Ind. Gen. Corp. Act, Burns. Stat. Ann. §25-205(a)(b) (1933).

[65] Wis. Stat. §180.12(3)(4) (1951); Model Act, §15; Ohio Gen. Corp. Act, §8623-4-4(b) (1927).

fairly may demand. Such authority is spelled out in the statutes in detail and with such clarity as the draftsman commands. Such an approach is necessary because of the history of restrictive judicial interpretation of corporate statutes, and is desirable in the interest of efficient business organization. Insofar as possible the lawyer should be in position to give the businessman an answer to his problem and a well defined procedure to follow.

Several codes now give the corporation express power to make donations for charitable, scientific, educational and religious purposes.[66]

Many statutes provide expressly for the voting trust, with the requirement that the trust instrument be available for examination by any shareholder at the registered office of the corporation.[67] All statutes limit permissible duration of the trust, ten years being a common limitation.[68] The rationale for such limitations is not clearly expressed. If the voting trust is desirable at all, what reason can be advanced for tampering with trust law?

With respect to meetings of directors and shareholders the Model Act, the Wisconsin law, and many others provide that any notice requirement may be satisfied by a signed waiver in writing,[69] and any corporate action may be taken without a meeting if a consent to the action be signed by all of the shareholders or directors entitled to vote.[70] Meetings may be held at such places, at such times and upon the call of such persons as may be provided in the by-laws.[71] Restrictions remain with respect to quorum. Under the Wisconsin law a shareholders' quorum must be at least one-third of the shares entitled to vote,[72] and a directors' quorum at least a majority of the members of the board.[73]

[66] Wis. Stat. §180.04(12) (1951); Del. Gen. Corp. Law, §2-9 (1935), S.B. 397, Del. Laws 1951; Ohio Gen. Corp. Act, §8623-119 (1927). In Ohio, shareholders must be given notice and opportunity to object to any expenditure in excess of one per cent of capital and surplus.

[67] Wis. Stat. §180.27 (1951); Mich. Gen. Corp. Act, §450.34 (1931); Del. Gen. Corp. Law, §18 (1935).

[68] Wisconsin, twenty years; Michigan and Delaware, ten years, with provision for renewal in Delaware. Where the voting trust agreement provided a duration of eleven years, it was held totally invalid, Perry v. Missouri-Kansas Pipe Line Co., 22 Del. Ch. 33, 191 A. 823 (1937), noted 22 MINN. L. REV. 276 (1938).

[69] Model Act, §27; Wis. Stat. §180.89 (1951); Ohio Gen. Corp. Act, §8623-45 (1927), Laws 1949, S.B. 82.

[70] Model Act, §38, as to shareholders only; Wis. Stat. §180.91. Such a provision in articles is invalid unless expressly authorized by statute, Audenried v. East Coast Milling Company, 68 N.J. Eq. 450 at 466-469, 59 A. 577 (1904).

[71] Wis. Stat. §180.23(1) (1951), shareholders; §180.37(1) (1951), directors; Ind. Gen. Corp. Act, Burns Stat. Ann. §25-207(c) (1933).

[72] Wis. Stat. §180.28 (1951).

[73] Id., §180.35.

Some statutes authorize delegating the power to make by-laws to the board of directors through provision in the articles.[74] Of course the ultimate power over by-laws remains in the shareholders, but amendment to the articles may be necessary to regain it once the power has been placed with the directors. The Model Act goes even further and places power over by-laws in the directors, unless expressly reserved to the shareholders in the articles.[75] The draftsmen of the Wisconsin law considered it unnecessary in the interest of flexible operation to place control of the by-laws beyond the power of a majority, but less than a two-thirds, shareholder interest. Under the Wisconsin law directors have the power to make by-laws, but their by-laws must be subordinate to those adopted by the shareholders.[76]

Most modern codes provide that directors need not be either residents of the state of incorporation or shareholders.[77] For corporate organizers who desire to insure continuity of management, several statutes permit classification of directors according to date of expiration of term; for instance, three classes of directors, each class with a three-year term, and one class to come up for election at each annual meeting. Some statutes impose no requirement as to the minimum number of directors in each class, with the result that only one director may come up for election each year.[78] Where such classification is possible, any right of cumulative voting can be nullified. The Wisconsin law protects the right of cumulative voting by requiring that the maximum number of classes, and the minimum number of directors in each class, shall be three.[79] The anomaly in the situation is that authority for cumulative voting was omitted from the Wisconsin law for political reasons, and introduced in the form of a separate bill, which failed to pass the legislature.

Another commonly used management device is the committee of directors with authority to exercise the powers of the board with respect to specified matters when the board is not in session. Several statutes, through provision for an "executive committee," limit the possible num-

[74] Del. Gen. Corp. Law, §12 (1935).
[75] Model Act, §25.
[76] Wis. Stat. §180.22 (1951).
[77] Wis. Stat. §180.30 (1951); Calif. Gen. Corp. Law, §804 (1947); Ill. Bus. Corp. Act, §33 (1933); Del. Gen. Corp. Law, §9 (1935).
[78] Del. Gen. Corp. Law, §9 (1935); Ohio Gen. Corp. Act, §8623-55 (1927), added by Laws 1949, S.B. 82.
[79] Wis. Stat. §180.33 (1951); also Ill. Bus. Corp. Act, §35 (1933), and Ind. Gen. Corp. Act, Burns Stat. Ann. §25-208 (1933).

ber of such committees to one.[80] The Wisconsin law permits the board of directors to create any number of such committees of at least three members, but forbids delegating to such committees authority to act with respect to dividends, election of officers, or the filling of board or committee vacancies.[81]

There has been considerable difficulty concerning the validity of director action establishing officer compensation where the officers concerned are members of the board. In a recent Wisconsin case where only one of three directors was disinterested, such a contract was set aside even though each interested director had absented himself while his compensation was under consideration.[82] The court referred to this take-a-walk procedure as "mutual back scratching." Realistically, a director's influence will be present even though he is physically absent, and a recent Delaware decision so indicated in sustaining a profit-sharing plan which was approved when the interested directors were physically present. However, the court stated that the interested directors should not be counted in determining a quorum, nor should their votes be counted in a vote on the plan.[83] Such contracts should be open to scrutiny, but validity should not be rendered uncertain solely upon the basis of rigid rules written in terms of the formalities of board action. The new Wisconsin law contains a provision that the board shall have authority by majority vote to establish reasonable compensation in such cases, irrespective of the personal interest of any of its members.[84]

In the interest of clarity, the Model Act and the Wisconsin and Illinois laws give to the directors the authority to sell, lease, mortgage or otherwise dispose of all, or substantially all, of the corporate property in the rare situation where such action is in the usual and regular course of the corporate business.[85] The Wisconsin law adds a provision that the directors shall have authority to dispose of less than substantially all the property in any event. Obviously the courts will scrutinize director action under this section upon the complaint of a shareholder, and directors will find it advisable to exercise such power with care, and only when the "usual course of business" and "less than substantially all the property" questions can be clearly and safely answered.

[80] Model Act, §38; Calif. Gen. Corp. Law, §822 (1947).

[81] Wis. Stat. §180.36 (1951); Del. Gen. Corp. Law, §9 (1935) and Ohio Gen. Corp. Act, §8623-60 (1927), authorize creation of committees with unlimited authority.

[82] Stoiber v. Miller Brewing Co., 257 Wis. 13, 42 N.W. (2d) 144 (1950).

[83] Kerbs v. California Eastern Airways, Inc., (Del. Ch. 1951) 83 A. (2d) 473.

[84] Wis. Stat. §180.31 (1951).

[85] Wis. Stat. §180.70 (1951); Model Act, §72; Ill. Bus. Corp. Act, §71 (1933).

C. *Recapitalization, Combination and Dissolution*

1. *Article Amendment.* Majority shareholders generally have power through amendment to place any provision in articles that could have been included in original articles, and sometimes in original articles as of the time of amendment.[86] This means broad power at any time to change the capital structure, and to alter the relative position of classes of shares with respect to the future as to dividend, redemption, conversion, asset preference, voting and pre-emptive rights.[87] In addition, recent statutes expressly include majority power to cancel rights to dividends which have accrued but have not been declared.[88]

2. *Combination of Corporate Units.* The judicial approach to interpretation of corporate enabling legislation historically has restricted freedom to combine with other corporate units. Such combination may be attempted through (a) acquisition by one corporation of stock in another in exchange for corporate stock or property or both, often followed by dissolution and liquidation of one of the corporations; or (b) statutory merger of one corporate entity into another, or creation of a new corporate entity to replace two or more others, without formal property transfers or dissolution and liquidation proceedings. Merger and consolidation are not legally possible without express statutory authorization.[89] Sale by a solvent corporation of all its assets is not feasible as a matter of practice without a statute authorizing majority shareholders to take such action, because in the absence of such a statute unanimous consent of all shareholders is required.[90] In the absence of statutory authority, majority shareholder sale of all assets is considered proper only in connection with circumstances warranting dissolution and liquidation proceedings, which in turn are within majority power only when the insolvent condition of the corporate business renders them advisable.[91] Statutory authority to acquire and hold stock in other corporations has been common since the beginning of the century, but until the modern codes such statutory authority as existed with respect to sale of assets was inadequate and uncertain in most juris-

[86] Wis. Stat. §180.50(1) (1951); Del. Gen. Corp. Act, §26 (1935); Ohio Gen. Corp. Act, §8623-14 (1927).

[87] Wis. Stat. §180.52 (1951); Calif. Gen. Corp. Law, §3601 (1947), Laws 1949, c. 997.

[88] Wis. Stat. §180.52(1)(j) (1951); Ohio Gen. Corp. Act §8623-14(3)(i) (1927).

[89] 15 FLETCHER, CYC. CORP., rep. vol., §7048 (1938).

[90] 2 COOK, CORPORATIONS, 6th ed., §670 (1908); 35 MICH. L. REV. 626 (1937).

[91] 2 COOK, CORPORATIONS, 6th ed., §629 (1908).

dictions,[92] and statutes authorizing merger and consolidation were enacted in only a few.[93] For instance, statutes simply authorizing sale of assets by majority shareholder action were construed strictly to prevent sale for stock in another corporation, or for any consideration other than cash,[94] and statutes simply authorizing merger could not be used to merge a domestic corporation with a corporation of another state.[95]

This is the background of the detailed statutes of recent date outlining carefully the authority and procedure for merger, consolidation and sale of assets.[96] It is not the purpose of this article to analyze their provisions. Needless to say their history should indicate to lawyers the importance of following the prescribed procedure to the letter.

3. *Dissolution.* The matter of corporate dissolution in the absence of controlling statute is adorned by some quaint decision law. It appears that upon dissolution by expiration of charter term, court decree or otherwise, the corporate real estate reverts to the original grantor or his heirs, personal property escheats to the state, actions to which the corporation is a party abate, and debts due the corporation are extinguished.[97] Analogies have been drawn to the death of a natural person,[98] but for some reason the legislatures have not provided adequately for administration of the deceased's estate, as they have at least in detail in the case of natural persons. Most general corporation codes still announce that the corporation, after its death by dissolution, shall continue in a comatose condition, usually for three years, before exhaling its last gasp.[99] During this period the directors continue as trustees for the purpose of continuing actions, distributing assets and winding up the business. Meanwhile, title to the property remains with the corporate entity, or passes to the stockholders subject to a trust for the creditors, and judicial action may be necessary to subject the property

[92] See Wis. Stat. §182.011(2) (1951); Avalon Realty Co. v. Gottschalk, 249 Wis. 78, 23 N.W. (2d) 606 (1946); First Nat. Bank v. Paramount Transit Co., 139 Kan. 808, 33 P. (2d) 300 (1934).

[93] An early statute, Del. Laws 1899, v. 21, c. 273, §54.

[94] An exception was sometimes made where the stock had an established market value and was the equivalent of cash, Geddes v. Anaconda Copper Mining Co., 254 U.S. 590, 41 S.Ct. 209 (1921), noted 30 YALE L.J. 633 (1921).

[95] Gott v. Live Poultry Transit Co., 17 Del. Ch. 288, 153 A. 801 (1931).

[96] Wis. Stat. §§180.62 to 180.68, 180.71 (1951); Ind. Gen. Corp. Act, Burns. Stat. Ann., §§25-230 to 25-235 (1933); Ill. Bus. Corp. Act, §§61 to 69 (1933).

[97] See discussion in Williston, "The History of the Law of Business Corporations Before 1800," 3 SELECT ESSAYS IN ANGLO-AMERICAN LEGAL HISTORY 232-234 (1909); 16 FLETCHER, CYC. CORP., perm. ed., §8113 (1942).

[98] Combes v. Keyes, 89 Wis. 297, 62 N.W. 89 (1895).

[99] 16 FLETCHER, CYC. CORP., perm. ed., §81.66 (1942).

to payment of debts or clear a purchaser's title. The confusion is compounded after the three years expire and winding up remains incomplete Since the statutes make no provision for such eventuality the courts must resort to the so-called common law cases to work out problems involving title to property and pending lawsuits.[100]

The Model Act, and the Wisconsin and Illinois laws, have attempted a new approach to the problem. They defer dissolution until liquidation and winding up are complete, and place no time limit upon winding up. The shareholder decision to dissolve is followed by filing a statement of intent to dissolve.[101] Thereafter normal corporate operation continues, except that authority is restricted to business activity necessary for winding up.[102] When all property has been distributed, all debts have been paid or provision for payment made, and provision has been made for satisfaction of any pending litigation, then articles of dissolution are filed containing recitals that the steps required for winding up are complete.[103] Remedies against the corporation, directors and shareholders are preserved for a period of two years after articles of dissolution are filed.[104]

The approach contained in these recent statutes should simplify dissolution procedure, and clarify the legal status and rights of creditors, shareholders and the corporation during the liquidation period.

II

THE INTERESTS OF CREDITORS, SHAREHOLDERS AND THE STATE

The broad authority conferred upon directors and majority shareholders in the interest of organizational flexibility and efficiency is a development of the past fifty years in the history of corporate legislation. Perhaps the only explanation for the slow development of adequate leg-

[100] State ex rel. Pabst v. Circuit Court, 184 Wis. 301, 199 N.W. 213 (1924); payment after three years to directors does not discharge the note, Drzewieski v. Stempowski, 232 Wis. 447, 287 N.W. 747 (1939).

[101] Wis. Stat. §§180.753, 180.755 (1951); Model Act, §§77-79; Ill. Bus. Corp. Act, §§76-78 (1933); See Uniform (Model) Business Corp. Act, §50, 9 U.L.A. 137 (1928); see also Ohio Gen. Corp. Act §§8623-79 to 8623-82 (1927).

[102] Wis. Stat. §§180.755, 180.757 (1951).

[103] Id., §§180.765, 180.767.

[104] Wis. Stat. §§180.787 (1951). The problem of title to corporate property forgotten in the final distribution may be the subject of a future amendment to the Wisconsin law. One solution is to vest it after articles of dissolution are filed in the last shareholders as tenants in common. See Uniform (Model) Business Corporation Law, §60 IV, 9 U.L.A. (1928).

islative standards and sanctions for protection of the interests of creditors and preferred and minority shareholders is the newness and difficulty of the problems and lack of agreement as to what the standards and sanctions should be. In default of legislative direction the courts have written much of the law in the field, and the results have been far from uniform or consistent.

A. *The Financial Problem*

The idea has persisted that as the price for limited liability to creditors, shareholders should be held to contribute some legally specified dollar amount of property to the corporate assets, and some portion of this amount should be maintained by the corporation as a margin or cushion in excess of corporate liabilities for the protection of creditors. Recent statutes contain the thought that the cushion is maintained to protect the liquidation rights of preferred shareholders as well as creditor rights. Distributions to shareholders in the form of dividends, and payments for purchase of their shares, should be permitted only so long as the indicated amounts of corporate property remain intact.

There has been uncertainty and disagreement as to the rules for measurement of the indicated amounts. It has been held that the creditors' cushion is to be measured by the value of property paid by shareholders for their shares without regard to the par value of the shares, with the result that dividends are payable although total assets are less than the par value of outstanding shares plus liabilities.[105] Yet upon insolvency, in the absence of statutory authority, shareholders have been held liable to creditor representatives for the difference between what they paid for their shares and the par valuation.[106] Some statutes permit payment of dividends if income statements for prior accounting periods show profit from operation, even though because of water or operational losses the total assets are less than liabilities plus the legally required creditors' cushion.[107] Some statutes permit unlimited allocation of consideration received for no par shares to capital surplus, and where there are no limitations upon the crediting of dividend payments against capital surplus, earned surplus remains intact for further dividends, and the creditors' cushion is pure illusion.[108] Unless

[105] Goodnow v. American Writing Paper Co., 73 N.J. Eq. 692, 69 A. 1014 (1908).
[106] Hospes v. Northwestern Mfg. & Car Co., 48 Minn. 174, 50 N.W. 1117 (1892).
[107] Del. Gen. Corp. Act, §34 (1935); Calif. Gen. Corp. Law, §1500 (1947).
[108] Wis. Stat. §§182.214, 182.219 (old law) (1951); Maine Rev. Stat. c. 49, §19 (1944); Ind. Gen. Corp. Act, Burns Stat. Ann. §§25-101(h), 25-205(c), 25-211 (1933).

the matter is pinned down by statute there is nothing to prevent debiting treasury shares against payments for purchase or redemption of outstanding shares, and entering the treasury shares on the balance sheet as an asset or an offset to outstanding shares.[109] Surplus remains intact for more dividends, and again the creditors' cushion is illusory. Where the standards for financial management are deceptive to the creditors they are written to protect, they are worse than no standards at all. Finally it is extremely difficult to devise practical tests for valuation of property invested which can be used as a measure of shareholders' liability to pay for shares and as a guide for control of corporate distributions. No better test has been found than the good faith of the individuals who do the valuing, and their judgment usually is conclusive unless clear evidence of obvious overvaluation is available.[110] And accounting for fixed assets upon the basis of cost less depreciation tends to freeze initial valuation errors, distort actual values, and prevent correction of asset figures for price level and real changes in asset values. An example of the problem is to be observed in the reconciliation necessary between book accounting and income tax accounting. But accounting on the basis of cost appears to be generally the only workable method.[111]

Directors are responsible for payments which violate the statutory standard; but there has been lack of agreement with respect to the extent of their liability, definition of the good faith which excuses from liability, and the parties entitled to enforce the liability.[112] Shareholders who receive the unauthorized distributions are required to pay them back under varying circumstances, and directors may have rights of indemnity against shareholders who receive the distributions knowing them to be unauthorized.[113]

[109] Rasmussen v. Roberge, 194 Wis. 362, 216 N.W. 481 (1927); Gipson v. Bedard, 173 Minn. 104, 217 N.W. 139 (1927).

[110] Coit v. Bold Amalgamating Co., 119 U.S. 343, 7 S.Ct. 231 (1886). Regardless of the test applied by the courts, good faith, true value, or reasonable judgment, cases of liability always involve obvious overvaluation.

[111] See comment, "Significance of Appreciation and Changing Price Levels in Corporate Dividend Policies," 35 MICH. L. REV. 286 (1936).

[112] See notes: 35 YALE L.J. 870 (1926); 26 MINN. L. REV. 400 (1942); 82 UNIV. PA. L. REV. 286 (1934); 38 COL. L. REV. 523 (1938).

[113] McDonald v. Williams, 174 U.S. 397, 19 S.Ct. 743 (1899); Detroit Trust Co. v. Goodrich, 175 Mich. 168, 141 N.W. 882 (1913); there is little decision authority with respect to director rights against shareholders, see Briggs, "Stockholders' Liability for Unlawful Dividends," 8 TEMPLE L.Q. 145, 183 (1934); Sharp v. Call, 69 Neb. 72, 95 N.W. 16, 96 N.W. 1004 (1903).

The cushion idea has been formulated in the complex statute and decision law which deals with corporate dividends, capital and surplus. It is a system of regulation which assumes agreement upon minimum standards for sound financial organization and operation, and which necessarily depends for enforcement upon a closing of the barn door after the horse is stolen. The Public Utility Holding Company and Investment Company Acts give to the Federal Securities and Exchange Commission broad power to supervise distributions to the shareholders of companies subject to those statutes,[114] but to place business corporations generally under such affirmative regulation, state or federal, would surely be a *long* step toward the end of free enterprise. It is arguable that the whole complicated structure of capital and surplus requirements should be junked and replaced with a more flexible standard, written in terms of a minimum ratio of assets to liabilities with a supplemental requirement as to current ratio, to control and guide the making of corporate distributions. Clauses prescribing such a standard are not uncommon in bond indentures and preferred share contracts restricting payment of dividends to common shares.

In any event minimum standards for the protection of creditors and preferred shareholders, and the incidence and extent of responsibility for their violation, should be agreed upon generally and clearly expressed in the statutes. Only through such an approach can business organization develop reasonably workable uniform standards, and corporate management be supplied with understandable rules for action which fairly consider the interest of the corporation, the shareholders and creditors. The Model Business Corporation Act of the American Bar Association is a hopeful move in this direction, and the Wisconsin law follows the Model Act closely on the subject.

Under the Wisconsin law the creditors' cushion is measured in terms of stated capital and capital surplus, and these terms are carefully defined. Stated capital at any time is the sum of (1) the par of all issued shares, whether outstanding or in treasury, (2) at least seventy-five per cent of the consideration received for issued no par shares, whether outstanding or in treasury, and (3) amounts transferred from earned or capital surplus by director resolution.[115] All reductions of stated capital through amendment to articles result in capital surplus. Reductions

[114] Public Utility Holding Company Act of 1935, §12(c), 49 Stat. L. 823, 15 U.S.C. (1946) §79*l*(c), S.E.C. Rule U-46(a); Investment Company Act of 1940, §19, 54 Stat. L. 821, 15 U.S.C. (1946) §80a-19, S.E.C. Rule N-19-1.

[115] Wis. Stat. §180.02(10) (1951).

through cancellation of purchased or redeemed shares result in capital surplus to the extent that the stated capital represented by the shares canceled exceeds the cost to the corporation of the shares redeemed or purchased.[116] Capital surplus may also result from allocation thereto of not more than twenty-five per cent of consideration received for no par shares, from issue of par shares for more than par, or from director action transferring earned surplus.[117] Ordinary dividends can be paid only to the extent there is earned surplus and if the payment will not leave the corporation insolvent, which is defined as inability to pay debts in usual course.[118] The only situations in which corporate distributions can be charged other than against earned surplus are the following:

(1) Accrued cumulative dividends on preferred shares may be charged against capital surplus if there is no earned surplus and the corporation will not be left insolvent;[119]

(2) Purchases of the corporation's shares may be charged against capital surplus or deficit provided (a) the corporation is not left insolvent, (b) the net assets are not reduced below an amount sufficient to cover the liquidation preferences of preferred shares, and (c) acquisition is authorized by the articles or by the class vote of two-thirds of the class purchased and of each class prior in rank on liquidation;[120] and

(3) "Distributions in partial liquidation" which must be identified as such to the recipient shareholders and may be charged against capital surplus or deficit provided (a) the corporation is not left insolvent, (b) net assets are not reduced below an amount sufficient to cover the liquidation preferences of preferred shares, (c) accrued cumulative dividends are fully paid, and (d) the distribution is authorized by the articles or by the two-thirds vote of each class of shares, and on this question shares have voting power regardless of the articles.[121]

Directors are jointly and severally liable *to the corporation* for the unauthorized amount of any distribution to which they have assented, and a director who is present at a meeting has assented unless his dissent is a matter of record in the minutes of the meeting.[122] Reliance in

[116] Id., §180.61.
[117] Id., §§180.16, 180.61(2).
[118] Id., §180.38.
[119] Id., §180.38(3).
[120] Id., §180.05.
[121] Id., §180.39.
[122] Id., §180.40. Directors held liable have a right of contribution against shareholders who receive the distribution knowing it to be unauthorized. Wis. Stat. §180.40(5)(a).

good faith upon corporate financial statements will be a defense to the director.[123] Directors who assent to corporate loans to officers and directors are sureties on the loan unless they can prove it was for a proper business purpose.[124] Shareholders are liable *to the corporation* for (1) the unauthorized amount of any distribution received by them,[125] and (2) the par amount of shares with par value and the amount for which no par shares were issued unless the shareholder is a transferee in good faith without knowledge that his shares were not fully paid.[126] Liability to pay for shares is not discharged by sale of the shares.

B. *Fairness to Shareholders*

As a practical matter it may be fruitless to attempt direct legislation with respect to most aspects of the fiduciary duties of directors and majority shareholders to manage the corporation with care, diligence and loyalty, and this perhaps explains the general lack of legislation in the field. Such statutes as exist are negative in nature, for instance statutes which declare corporate contracts not invalid or voidable simply because directors voting for them have a personal interest, and which place the burden of disclosure and proof of reasonableness and fairness upon the interested directors.[127] These statutes reflect legislative dissatisfaction with court decisions which hold such contracts void without regard to fairness or reasonableness.[128] The necessity of considering each case of alleged violation of fiduciary responsibility on its facts has left the development of this area of corporate law largely to the courts.[129]

Corporate managers and majority shareholders have made wide use of the flexible procedure and authority to recapitalize and combine with other units which has been spelled out for them in modern corporate legislation, and this use has prompted litigation and development of a

[123] Id., §180.40(3).
[124] Id., §180.40(1)(d).
[125] Id., §180.40(5)(b).
[126] Id., §§180.14(1)(2), 180.20.
[127] Calif. Gen. Corp. Law, §820 (1947); Mich. Stat. Ann., §21.13-5 (1931); R.I. Gen. Laws, c. 116, §21 (1938).
[128] Federal Mortgage Co. v. Simes, 210 Wis. 139, 245 N.W. 169 (1932); Hotaling v. Hotaling, 193 Cal. 368, 224 P. 455 (1924).
[129] See Uniform Business Corporation Act, §28II, which has not been enacted in any state, and reads: "If, by the articles of incorporation, voting power is granted to the holders of shares of a certain class or classes and denied to the holders of shares of other classes, then the person or persons exercising such power shall stand in a fiduciary relation to the entire body of shareholders and shall be responsible to the corporation, for the benefit of all shareholders, for any violation of the obligations of such relationship."

body of decision law which insists that authority granted in unlimited terms be exercised with fairness to minority interests and not primarily to further the special interest of those exercising it. Where majority shareholders have statutory authority to sell all the assets, dissolve and liquidate, merge or consolidate, or amend the shareholders contract, minority shareholders may still enjoin the exercise of the power or obtain damages where the purpose is to freeze them out or principally to affect adversely their relative position with respect to dividends, assets or voting.[130] Exercise by directors of authority delegated in unlimited terms may be enjoined upon the same basis.[131] Directors may not seize business opportunities for themselves without disclosure to the corporation and proper regard for its interest.[132] Directors and officers may be held to refund salary and bonus to the extent that it amounts to waste of corporate assets.[133] And majority shareholders may be liable for abuse of authority delegated to and exercised by directors where it can be established that the directors acted as puppets.[134] Some affirmative regulation has been imposed by statute, for instance under the Securities Exchange Act of 1934 with respect to proxy solicitation and misuse by directors and officers of inside information in the purchase and sale of corporate securities listed on a national securities exchange.[135]

One of the most difficult questions is the extent to which majority shareholders should be allowed to exercise their broad authority to change relative rights of classes of shares against the objection of minority shareholders in corporations which existed prior to enactment of the statutory provision which awarded such authority to majority shareholders for the first time. The question is discussed in the language of

[130] Kavanaugh v. Kavanaugh Knitting Co., 226 N.Y. 185, 123 N.E. 148 (1919); Lattin, "Equitable Limitations on Statutory or Charter Powers Given to Majority Stockholders," 30 MICH. L. REV. 645 (1932).

[131] ". . . the statute does not impose any restraint upon the apparently unbridled power of the directors [to set the consideration for issue of no par shares]. Whether equity will, in accordance with the principles which prompt it to restrain an abuse of powers granted in absolute terms, lay its restraining hand upon the directors in case of an abuse of this absolute power, is another question which will be . . . answered in the affirmative." Bodell v. General Gas & Electric Corp., 15 Del. Ch. 119 at 128, 132 A. 442 (1926).

[132] Production Machine Co. v. Howe, (Mass. 1951) 99 N.E. (2d) 32, noted 50 MICH. L. REV. 471 (1951); note, 30 MARQ. L. REV. 117 (1946).

[133] Rogers v. Hill, 289 U.S. 582, 53 S.Ct. 731 (1933).

[134] Zahn v. Trans America Corp., (3d Cir. 1947) 162 F. (2d) 36; (D.C. Del. 1951) 99 F. Supp. 808.

[135] Securities Exchange Act of 1934, §14(a), 48 Stat. L. 895, 15 U.S.C. (1946) §78n, S.E.C. Rule X-14A; §16(b), S.E.C. Rule X-16A; note, 50 MICH. L. REV. 474 (1952).

state impairment of contract rights and due process of law, and decided upon the basis of the court's conception as to how far such power should be exercised under justification of business necessity before a halt must be called in all fairness to the minority shareholder. One cannot hold out much hope to the minority shareholder unless an interest resembling a creditor's right, such as to accrued cumulative dividends, is involved.[136]

An effort is made in the modern corporation code to supplement the protection developed in decision law against abuse by management and majority shareholders of the broad authority possessed by them under modern statutes. Very little of this legislation imposes direct restraint upon management. The statutory financial standards controlling corporate distributions and the common statutory prohibition against voting treasury shares are exceptions.[137] For the most part the statutes are intended to make procedures available to minority shareholders adequate for their self-protection against abuse. Specifically these statutes are intended to guarantee to minority shareholders (1) the right to obtain information concerning the management and organization of the corporation, (2) the right to vote by classes with respect to important corporate decisions likely to affect minority shareholders adversely, whether their shares have voting power under the articles of incorporation or not, and (3) an adequate and inexpensive remedy if they prefer to withdraw from the corporation rather than go along with fundamental changes in the organization.

For instance, the Wisconsin law requires that a complete voting list be available for inspection at the registered office for ten days prior to any shareholders meeting, and that financial statements be made available to shareholders on request.[138] Shareholders of six months' standing and holders of voting trust certificates have the right, for a proper purpose, to examine the "books and records of account, minutes and record of shareholders and to make extracts therefrom."[139] Corporate officers who refuse the right to examine are subject to action for a penalty not to exceed $500, and have the defense that the requesting shareholder has used shareholder lists or information improperly in the past

[136] See Wis. Stat. §180.95 (1951); Schaffner v. Standard Boiler & Plate Iron Co., 150 Ohio St. 454, 83 N.E. (2d) 192 (1948); McNulty v. W. & J. Sloane, 184 Misc. 835, 54 N.Y.S. (2d) 253 (1945); Kenosha, Rockford & R.I. R. Co. v. Marsh, 17 Wis. 13 (1863); Midland Truck Lines, Inc., (Mo. 1951) 241 S.W. (2d) 903.

[137] Wis. Stat. §180.25(2) (1951); STEVENS, CORPORATIONS, 2d ed., §116 (1949).

[138] Wis. Stat. §§180.29, 180.43(1) (1951).

[139] Id., §180.43(2)(3).

or otherwise is not acting in good faith.[140] A shareholder may petition a court of record for an order that books and records be brought within the state for examination upon "proper cause shown."[141]

The Wisconsin law entitles shareholders to vote by class, whether or not the class of shares has voting power under the articles, with respect to (1) any amendment to the articles which will affect adversely the relative position of the class in any one of a list of respects intended to include all important characteristics of the shareholder contract;[142] (2) any plan of merger or consolidation which will affect adversely the relative position of the class in any of the respects included in the list relative to amendments;[143] (3) any distribution in partial liquidation;[144] and (4) any purchase by the corporation of shares of the class or of any class equal or junior in rank which is to be charged against capital surplus or deficit.[145] In addition, shareholders are entitled to vote by class upon the issues of dissolution or disposal of all or substantially all assets other than in usual course of business, provided such voting power is conferred in the articles.[146]

Finally, most modern codes provide a statutory remedy to shareholders who dissent to merger, consolidation, or sale, lease or exchange of all or substantially all assets other than in usual course of business. The remedy is by court petition for recovery of the fair value of shares as of the time the corporate action in question is authorized.[147] The remedy and the measure of recovery are clear, but the statutory procedure pursuant to which the shareholder evidences his dissent and preserves his remedy is detailed and has been construed rather strictly in the courts.[148] It is usually held that this statutory remedy is not exclusive of the common law remedies of injunction or damages for con-

[140] Id., §180.43(4) (1951); see N.Y. Stock Corp. Law, §10 (1923).

[141] Wis. Stat. §180.43(5)(6) (1951).

[142] Wis. Stat. §180.52 (1951); see Ohio Gen. Corp. Act §8623-15(4) (1927); Minn. Bus. Corp. Act, §301.37-3(3) (1933).

[143] Wis. Stat. §180.64(2) (1951); the following statutes require a vote only of shares entitled to vote under the articles: Ind. Gen. Corp. Act, Burns Stat. Ann. §25.231(b)(c) (1933); Ohio Gen. Corp. Act, §8623-67I(B) (1927); Minn. Bus. Corp. Act, §301-42-2 (1933).

[144] Wis. Stat. §180.39(2) (1951).

[145] Id., §180.05(1)(c).

[146] Id., §§180.71(2), 180.753(2).

[147] Wis. Stat. §180.69 (merger or consolidation), §180.72 (sale, lease or exchange of assets) (1951); Ohio also gives the remedy in the case of amendments to articles which adversely affect the shareholder's interest. Ohio Gen. Corp. Act, §8623-14, 72 (1927).

[148] Geiger v. American Seeding Machine Co., 124 Ohio St. 222, 177 N.E. 594 (1931); In re Camden Trust Co., 121 N.J.L. 222, 1 A. (2d) 475 (1938).

version of shares.[149] The statutory right is clear and certain, whereas the common law remedies are discouragingly uncertain because they depend upon proof of a violation of statutory authority or majority abuse of statutory authority to take the action in question.

C. *Relation to the State*

Through the period of statutory restriction upon corporate organization, beginning with the Bubble Act and ending in the United States at the turn of the present century, the unincorporated business organization experienced a remarkable development. Much of the record has been lost because unincorporated organization was beyond the pale of the law. But the economy was expanding and business had to go on, and those in charge of the law's administration winked at the unincorporated association.[150] In the United States many large associations were organized under the joint stock company or business trust form in order to avoid regulation, taxation and organizational restriction imposed upon corporations.[151] Legislative authority to sue and be sued in the name of an association officer was granted in many states, and numerous statutes were enacted dealing with other problems peculiar to the unincorporated association.[152] Some states have provided by statute for forms of organization with limited liability and many corporate privileges in addition to the corporation.[153] Thus at the close of the nineteenth century the relation of the state to business organization was defined not only in the corporation enabling act but in a mass of legislation dealing separately with the unincorporated association.

Several modern legislative trends are operating to eliminate most of the advantages formerly associated with business organization under the joint stock or business trust rather than the corporate form. In the

[149] Johnson v. Lamprecht, 133 Ohio St. 567, 15 N.E. (2d) 127 (1938); Cole v. National Cash Credit Assn., 18 Del. Ch. 47, 156 A. 183 (1931); but the remedy is made exclusive by statute in at least two states: Mich. Gen. Corp. Act, §§44, 54 (1931); Calif. Gen. Corp. Law, §4123 (1947).

[150] DUBOIS, THE ENGLISH BUSINESS COMPANY AFTER THE BUBBLE ACT, 1720-1800, c. III (1938).

[151] WARREN, CORPORATE ADVANTAGES WITHOUT INCORPORATION (1929); People ex rel. Winchester v. Coleman, 133 N.Y. 279, 31 N.E. 96 (1892).

[152] People ex rel. Winchester v. Coleman, 133 N.Y. 279, 31 N.E. 96 (1892); Jardine v. Superior Court, 213 Cal. 301, 2 P. (2d) 756 (1931); Note, 88 A.L.R. 164; Sturges, "Unincorporated Associations as Parties to Actions," 33 YALE L.J. 383 (1924); WARREN, CORPORATE ADVANTAGES WITHOUT INCORPORATION, c. 6 (1929).

[153] For instance, Pennsylvania Limited Partnership Association and Registered Partnership, Purdon's Pa. Stat., title 59, §§171, 241; Andrews Bros. Co. v. Youngstown Coke Co., (6th Cir. 1898) 86 F. 585; Uniform Limited Partnership Act, 8 U.L.A.

first place, in tax legislation and in statutes regulating admission of foreign corporations, the issue and sale of securities and other activity, the statutory definitions have been broadened to include joint stock companies, business trusts and unincorporated associations generally.[154] In the second place, the trend in modern corporate enabling statutes toward convenient organization requirements, flexible operating procedure, and removal of most affirmative restrictions upon operating procedures and form and size of organization has removed much of the incentive to organize outside the corporation enabling act in order to obtain desired freedom of action and control for management. Finally, organization under the modern corporate code makes available such convenient procedures for business reorganization as statutory merger and consolidation, procedures not open to unincorporated associations. With the incentives gone it may be expected that in the future fewer businesses of any size will be organized other than under the corporation enabling act. The area of choice is being narrowed to the corporation and the partnership in one of its several forms.

The ultimate consequences of these statutory developments are not altogether clear, but surely they will increase uniformity in the structure and characteristics of business organization throughout the country, which uniformity will become more pronounced as more jurisdictions enact into law the principles of organization set forth in such drafts as the American Bar Association Model Act. There has been much copying already as the various modern corporation codes have been enacted successively in the past twenty-five years, and the Uniform Corporation Law and the Delaware law have exerted a tremendous force toward uniformity. The Delaware law has had particular influence because so many corporations doing business in other jurisdictions are incorporated under it, but the modern corporation codes certainly are minimizing the incentives to incorporate today under the Delaware law.

The legislative trends discussed in this article may help to explain why practically all business organizations of any size are organized today under one or the other of the recent corporation enabling codes,

[154] Wis. Stat. §180.02(2) (1951): "'Foreign corporation' means a corporation, joint stock company or association organized otherwise than under the laws of this state. . . ." Wisconsin Securities Law, Wis. Stat. §189.02(2) (1951): "'Person' includes an individual, a corporation, a partnership, an association, a joint stock company, a trust, an unincorporated organization, . . . and any other entity." See Hemphill v. Orloff, 277 U.S. 537, 48 S.Ct. 577 (1928).

or at least under a corporation enabling statute. This is a thing we take for granted, while as a matter of fact it is a situation without precedent in the history of English business law. It is a situation in which the relation of the state and the task of the legislature with respect to the organization of business not subject to affirmative state regulation is greatly clarified and simplified. Now the legislature may devote its entire attention to the improvement of the corporation enabling statute, and know when it gets through that its work will have general application. The requirements of modern corporate codes with respect to minimum financial standards, fair protection of minority shareholder interests, and responsibility of corporate directors and officers should tend to become more universally applicable and generally understood in the world of business organization. It is to be hoped that the legislative trends of recent years will lead to a clearing of the air, and perhaps to a better understanding by business organizers and managers of what is expected of them. Another pious hope is offered—that these developments will help in some small way to halt eventually a parallel trend toward affirmative federal regulation of all business organization and activity.