1893

The Right of Corporations to Combine

George D. Richey
Cornell Law School

T H E S I S.

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INTRODUCTION.

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Practicing lawyers in so progressive a country as America are continually met with new devices, with new legal situation with want of remedies, for which neither the text-books nor their legal education afford them precedent or direct advice. The most important of these novations of the law and society is the combination of capital in its many forms. We have heard much of late years, and in fact for all time, of the dangers of corporations, capital etc. But now the legal profession is confronted by situations far more preplexing and involving immense interests. Every student knows how corporations have grown from a monastic instutition to the predominance they now occupy in the business world; but American ingenuity has invented a legal machine which may swallow a hundred corporations or a hundred thousand individuals; and then with all the corporate irresponsibility, their united power be closed like a dynamo in portable compass , and weild-

ed by one or two men.

The tendency of the day is towards corporate aggregation of capital and effort. The liberal policy of state governments allowing the formation of corporations under general laws for an almost unlimited number of objects, facilitates an aids this tendancy. A large and constantly and increasing proportion of the business of the country has come to be transacted by these artificial agencies. It is a logical sequence and matter of common observation that the number of controversies involving this branch of the law and requiring settlement by the courts is increasing and will continue to increase. The development of resources has but fairly begun, and the field in which corporations may operate and imploy their capital to advantage is virtually unlimited. Hence the law upon this subject may be said to be in its infancy.

Of course it is not evry combination of capital that is illegal. We hear a great deal about "Trusts", "Combines", "Monopolies", "Corners", etc., in these days when capital is playing so important a part in the history of our country. Every body is talking about trusts and denouncing them. Under such circumstances it is not suprising that the evils of combinations have been greatly exaggerated. The good

side has been overlooked. That there is a good side to this question as well as a bad one will not be disputed if an investigation is made. Aggergations of capital have many advantages and may be weilded for the public good. One of the chief items of benefit is the cheapening of the cost of preduction. The dream of every manufacturer is tto increase his output with the same expenses or less if possible. Under the consolidation one set of officers takes the place of many. The increased capital enables them to buy in large quantities and at opportune times.

From these remarks we may infer that there are at least three ways of viewing these problems : the sentimental; the economic; and the legal ways. In this thesis it is proposed to treat of these combinations only from the legal point of view. Courts only deal with the laws as they are; they cannot make them. This leaves the other aspects of the situation to be discussed by the legislatures and the people who alone can make the cahnges claimed to be necessary.

The origin of the word "Trust" seems to have been the well known Standard Oil Monopoly. The defenders of the trust point to this as a justification both of the need of the invention and its practical success. In the Standard Oil case there were a few men who had acquired a controling interest in a few (at first) manufacturing or mining properties situated in different states. How could they manage them all ? Not personally, for they wished to avoid personal liability; not through numerous corporations, for, as their acquisitions increased, it was seen that the whole time of these two or three men would be taken up by going about to corporate meetings, publishing notices, placating stockholders, and complying with the (to them) vexatious restrictions concerning corporate management of the several states. To meet this immergency the Standard Oil Trust was organized.

As a corporation cannot be created except by the legislature, Hoadly v. County Commissioners, 105 Mass. p.526, Stone v. Flag, 72 Ill. 397. So it cannot without the authority of the legislature merge its existence in that of another corporation. (New York Canal Co. v. Fulton Bank, 7 Wend. 412.

Pearce v. Madison, 20 How. (U. S.) 441. Clearwater v. Meridith, 1 Wall. 25, 39. Previous to the so called "Trusts", efforts to secure concert of action among corporations have been principally made either,

1. By one corporation taking stock in anther;

2. By one leasing the property of another;

3. By contracts between the Boards of Directors, having one or more common members ; and

4. By consolidation under general or special statutes.

Taking up the first method we find that one railroad company cannot purchase shares of stock in another railroad company, especially where the purchase is for the purpose of controlling or absorbing the latter. (Cook on Stockholders Sec. 315 b, Central Railroad Co., v. Collins, 40 Ga., 582, Hazelhurst v. Savvannah Railroad Co., 43 Ga., 13. , Elkins v. Camden and Atlantic Railroad Co., 36 N. J. Equity, 5. Morawetz says (p. 212), that the sale of the property of one corporation to another in consideration of a transfer of shares in the latter company to the share holders of the former is clearly not impliedly authorized. A transaction of this description would, in effect, amount to a consolidation of the two comapnies, but he adds that a corporation may sell out its assets, and receive in payment, stock in another

company having a fixed money value, and convertable into cash at any time. It may be distributed in specia among t ose share holders who are willing to accept it, but should be controverted into cash and the proceeds destributed among those who do not consent to the arrangement. This was held in the case of Treadwell v. Salisbury Manufacturing Co., 73 Mass. 393., where the corporation sold all of its property to another corporation against the wishes of a minority of the stock holders. This restriction on thus securing control does not prevent a controlling xtock holder in one corporation from becoming the controlling stock holder in another. (Havemeyer v. Havemeyer, 43 Superior Ct., 506.) But the right to hold such controlling interests in different compaines is conceded to be subject to remedies in a court of equity if the rights of associates in either are prejudiced by a breach of duty or of trust in the excercise of such controll. In Pratt v. Jewett, 75 Mass. 34 it was held not reasonable cause for dissolution of a manufacturing company that one person owned the majority of the stock, and for many years has controlled the elections and managed the company, without regard to the wishes and interests of the petitioners, and so as to result in a loss. The second subdivision as given not being as important as the others we will omit to discuss and proceed to the third.

We will now proceed to the third subdivision.

The directors elected to controll and manage the corporations are trustees of a franchise granted by the state. They cannot convey away the corporate power to any external bodies, nor bind the corporation by executory contract to exercise corporate powers in a manner inconsistant with the property right of the stock holders. Hence all attempts to secure concert of action among corporations by executory agreements between their boards of directors are somewhat uncertain, as may be seen in some of the pooling arrangements between carrier companies. In the case of a trust if the power to elect a board in each of several corporations is secured, and lodged in one hand, no contract between the several boards is necessary. Each corporation in such a case is left in a legal fence free, and does not enter into any contract in restriction of a frnachise; and it is conceived that the conduct of neither board can be impeached on an allegation that it had entered into any executory obligation in the nature of a combination or consolidation an usurpation of power.

The third division included pooling contracts. These involve, in one form or another, embarrasments arising out of the limits of the powers of the corporations and their

directors, and out of the fiduciary relation of the directors to stock holders, and the incopacity of a director in two boards to sanction a contract between them. The fact that stock holders have not hitherto been regarded as holding any fiduciary relation to each other or to their company has lead to the invention of the trusts of stock for the controll of corporations.

We will now consider the fourth division.

In a consolidation by statute the rights franchises and effects what two or more corporations are by legal authority and agreements of the parties combined and united into one whole, and committed to a single corporation , the stock holders of which are composed of those (as far as they choose to become such) of the companies thus agreeing, this is in law a consolidation, whether the consolidated company be a new one then created, or one of the original companies continuling in existance with only larger rights, capacities and property. (66 Ala. 656.) Reorganization is a term generally used to indicate the formation of an entirely new corporation for the purpose of purchasing the property of another corporation, and superceeding it in business without incuring any liability to its creditors. Morawetz 2 ed. 811. Whether the consolidating compaines are extinguised or not depends upon the legislative intent as manifested in the statute under which the consolidation is effected. (Central Railroad and Banking v. Georgis 92 U. S. 665; Bove v. The Junction Railroad Co., 10 Ind. 93.) Corporations cannot be consolidated except by the express sanction of the state. This sanction may be granted by a general law or by the original charter of a consolidating

comapnies. 19 Wall. 241.

It seems that a subsequent ratification of an unauthorized consolidation is sufficient, Bishop v. Brainard, 28 Ct., 289. The franchises of the consolidated coampny are measured by the act authorizing the consolidation, whether it describes the enterprise in terms and thus provides a complete constitution, or refers to the charters of the old companies expressly in corporating their provision or extend them by implication. Moraweitz 2 ed. sec. 547.

Mode of consolidation. Where the statute provides for the the mode of consolidation, every requirement must be strictly complied with (Railroad v. Tharp, 28 Mich. 506. Mansfield &c., Railroad v. Drinker, 30 Mich. 124.) But such compliance will be presumed in the absence of evidence to the contrary and connot, be inquired into collateraly. Swartout v. Railroad 24 Mich. 389. If the statute only confers the naked power, the companies may agreement fix the terms. But no consolidation can take place without some action fully authorizing the same. (Mason v. Finch, 28 Mich. 282.) Power to consolidate does not include power to lease, or enlarge the power to convey lands conferred by the charter. (Mills v. The Central R. R. Co., 41 N. J. Equity.5). Archer v. Terre Haute R. R. 10 2 Ill. 493. But under a general power to consolidate with any other company it may consolidate with

another company whose charter contains no such power. Matter of Prospect Park R. R. Co., 67 N. Y. 371. And when a consolidation is effected, the new company enjoys the same presumption as to the rightfulness of its legal existence as an original company. Belle v. Penn. R. R. 10 Atlantic 741.

The legislature cannot compel the consolidation of private corporation. (Masonrv. Finch 28 Mich. 282, Penn. College cases 13 Wall. 190, 212.) Although it has plenary power in this respect over municipal corporation. One Dill. Mun. Copp. 4th Ed. Sec. 44. And it may compel a consolidation under a governing statute giving it power to alter revoke or annul charters. Penn. College cases 13 Wall. 190, Curative acts validating defects in corporate organiations are generaly upheld where the legislature could have given the corporation a valid corporation in the first instance. (Syracuse City Bank v. Davis, 16 Barb. 188, Mitchell v. Deeds, 49 Ill. 416, 19.)

We now come to the consideration of trusts proper. A "Trust" so called is it a vice to secure concert of action among a number of corporations of similar interests, by separating the voting power and the ownership of the stock, in each one to a sufficient extent to concentrate the voting power, and the ownership of the stock, in each one, to a sufficient extent to concentrate the voting power of a majority of the stock in each corporation, in the hands of a single committee or an association whose policy will therefore animate all the Boards of Directors so that the corporate action of all may be indentical without contract. Under this arrangemant it is intended that the beneficial interest in the stock minus the voting power shall rest where it was before. The most recent as well as one of the best cases on the law of trusts is the sugar trust case in 121 N. Y. 582. This was an action brought by the Attorney General of the state of New Yo rk v. The North River Refining Co., for a dissolution of its charter upon the fround that it had exceeded its corporate powers by entering into the trust agreement. The case was ably argues and taken to the court of Appeals where the decisions against the company were affirmed, thus desolving the corporation. The purposes of the

combination, as stated in the trust deed, were : to furnish protection against unlawful combinations of labor; to protect against inducements to lower the standard of refined sugars; to promote the interests of the parties in all lawful and suitable ways.

The point was raised that the company itself, in its corporate capacity, had not entered into the combination, but only the share holders in their individual capacity. The fact however that the trust deed provided for certain things to be done by the corporation, and that these things had been done, constituted a ratification by the corporation of its share holders agreement and made the transaction properly a corporate act.

The decision does not, however, directly answer the inquiries as to what stock holders may individually do, which is now one of the chief questions of practical interest. Although this question is not answered the reasoning which leads the court to answer in the negative the question whether the corporation itself can as such transfer its powers to a trust, is instructive as bearing on that question. The court first asked what this defendant corporation had done or ommitted. It concludes that it has renounced its powers by trnasferring the power to make dividends, to go on with

business, and to mortgage the property to a third party; this has been done by a contract to which the corporation was a party, and not by the concurrance in choosing directors who would hold those powers under a contemplated policy; this contract having been made by the stockholders and trustees acting as such at a corporate meeting by corporate resolutions and attested by corporate instrumentality, must be deemed a corporate act. In all this, acts of the stockholders are in element, but seem to be so treated because they were done under corporate forms, and cooperated with corporate acts or ommissions in an actual divesting of corporate powers.

Perhaps opinions will differ as to whether this reasoning will lead also to the conclusion that a trust is illegal which is constituted by stockholders acting as individuals, and seeking not to divest their corporations of powers, but to secure a board of directors who shall exercise those powers in the regular corporate manner, and freely, but in harmony of policy of other corporations. However this may be, it seems clear that the court have not in any wise directly impuned of validity of purly stock trusts, constituted by stock holders alone with intent to exercise regularly and not to renounce the corporate powers and franchises.

This case carefully avoids discussing the problems of political ecomomy and combinations and monopolies in restraint of trade and commerce. It takes the discussion out of the catagory of criminal conspiracy and puts the decision on the clear and strong civil ground of a renunciation of the corporate powers by the act of the corporation. To quote from Finch J. : "And so we have reached our conclusion, and it appears to us to have been established that the defendant corporation has violated its charter and failed in the performance of its corporate duties, and that in respect so material and so important as to justify a judgment of dissolution. Having reached that resolve it becomes needless to advance into the wider discussion over monopolies and competition and restraint of trade and the problems of political economy. Our duty is to leave them until some proper immergency compells their consideration. Without either approval or disapproval of the views expressed upon that branch of the case by the courts below, we are enabled to decide that in this state there can be no partnerships of separate and independant corporations, whether directly or indirectly through the medium of a trust ; no substantial consolidations which avoid and disregard the statutory permissions and restraints; but that manufacturing corporations must be and remain several as they were created, or one under

The solution of this phase of the question will depend much uppn the settlement of the much discussed problem as to whether there is a substantial and vital destinction between the aggregate of the individuals who compose the corporations and the corporation itself; whether the members themselves are the corporation.

The underlying question is whether there is for this purpose a substantial and vital destinction between the aggregate corporation and the individual. As yet the law has no one answer to this question in all its forms, and it will be hard to adjust it to all situations. For many purposes ther are essentially different. Some text writers have insisted strongly on the destinction; others have repudiated it. Of the latter class Moraweitz is prominent. In Vol. L. Sec. 27 he says : "The statement that a corporation is an artificial person or entity a part from its members is merely a description in figurative language, of a corporation viewed as a collective body; a corporation is really an association of persons, and no judicial dictum or legislative enactment can alter this fact." But at Sec. 232 he says : "In all cases it is indispensable that the fiction of a corporate entity, a part from the individual share holders, be preserved unimpared, in measuring and in

enforcing those rights and obligations which are of a corporate character."

In the case of Internation W. & T. Co., v. McMonan 41 N. W. 510, it was held that the corporation could purchase personal property from one of its members; the member in that case being its president. The court said : "There is no legal identity between individuals and a corporation which will prevent it from becoming a purchaser in good faith from one of its members". Waterman on Corporations Sec. 3 said : "The corporation has an existence separate and distinct from the persons composing them, who cannot individually exercise corporate powers, enfore corporate rights, or, as a rule be made responsible for the corporate acts..... The property of a corporation is legally vested in itself and not in its members; as individuals they cannot, even by joining together unanimously, convey a title to it. Nor can they make a contract that will bind it, or enfore by action a contract that has been made with it. The artificial person called the corporation must manage its affairs in its own name as exclusively as a natural person manages his property and business."

Statutes on consolidation.

Under New York law the provision of Sec. 8 to 13 of the business corporation las, corporations may be consolidated where "they are organized under the laws of this state for the purpose of carrying on any kind of business of the same or a similar nature, which a corporation organized under this chapter migh t carry on." This is done by the Boards of Directors making an agreement to that effect, and submitting it to the stockholders for their approval. It must be approved by at least two-thirds of the stock in each corporation. Any desenting stock holder may apply to the Supreme Court a nd obtain an appraisal of his stock, and after receiving the amount he ceases to be a member of the corporation. By this method the old corporations cease to exist and the new ones take their place, and enjoy all the rights, franchises and privileges possessed by the original corporation.

Under the United States law passed in 1890 we have certain provisions aimed at the destruction of trusts. Sec. 1 provides that every contract, combination in the form of trusts or otherwise, or conspiracy in restraint of

trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal. Every person who shall make any such contract or engage in any such combination or conspiracy shall be deemed guilty of a misdemeanor, and on a conviction thereof shall be punished by fine not exceeding Five Thousand Dollars, or by imprisonment not exceeding one year, or by both said punishments, in a discression of the court. The U. S. Circuti Courts are given jurisdiction, and all trust property intransit between the state may be confiscated. This seems to apply only to trusts between the states.

Sec. 1798 of the Civil Code is the one that gives the Attorney General the right to bring an action for the forfeiture of the charter of a corporation where it has exceeded its powers. It was under this section that the case of People v. The North River Sugar Refining Co. 121 N. Y. 582 was brought. This section provides,

1. Where a corporation had offended against any provision of an act, by or under which it was created, altered, or renewed, or an act amending the same, an applicable to the corporation; or,

2. Violated any provision of law, whereby it has forfeited its charter or become liable to be dissolved, by the

abuse of its powers; or,

3. Forfeited its privileges or franchises, by a failure to exercise its powers; etc.

On the criminal side of the question in this state we have section 7 of the stock corporation law taken in connectin with Sec. 158 of the Penal Code. Sec. 7 of the stock corporation law provides: "No stock corporation shall combine with any other corporation for the prevention of competition." The words in the Penal Code that apply to this question are A person is guilty of a misdemeanor who conspires to cheat and defraud another out of property, by any means which are in themselves criminal, or which if executed, would amount to a cheat, or to obtain money or any other property by flase pretenses.

During the last session of the legislature this law against combinations and trusts has been strengthened. It is Chapter 716 of the Laws of 1893, which are not yet published. It provides against restraints of trade and monopolis both by individuals and persons as well as corporations.

C O N C L U S I O N.

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Under our constutional system of government there are no certain and adequate legal means by which abuse of privileges of united capital by persons and corporations for commercial and industrial purposes can be reached and remidied. If course much less serious and threatening tendancies have been corrected by amendments to the constitution. At the same time one of the fundamental ideas of a government upon equality of rights before the law and great individual libertyis non-interference with purely economical matters. Sunctuary legislation is not favored by our people unless it be confined to such speeches of business as are in themselves demoralizing and vicious. The peculiar res ults which have folowed the unrestricted wielding of power inherant in the possession of a large accumulation of wealth was not foreseen by the founders of this or other modern

nations, and is not probable that any checks upon the exercise of the powers could have been provided even if such checks had been deemed advisable.

As has before been said there is a great deal of public agitation over the problems involved in these situations, and that there is considerable exaggeration of the resulting evils. I will here quote a fair speciman of some of the flights in which some indulge." "The older gospel of economis science is being rapidly confuted by the developments of modern training. Formulas enunciated with oracular dogmatism are every day falsified by experience, and the philosophy of the closet is laughed to scorn by the finance of the stock exchange. Demand and supply no longer maintain a self-adjusting equlibrium and prices, forced up and down by sheer leverage of capital, violate all the cannon of science by ceasing to bear a fixed proportion to cost of production. Competition the talismanic force pointed to by theory as the automatic regulator of the commerical machine, his client by the antagonastic action of combination, and the vast engines of cosmopolitan industry are captured and controlled by the league forces of organized speculation. Theoretic science is defied by the audacious juggelery of financil experts, and its maxims are as much out of date in explain-

ing the perturbations of the money market as those of the Ptolemaic system in co-ordinating the teloscopic horizons of modern astronomy." (Miss. E. M. Clerke in Dublin Review, April 1889.)

But the mystery which in the minds of some obscures this subject is a business mystery and not a legal one. Each of the legal principales which have rendered these combinations possible is easily comprehended and generally familiar. Nearly all of them have long been recognized and frequently and separately applied. The modern spirit of organization has recently discerned the results that can be worked out through the combination of these familiar principles; and the secrecy which has attended the operation of the device is a matter of business policy simply.

There is at the present writing an Anti-Trust Convention being held in Chicago. It is composed of representative men from nearly all of the states. It was brought about by Gov. Nelson of Minnesota, who, in accordancew with a resolution adppted by the Minn. legislature issued an invitation to all of the states of the Union to take part in a conference to devise means to overthrow trusts and combines. The Sherman anti-trust law is denounced as an experiment and that its

results have been fruitless. This law was the one quoted as the U. S. Trust Law in the division under statutes. Gov. Nelson says "What is needed, is a law whil will enumerate the acts of the trusts which are illegal. It ought to prescrine a short and simple form of indictment. In order to simplyfy the rules of evidence in such cases the law should provide that certain visible acts of the trusts and their agents should be accepted as prima facial evidence of an illegal combine. The law should be made to clearly define what is a monopoly of trade. The legislatures of the various states must be looked to for relief. While the Sherman law is an experiment it will do as an entering wedge. It is for us to enlarge upon it. It is for us to devise a plan to fight this work form of the modern anti-christ. What is necessary is concerted action between the federal and state authorities. I suggest that this convention appoint a permanent committee on legislation, whose duty it will be to devise suitable laws and means to have them passed."