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Enforcement of By-Laws

Thomas Conyngton

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By Thomas Conyngton

Member of the New York Bar

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Mandatory and Directory By-Laws

As to observance and enforcement, by-laws may be classified into those that are mandatory or imperative, and those that are merely directory or declaratory.

A mandatory by-law is one which instructs or prescribes how or when some act shall be performed, and the non-observance of this procedure renders the act void. A directory by-law, on the other hand, prescribes how or when certain things shall be done, but the mere fact that they are not done in that manner or at that time does not render them void.

Thus a by-law directing the stockholders' annual meeting to be held on a specified day is mandatory, and if the meeting were held on another day—unless in accordance with other legalizing by-law or statutory provisions—its proceedings would be wholly void. But a by-law prescribing the order of business at a stockholders' annual meeting is merely directory, and if not observed does not render the proceedings void.

Other examples of mandatory by-laws are those prescribing the manner in which special meetings must be called and notified to the stockholders; providing the method of appointing standing committees, and fixing the quorum at stockholders' and directors' meetings, when this can be legally done in the by-laws.

Examples of directory by-laws are those prescribing the method of issuing stock, how money shall be deposited, the form of the corporate seal, and the like. The violation of by-laws of this nature may perhaps subject the offending corporate official or officials to a penalty or to removal but does not invalidate the action. The principle is the same as applies to statutory or charter provisions. Thus, "The breach or neglect of such provisions of law, although only directory in their character, may

* The last of three articles by Mr. Conyngton, covering the nature, adoption and enforcement of by-laws. Sustaining citations are omitted.

render officers personally liable for neglect of duty or subject the corporation to proceedings on the part of the government for disregard of the requisitions of its charter, but it does not impair the validity of its recorded acts so far as to affect the rights of third parties."

The distinction is pointed out in an early Arkansas case: "One of the criterions by which to determine whether the requirements of a statute are imperative or merely directory is that those acts which are of the essence of the thing required are imperative, while those which are not of the essence, are directory. The case before us is an apt illustration of the rule. The giving of sixty days' notice is imperative, and must be strictly complied with because it is of the essence of the thing to be done—the *mode* of doing so is directory, because not of the essence, and may be either by publication in the manner prescribed by the charter or by actual personal notice."

An illustrative case is that of Warner v. Mower, 11 Vt., 385 (1839), in which referring to the notice for annual meeting alleged to be necessary it was said: "But if such a provision in the statutes of the corporation, in relation to the annual meeting, had been found in express terms, it should still receive the same construction which similar provisions do in legislative statutes. When the statute is merely directory—*i. e.*, directs the manner of doing a thing, and is not of the essence of the authority for doing it—a compliance with its requisitions is never considered essential to the validity of the proceedings, unless such is the evident or expressed intention of the legislature."

Provisions as to publication of notices of assessments or calls on stock are usually mandatory, and conformity with the statute or by-law is a condition precedent to enforcement of such assessments or calls by suit.

A by-law requiring that directors be chosen at the annual meeting is merely directory and does not imply that an election of directors held subsequently would be void.

Force of By-laws

Theoretically by-laws are the means through which the stockholders or members give their instructions for the management of the corporation, and prescribe limitations under which this

management is to be exercised. This theory is completely overturned in those states, like Illinois and Kentucky, where the directors have the sole power to make by-laws, but even here the officers and directors are bound to obey the requirements of the directors' by-laws, and in case the directors make improper by-laws or fail to make those desirable or necessary for the control of the corporation, the delinquent officials can always be replaced at the next election with directors more amenable to the demands of equity.

As stated, it is the duty of directors and officers of corporations to obey its legal by-laws. Usually in the ordinary business corporation the by-laws do not impose any positive duty upon the individual stockholder, but in the few cases in which they do, the duty must be performed.

In the various non-stock corporations more positive duties are imposed on members. By-laws prescribing the payment of dues, the payment of premiums in mutual insurance companies, the prohibitions of immoral conduct in various secret organizations and religious bodies, and even the actual control of business relations with other societies, have been sustained.

PENALTIES FOR VIOLATION OF BY-LAWS. STOCK CORPORATIONS

In some states, as New Jersey and California, the statutes permit a stock corporation to impose direct penalties for violation of by-law provisions. In New Jersey, Michigan, North Carolina, Pennsylvania, Rhode Island, Wisconsin and New Mexico these must not exceed $20. In California, Montana, Idaho, North Dakota, Oklahoma and South Dakota the limit is $100. Where there is no statutory authority for fines it does not appear that stock corporations can legally impose such penalties or collect such penalties if imposed.

In Monroe Dairy Assn. v. Webb, 40 App. Div. (N. Y.), 49 (1889), the court said:

"Despite the reiteration in text books and in many judicial opinions of the statement that corporations have the implied power to impose pecuniary fines for the violation of their by-laws, which may be enforced in an action for debt, we are very much inclined to question the authority of any private corporation in this state, or at least of any private stock corporation,

without express legislative authority, to impose fines for the violation of its by-laws for which the incorporator may be sued and amerced in his property. In England, where our laws on the subject originated, corporations, as a rule, were municipal. When private, such as trade guilds, they were invested with no small share of governmental powers. Business corporations formed solely for pecuniary profits, which constitute the great majority of corporations in this country, were not corporations in England, but merely joint stock companies.

"It is said by Mr. Morawetz, Private Corporations, § 491: 'The term "By-law" was originally applied to the law and ordinances enacted by public or municipal corporations. The difference between a by-law of a private company and a law enacted by a municipality is wide and obvious. The former is merely a rule prescribed by the majority, under authority of the other members, for the regulation and management of their joint affairs. A by-law of a municipal corporation is a *local law,* enacted by public officers, by virtue of legislative powers delegated to them by the state.' In the matter of Long Island Railroad Co. (19 Wend., 37) it was held that an incorporated company had not the power to enact a by-law subjecting stock to forfeiture on account of the non-payment of installments due thereon without express legislative authority. In corporations or associations which possess the power of expelling their members for breach of their duty to the corporation, or for misconduct as corporators, the corporation may doubtless provide reasonable fines for such misconduct, the payment of which can be enforced by expulsion of the member who fails to pay his fine. But I fail to find a reported case in this country where recovery has been had for a fine imposed by a by-law of a private corporation."

In Thomas v. M. M. P. Union, 121 N. Y., 45 (1890), the court said in reference to the imposition of fines by a membership corporation, "No process is provided by which the corporation can collect them, and then payment, if made at all, must necessarily be by the voluntary action of the plaintiff."

Nor may the ordinary corporation enforce its by-law by expulsion or forfeiture, for the rule is that corporations organized for gain have no power of expulsion or forfeiture unless granted by charter or statute.

PENALTIES FOR VIOLATION OF BY-LAWS: MEMBERSHIP CORPORATIONS

If such power is given in their charters, constitutions or by-laws, membership corporations and voluntary associations have power to expel contumacious members for proper cause or to fine them and then suspend them until payment is made.

In Monroe Dairy Assn. v. Webb, 40 App. Div. (N. Y.), 49 (1899), already quoted from, the court said further:

"The respondent relies largely on the authority of Matthews v. Associated Press (136 N. Y., 333). There it was held that a by-law of the corporation prohibiting its members from receiving the news dispatches of other news associations covering a like territory, and providing that for an infraction of the by-laws the members should be suspended from the rights and privileges of the association, was valid. The case is not in point. The corporation there was of a different character from the plaintiff. In corporations or voluntary associations, such as clubs, stock or mercantile exchanges, benevolent institutions, medical societies, and the like, there exists a personal duty on the part of the member to conduct himself, in matters under the cognizance of the corporation, in compliance with its rules. In corporations of this character the power of amotion exists, and a member may be expelled for a violation of the rules of the corporation, or even for an offense which has no immediate relation to the corporate character of the party, but is of so infamous a nature as to render the offender unfit to associate with other members. In all corporations, however, of this class, there is a personal and corporate duty from the member to the corporation, while in mere trading or business corporations, having capital stock, there is, as already stated, no greater duty resting upon a member than to pay for the stock for which he has subscribed. Even for a failure to comply with this duty, we have seen that his stock can not be forfeited and he expelled from the corporation, except where express statutory authority is given. 'With regard to what are called joint-stock incorporated companies, or, indeed, any corporations owning property, it can not be pretended that a member can be expelled, and thus deprived of his interest in the stock or general fund, in any case by a majority of the corporators, unless such power has been ex-

pressly conferred by the charter.' If the learned authors by the expression, 'any corporations owning property,' intended to include clubs, exchanges, and similar organizations which may own property but have no share stock, the text does not give correctly the law of this state in that respect. But, in other respects, it is an accurate statement of the law. The case cited recognizes the distinction between trading and other corporations. A man might commit the most heinous crime, and it would hardly be claimed that thereby he forfeited his bank stock or railroad stock."

It must be noted, however, that unless authority for the expulsion of a member is found in the law of the society, *i. e.,* its charter, constitution or by-laws, or the statute under which it is organized, such power does not exist. Also it is essential to the exercise of such power that the offending member be notified, that charges be formally preferred against him, and he be heard in his own defense. If the accused refuses to appear when duly summoned before the proper tribunal of the corporation, he may then be expelled for contempt. If, however, the member is expelled without an opportunity to be heard or a fair trial, his expulsion is of no effect and injunction will lie to prevent expulsion, or a written mandamus will be granted for his reinstatement.

There is a distinction to be drawn between cases where property rights or money demands are in question and in which the rights of the individual are based upon the nature of his contract with the corporation, and those other cases in which it is only sought to discipline the member for conduct subversive of the objects of the organization or contrary to good morals. In cases involving improper conduct the courts are slow to interfere and when their aid is asked it must be shown that (1) the rules of the organization are against natural justice, or (2) that the attempted discipline does not conform to the rules of the organization or that there is manifest *mala fides,* or (3) that there has been no hearing, or (4) that the member has not exhausted his remedies within the society.

When fines are imposed as for default in paying dues, assessments or installments on shares in building associations, the fines so imposed must be reasonable. In Endlich on Building Associa-

tions (§ 425), the author says: "The proper measure of fines is the real damage the Building Association sustains from the failure of a member to pay his dues, which damage is really equal to interest upon the amount, together with the proportion coming to it from the then obtainable premiums upon the sale of money. The fine should be slightly in excess of this, so as to make it more profitable to members to pay promptly than to lag behind. A fine of from one to two per cent a month would in nearly all cases be sufficient and just." Such a fine certainly could not be deemed unreasonable.

Violation of By-laws by Officers

An officer who of his own motion violates a by-law (1) is liable for any damage resulting to the corporation or to any stockholder as a consequence of such breach; and (2) renders himself liable to amotion or removal by action of the board of directors.

If damages are sought, the liability of the officer in fault must be determined by the usual legal means of suit in a court of law. If it is sought to remove the offender, charges must be preferred, he must have due notice thereon, and be given opportunity to answer them and to defend himself before he may be removed.

In New York by statutory provision it is provided that any officer may be removed at pleasure by the board of directors. Elsewhere a similar provision is frequently inserted in the by-laws. While this power on the part of the board is liable to abuse, it not infrequently saves much difficulty.

A difficult situation sometimes arises where the board of directors instructs an officer to do something which he considers forbidden or otherwise ordered by the by-laws. Generally the officer is perforce compelled to accept the board's construction of the by-law provision, even against his own belief. Though he may be right he is not usually in a position to assert his judgment. He must either obey or resign.

Violation of By-laws by Directors

A single director as such has no authority in corporate mat-

ters and therefore cannot in his capacity as a director violate the by-laws, except by neglecting to give such measure of care and attention to the corporate business as the by-laws may prescribe. As a board, directors very frequently override the by-laws. In such event any dissenting director or directors should protest against the violation of the by-laws and ask that such dissent be recorded on the minutes. By so doing they may avoid any personal liability in the matter.

Those voting in favor of a violation of the by-laws or acquiescing in neglect to enforce by-laws, make themselves liable to the corporation for all damages resulting from such action. If the corporation becomes insolvent through such action or failure to act, the receiver can recover from the directors at fault. But if stockholders acquiesce in long continued violation of, or omission to observe, by-laws on the part of directors, usage will operate to repeal the by-law and it has been held that in such case the directors cannot be held liable for the consequence of such action or omission.

If no loss results from action contrary to the by-laws, the directors are not likely to suffer any penalty for such violation. Naturally the board of directors composed of the offenders or dominated by them, will not call such offenders to account, and almost the only remedy the stockholders have in such cases is to replace the offending directors at the next annual election.

Stockholders may have a common law power to remove directors for adequate cause but the difficulties in exercising this power are such that it is but rarely used. In some few states directors may by statutory provision be removed by a two-thirds vote of all the stock. In some states such power can be secured by special provision therefor in the charter.

Directors cannot be removed by their fellow directors, and by-laws attempting to confer such power are illegal.

Gross abuse of office on the part of the directors amounting to fraud, oppression or open wrong, would be sufficient ground for interference by the courts. In such a case a criminal prosecution could also usually be instituted.

Violation of By-Laws by Stockholders

Individual stockholders of a corporation cannot, as a rule,

violate the by-laws, since the by-laws are their own commands to the directors and officers prescribing the management of the corporation. Violations of the by-laws by the stockholders in part or in whole may, however, occur. For instance, in those sections of the by-laws relating to the holding of the annual meeting there are usual mandatory provisions as to the place, the day and the hour. If the stockholders or a portion of the stockholders violate the by-law provisions as to annual meeting in any of these particulars, the meeting so held is void.

Thus People v. Albany, etc., R. R. Co., 55 Barb., 344 (1869) had its origin in the notorious proceedings of Fiske and Gould when wrecking the Erie Railroad. On the particular occasion they were in the minority but met in the office of the corporation fifteen minutes before the appointed time, called the meeting to order and captured its organization. The majority protested and took the case into courts, and the irregularity in calling the meeting to order before the appointed time was held sufficient to void the entire action of the meeting.

A more difficult case is where the minority without specific violation of the by-law provision get control of the meeting by force, fraud or irregular procedure. In such case the aggrieved stockholders may withdraw, resting upon the errors, fraud or irregularity in the organization to set aside any election subsequently held. Or they may continue to take part, to vote under protest and take legal action later if their rights are overridden. Even though in a majority, they cannot legally withdraw and hold another meeting in the same room or just outside the room or in an adjoining room. "The acts of a majority at a corporate meeting are not binding upon the company, unless the proceedings are conducted regularly and in accordance with general usage, or in the manner prescribed by the charter and by-laws of the company."

In case it is impossible to hold a meeting in the specific place, as for instance when the specified room is locked and no key can be found, then the stockholders should assemble outside the door, in an adjoining room, or as near to the specified place as possible, and meet there.