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Second Article

Corporate Power of Adoption

The power to make by-laws for the government of the corporation and the guidance of its officers is one of the inherent and essential powers of a corporation. As was said by Lord Hobart in the early part of the seventeenth century: "Now I am of the opinion, that though power to make laws is given by special clause in all corporations, yet it is needless; for I hold it to be included, by law, in the very act of incorporating, as is also the power to sue, to purchase or the like."

A century and a half later, Blackstone includes among the "powers, rights, capacities and incapacities" of the corporation, "the power to make by-laws or private statutes for the better government of the corporation; which are binding upon themselves, unless contrary to the laws of the land, and then they are void. This is also included by law in the very act of incorporation; for as natural reason is given to the natural body for the governing it, so by-laws or statutes are a sort of political reason to govern the body politic. And this right of making by-laws for their own government, not contrary to the law of the land, was allowed by the law of the twelve tables of Rome." Later Kyd includes among the incidental powers of corporations, the power "To make by-laws, or private statutes for the better government of the corporation."

More recent statements are of the same general tenor. "Corporations have the right to manage and control their affairs subject to the general laws of the land as they may deem advisable, and, as incident thereto, to make such by-laws as will best effectuate the objects proposed to be accomplished." "Although the authority to enact such by-laws, is frequently declared in the charter of the corporation, or by some general law, yet the

* Sustaining citations have been omitted.

authority to enact them does not depend upon such declaration, but is an inherent right which, in the absence of some positive legislative restriction, is incident to every corporation." "Where a corporation is created there goes with it the power to enact by-laws for its government and guidance, as well as the guidance and government of its members. The power is necessary to enable a corporation to accomplish the purpose of its creation." "The incidental power of the corporation to make by-laws results from the necessity of such power to enable the body politic to answer the purposes for which it was created." "The right of a private corporation to enact such by-laws is inherent and incident to its existence." Or as expressed in one of the early New York cases, "The power to make by-laws is one of the characteristic features of a corporation."

This common law power to adopt by-laws inheres in voluntary associations as well as private corporations. "A voluntary association whether incorporated or not, has, within certain well-defined limits, power to make and enforce by-laws for the government of its members."

Limitations upon Corporate Power of Adoption

The power of the corporation to adopt by-laws is limited to such enactments as do not conflict with the law of the land, the charter of the corporation and the general rules of equity and justice. By-laws must also be confined to carrying into effect the proper purposes of the corporation as defined by its charter. *Ultra vires* by-laws are void.

If the statutes of the state or the corporate charter expressly empower a corporation to make by-laws for particular purposes or relating to specified matter, it has been supposed that the legal maxim *expressio unius est exclusio alterius* would apply and that the corporation would be incapacitated to make by-laws for other purposes or relating to other matters. The doctrine appears to rest solely on one early case. "This was the case of the Hudson's Bay Company, who were made a corporation by charter, and were thereby empowered to make bye-laws for the better government of the company, and for the management and direction of their trade to Hudson's Bay: 'which' it was said 'implied a negative that they could not make any other bye-laws

in relation to projects of insurance.' " The author, however, continues further, "It is apprehended, that without this implied negative, arising from the power to make bye-laws being expressly given, they could not have made any bye-law on any subject which did not relate to their trade to Hudson's Bay; because any such bye-law would have been foreign to their institution."

But one case directly involving the principle of *expressio unius est exclusio alterius* seems to have come before the courts in this country. In this case the legality of a by-law restraining the transfer of stock was at issue. The action was brought in Rhode Island. The court held that, as the defendant corporation was organized under the laws of Maine, the laws of Maine should apply; and, apparently basing its decision upon a misapprehension of the ruling in *Kennebec, etc. R. R. Co. v. Kendall,* 31 Me., 470 (1850), held that the Maine statutes having specified certain subjects upon which by-laws might be passed, by-laws on any other subject were *ultra vires,* and the particular by-law not being among those permitted by the statute was therefore void and of no effect. Upon a re-hearing this ruling was repudiated. The by-law restraining the transfer of stock was again declared invalid, but this time upon the broader and better ground that it was in itself *ultra vires* and against public policy. It may be said further that the general doctrine is of but little importance in these present days, since the power to make by-laws when conferred by charters of modern corporations, is almost invariably in terms so general as to permit of by-laws for any proper corporate purposes; and the power when conferred by statute, as is the case in many states, is usually so broadly stated that the question of limitation does not enter.

Where, however, a power is given to a *select body* in contradistinction to a power given to the *whole body* to make by-laws on a particular subject, the doctrine does apply and such select body cannot legislate beyond the specified subjects. Thus where the stockholders, the charter, or the statutes empower directors on particular subjects, their authority does not extend to making by-laws on other subjects. Likewise, where power is given to a board of aldermen or to some other municipal body to legislate on particular subjects, there is no inherent power in such body to legislate on other subjects or to go beyond the limits of the specific authority.

Adoption of By-Laws

Stockholders' Power to Adopt

Unless otherwise vested by charter or statute provision, the power to make by-laws rests with the stockholders who must act in duly assembled meeting. The stockholders have but few functions to perform and this right to make by-laws is one of the most essential and important. "This power, like every other incidental power, is incident to the corporation at large, and not to any select body." As stated in *Angell v. Ames* (Sec. 327) "Unless by the charter, or some general statute to which the charter is made subject, or by immemorial usage, this power is delegated to particular officers or members of the corporation, like every other incidental power, it resides in the members of the corporation at large."

Directors' Power to Adopt

The board of directors have no power to enact by-laws unless so authorized by law, by the articles of association or by proper action of the stockholders. Even when the statutes give the directors power to make by-laws on prescribed matter, the power to make all other needful or necessary by-laws is conferred upon the corporation itself and can be exercised only by the stockholders.

The stockholders may, however, delegate the power of adopting by-laws to the directors. The power is "incident to the corporation at large, and not to any select body; yet where it belongs to the corporation at large, they may delegate it to a select body, who then become the representatives of the whole community, and may exercise it to the same extent that the whole community might do." But the stockholders cannot delegate to the directors, save by charter amendment, the exclusive right to make by-laws.

When power to make by-laws is not given by charter or the law of the land to the directors, they only have power to make by-laws subordinate to those passed by the stockholders. That is, the board of directors may legislate upon any new subject concerning which the stockholders have passed no by-laws, or they may pass additional by-laws supplementing by-laws already passed by the stockholders, but they cannot repeal or

alter a stockholders' by-law already adopted, and if there is any conflict between the directors' by-laws and the stockholders' by-laws, the stockholders' by-laws will prevail. Also even though the directors are empowered to make by-laws by the charter or the by-laws, the stockholders may under any ordinary circumstances recall the directors' power at any time by an amendment of the charter provision or by a repeal of the enabling by-law.

When the power to adopt by-laws is given the directors by charter provision, this does not exclude the stockholders from making by-laws, unless expressly so stated or directly to be implied from the terms of the charter.

In Illinois, Kentucky and the District of Columbia the directors of a corporation are by statute given the exclusive power to make, amend and repeal by-laws. This precludes the stockholders absolutely from any voice in the regulation of corporate affairs and is a curious reversal of the usual theory of corporate action. It permits the directors, who act as trustees of the corporation, to prescribe their own duties and responsibilities and takes from the stockholders all power to limit or restrain the directors' action in any way. In these states where this condition prevails not even by charter provision or by the action of the directors themselves may the power of the directors as to by-laws be altered or abridged.

Thus in a recent Illinois case, the directors had passed a by-law requiring that by-laws passed by them should be ratified by a vote of the stockholders before they were binding upon the corporation. The court held, however, that the stockholders' ratification was not necessary. "If it be held that the limitation found in by-law No. 16, requiring the ratification by the stockholders of a change of the by-laws made by the directors, is valid and binding, then we are to hold in effect, that one board of directors at one time may place a limitation upon themselves or future boards of directors in the matter of making by-laws, and add requirements neither provided for in, nor contemplated by, the law of their creation. Such, we think, is not the law, nor do we think it should be so."

In certain other states, as New Jersey, Delaware and Pennsylvania directors may by special charter provision be given power to alter the by-laws. Thus in New Jersey the statute reads:

"The power to make and alter by-laws shall be in the stockholders, but any corporation may in the certificate of incorporation, confer that power upon the directors; by-laws made by the directors under power so conferred may be altered or repealed by the stockholders."

In states such as New Jersey in which the statutes provide that power to make by-laws may be delegated to the directors by charter provision, the extent of the power which can be granted depends entirely upon the wording of the statutes. Under the New Jersey statute it is doubtful whether the directors can be given power to repeal a by-law passed by the stockholders. Also it is to be noted that in New Jersey by-laws enacted by the directors are by the statute provision always subject to amendment and repeal by the stockholders.

In other states, as New York and Minnesota, the directors are by statute given power to make by-laws in conformity with or subordinate to the by-laws adopted by the stockholders. Thus the New York statute reads:

"Subject to the by-laws, if any, adopted by members of a corporation, the directors may make necessary by-laws of the corporation."

Under this provision, it is obvious that the exclusive power to make by-laws could not be conferred upon the directors by the charter. From the practical standpoint the directors, whether authorized to adopt by-laws or not, have authority under their general powers of management to provide for almost any contingency not already provided for, even though the matter affected be a fit subject for by-law regulation. In such case the board passes a resolution providing for the matter under consideration, and this resolution controls and has the effect of a by-law until it is repealed or superseded by action of the stockholders. In a recent text book this rule is given as follows: "Even where the power to enact by-laws is lodged with the shareholder, the directors may always and in subordination to the shareholders, make rules for their own orderly action and for the government of the company's agents. By whatever name these rules may be called, they are in their nature by-laws."

Procedure for Adoption

(*a*) Formal Procedure. Whenever the statutes prescribe the method by which by-laws are to be adopted, no other legal method

exists. Under such circumstances by-laws must be adopted in strict accordance with the statutory requirements, and any other method of adoption is ineffective and by-laws so adopted are invalid.

Likewise, if the charter prescribes the method by which by-laws are to be adopted, this method must be strictly followed and by-laws adopted otherwise are of no effect.

If neither the statutes nor the charter prescribes the method of adoption, the rules of the common law apply, and by-laws may then be adopted by a majority of the assembled stockholders at any duly constituted meeting.

Speaking generally, by-laws may be adopted only at a duly assembled meeting of the members or stockholders of the corporation or at a duly assembled meeting of the directors when these latter have power to adopt by-laws. It is usually provided that a quorum must be present at the meeting and a majority of the votes cast thereat must favor the adoption of the proposed by-law. It is obvious that by-laws cannot be adopted before incorporation as the corporation is not in existence then. Nor after incorporation can by-laws be adopted at meetings held outside the state unless the statutes or charter so provide.

When neither statute, charter nor by-law provides that the presence of a quorum at the meeting is necessary for the adoption of by-laws, the common law rule prevails; and under this rule the stockholders who assemble at the proper time and place for the meeting constitute a legal quorum regardless of their number and may adopt by-laws and take any other proper corporate action. As stated in Cook on Corporations, Sec. 607: "The law is clear that those stockholders who attend a duly called stockholders' meeting, may transact the business of that meeting, although a majority in interest or in number of the stockholders are not present."

In a select body, as the board of directors, the common law rule as to quorum is different. Here a majority of the entire body must be present to constitute a quorum, unless expressly otherwise provided by some competent authority. The vote of a majority of this quorum is, however, sufficient to adopt by-laws.

As by the common law rule, a bare majority of a quorum of

stockholders may alter the by-laws of a corporation, it is obvious that where this rule prevails—as is the case whenever the statutes are silent on the subject and neither charter nor by-laws provide otherwise—a very small minority might under some conditions be able to alter the by-laws of the corporation, possibly entirely against the desires of a non-present majority. To avoid this possibility, it is usual to provide in the charter or by-laws that a majority of the outstanding stock shall be necessary to constitute a quorum.

Unless otherwise specifically provided by some competent authority, additional by-laws may be adopted at any regular or stated meeting of the body having power to adopt or amend, or at any special meeting where such proposed action has been specified in the call and set forth in the notice to those entitled to participate. In a Pennsylvania case it has, however, been held that the by-laws cannot be amended at an annual or stated meeting unless such action has been announced in the notice of the meeting. This is contrary to the general law on the subject.

(*b*) Irregular Procedure. As already stated, when the procedure for adoption of by-laws is fixed either by the charter or statute, they cannot be adopted by any other procedure. "Neither a by-law nor a usage having the force of a by-law can be supported if repugnant to any provision of the charter * * *. The charter is the measure of its powers and privileges, and, where the mode of exercising any of its functions is therein prescribed, it must be strictly pursued." But when neither charter nor statutes prescribe the method of adoption, a corporation may adopt by-laws by its acts and conduct, as well as by an express vote in writing.

Irregular adoption is in most cases by usage. It is well settled that unless otherwise required by statute, by-laws may be unwritten—never recorded. In *Mutual Fire Insurance Company vs. Tarquhor,* 86 Md., 668, it was held that "A long continued, unbroken and uninterrupted custom or usage, such as is set up by the defense in this case, is held by all the authorities, to which we have been referred, to be of the nature of a by-law, and to be equally obligatory and binding." In another similar case it was held that "A custom or usage so long continued and so invariably pursued has the force of a by-law, and not being repugnant to any of the provisions of the charter, is valid."

No particular length of time is required to establish usage. In a Wisconsin case it was said: "It thus appears from the pleadings that at least three annual meetings for the election of officers had taken place prior to that at which the defendant claims to have been elected to the office of treasurer, which was time enough for a usage to spring up and become established as well as to give a practical construction to the by-law."

As before stated, by-laws cannot be adopted before incorporation, but if by-laws are so adopted, subsequent usage of, and acquiescence in these by-laws may be held to imply adoption.

Where the by-laws of a close corporation required five directors, and the stockholders, three in number, ignored the by-laws and elected but three directors, it was held that the by-law was "changed by the unanimous consent of the stockholders," and that the board of three was a legal board.

Thus, also, where by-laws were published and acted upon as the by-laws of the company, no record showing their adoption but the by-laws bearing the signatures of more than a majority of the incorporators, it was held that such by-laws "were undoubtedly adopted, though informally."

And where the directors were given exclusive power by charter to adopt by-laws, and the stockholders adopted by-laws before incorporation, and these, though never formally adopted by the directors, were regarded by them and acted upon as the by-laws of the corporation, it was held that this recognition was equivalent to an adoption.

Record of By-Laws

When by-laws are adopted it is the duty of the secretary of the corporation to record them properly, preferably in the minute book. Such entry affords the best legal evidence of the adoption of the by-laws if at any time it is desired to prove their legality.

In some few states, *viz.*, California, Idaho, North and South Dakota, and some few others, the by-laws must be entered in a "Book of By-laws" before they become legally effective. In California and North Dakota this book of by-laws must be kept open to the inspection of the public. In Minnesota the by-laws must be filed with the Secretary of State and also be posted for inspection in the principal place of business of the corporation.

In Nevada the by-laws must be entered in a book of by-laws which must be kept at the principal office of the corporation. In Iowa a copy of the by-laws and a list of the corporate officials must be kept posted in the principal places of business of the corporation for public inspection. In Nebraska a copy of the by-laws must be posted in the principal office of the corporation. In the Philippines a copy of the by-laws must be kept in the principal office of the corporation for inspection, and a certified copy must be filed with the Chief of the Division of Archives and be by him filed with the original certificate of incorporation.

It is to be noted, however, that while, as a matter of good practice, by-laws should always be properly recorded, they need not necessarily be in writing or be recorded in any other way unless required by some competent corporate authority.

By-Laws as Evidence

If the by-laws of a corporation are to be used as evidence in a court of law, they must be pleaded, and the minutes of the meeting at which they are adopted and in which their adoption is recorded should be introduced. This is the best evidence that can be had.

If the original minutes cannot be produced, a printed copy of the by-laws as distributed among the members or stockholders may be used, or, if no better evidence can be had, parole evidence of the actual usage of the particular corporation in regard to the matter to be established, may be introduced. When better evidence can be had, the testimony of officers of the corporation as to its by-laws is not competent.

By-laws informally adopted may be proved by usage. "By-laws may be proved as well by the acts and uniform course of proceeding of the corporation, as by an entry or memorandum in writing."

For all ordinary business purposes, where it is desired to prove the by-laws of a corporation or some portion thereof, the by-laws, or the particular portions to be proved, are copied and the correctness of this copy is then certified by the secretary or equivalent officer and evidenced by the corporate seal. These certified copies may in most cases be used in any action at law against the corporation as evidence as to the subject-matter of the particular by-law or by-laws so certified.