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THE AMERICAN LAW REGISTER

FOUNDED 1852

UNIVERSITY OF PENNSYLVANIA

DEPARTMENT OF LAW

Vol. { 53 O. S. } { 44 N. S. }	FEBRUARY, 1905.	No. 2.
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THE LIMITATIONS OF THE POWER OF A
STATE UNDER A RESERVED RIGHT TO
AMEND OR REPEAL CHARTERS OF INCOR-
PORATION.

(Continued from page 47.)

II. THE CORPORATORS INTER SE AND THE STATE.

When two or more persons wish to enter into a partnership for the transaction of business they commonly draw up articles of agreement which are to determine the relations to exist among them—the scope and nature of the enterprise, the voice that each shall have in its management, the method and proportion in which the profits arising from the enterprise are to be divided. The law does not require that they first secure from the state any distinctive franchise or privileges, inasmuch as the common law always recognized the right of a person to embark in a mercantile enterprise, which was then subject only to the taxing and police powers of the state.

Similarly the common law recognized the right of association of individuals into what we now term “unincorporated associations”—organizations formed usually for social, beneficial, or like purposes. Persons entering into such associa-

tions also may and usually do draw up articles of association regulating their joint and respective rights of property, management, and other interests, and the courts will enforce such agreements or by-laws as the organic contract determining the status and rights of membership in such organizations.

In the case of the corporation the same underlying conception of a voluntary association exists. In fact, such an association is formed in just the same manner as a partnership or an unincorporated association. The incorporators meet and determine upon the kind of enterprise in which they wish to embark their capital; they decide upon the amount of capital to be employed, the extent of interest which each incorporator is to have in the property and dividends arising from the investment and exploitation of the capital, the officers and directors who are to manage the conduct of the business, and the power which each of such officers is to have; they thus provide a scheme of organization and membership—of true partnership. Having effected such an organization, they might step out at once into the mercantile world and launch their enterprise as a business partnership without securing any charter or franchise at all. But if they wish to conduct their venture under certain privileged conditions—as, for example, if they wish their organization to have the right of perpetual succession, to be able to sue and to be sued in a common name, to have a joint or corporate seal, and the members to trade subject only to a limited liability to creditors—they must, to secure these privileges, first obtain a corporate license from the state; they must get the right to be a corporation. The franchise of incorporation, therefore, is nothing more than a license from the state to do business under certain privileged conditions. The franchise does not constitute the association; it is a gift by the state to the association. The incorporation does not create the organization any more than an automobile license creates an automobile. The automobile is brought to a municipality to be licensed under its police regulations to do certain things—to be operated and run within certain governmental limits; so the corporation comes, fully existent, fully organized, to the state and asks the state for

the license or privilege of trading in a corporate capacity. Therefore the contract of association among the corporators exists wholly independently of the state—as much so as does any contract drawn up between two private individuals or among several individuals; the state uses this contract merely as a basis upon which to formulate its own contract with the corporators—the contract which we call then the charter of incorporation.

If this be true, it is to be noted, then, that the real contract existing among the corporators is entered upon by them prior to the actual incorporation of the association or group. Unfortunately, however, the charter which the state grants to the association frequently purports to set out the essential terms of this prior contract or agreement, so that the confusion arises which causes the more or less prevailing belief that the charter given by the state to the corporation gives to it not only a contractual right and a contractual liability with reference to the state itself, but also all the contractual rights and liabilities existing among the corporators themselves. The state, instead of granting a mere tag or numbered card, as in the case of the automobile, insists that the charter license shall itself set forth the nature of the corporate enterprise, the amount of the capital stock, the number and names of the directors and officers of the association—in short, all the essential parts of the agreement previously entered into by the corporators, but not, in most cases, formally drawn up and executed by them until the application for the charter itself, which first embodies the formal expression of this prior agreement. From this mere circumstance of physical identity—an identity to be regretted, for much “bad” law might have been avoided were these two contracts expressed in totally distinct instruments—comes the trite statement that the charter of a corporation constitutes a contract, not only between the state and the corporation under the doctrine of the Dartmouth College Case, but also as among the stockholders or corporators themselves.

Says Cook (on Corporations, Vol. II, Sec. 669): “That a charter constitutes a contract between the corporation and

its stockholders is a principle of law that has become firmly imbedded in the jurisprudence of modern times. Upon this principle of law rest the stability, permanence, and honesty of management of many corporations, particularly those of railroads, and from it arises much of the confidence, safety, and protection of the stockholder himself. It was first promulgated in America in 1820 in *Livingston v. Lynch*, 4 Johns. Ch. (N. Y.) 573, and was applied to corporations in *Hartford and New Haven R. R. Co. v. Crosswell*, 5 Hill (N. Y.), 383 (1843), and in England, in 1824, in *Natusch v. Irving*.⁶³ These cases have been followed by a long list of supporting decisions. They were the first to establish clearly the doctrine that any act or proposed act of the corporation, or of the directors, or of a majority of the stockholders, which is not within the express or implied powers of the charter of incorporation or of association—in other words, any *ultra vires* act—is a breach of the contract between the corporation and each one of its stockholders, and that consequently any one or more of the stockholders may object thereto and compel the corporation to observe the terms of the contract as set forth in the charter.”

Says Morawetz (on Private Corporations, Vol. II, Sec. 1047): “Whatever doubt there may be as to the correctness of the doctrine that a charter of incorporation embodies a contract between the state and the incorporators, there can be no doubt that the charter of an ordinary business corporation embodies a contract among the incorporators themselves. The shareholders of such a corporation mutually agree to unite for the purposes indicated in their charter. Each shareholder agrees to contribute his proportionate share of the capital of the association, and each, in return, becomes entitled to a share in the profits and in the management of the corporate affairs. The agreement thus created is, in the strictest sense of the word, a contract, and every reason exists for treating it as a contract within the meaning of the provision of the Constitution of the United States that no state shall pass any law impairing the obligation of contracts.”

⁶³ Gow on Partnership, 398; also 2 Cooper's Ch. 358.

Says Thompson (Commentaries on the Law of Corporations, Vol. I, Sec. 71): "The relation between a corporation and a stockholder is one of contract, and hence any legislative enactment which, without the assent of the stockholders, authorizes a material change in the powers or purposes of the corporation not in aid of its original object is not binding upon him." . . . Nor can the legislature, in an amendatory act, "authorize the majority to accept the amendment so as to bind the minority, because this would have the effect of impairing the obligation of the contract entered into among the corporation, the majority and the minority in the original subscription."

From these well-recognized principles—to be criticised only because of their assuming that the charter constitutes the contract among the stockholders in any sense other than that already explained—result the numerous decisions which hold that the state cannot, under the Federal Constitution, amend or authorize the amendment of the charter in such manner as to violate the contract which it expresses as having been determined upon by the incorporators in entering upon the corporate enterprise. If the state directly enacts an amendment of the charter, it is violating the Dartmouth College decision by impairing the obligation of the contract existing between itself and the corporation. If the state merely authorizes an amendment of the charter, or of the general scope and purpose of the enterprise,—that is, passes an act permitting some, or a majority, or any number of the incorporators less than all, to change the charter, the nature of the enterprise, or the management of the corporation,—it is impairing the obligation of the contract existing among the incorporators, and is violating the provision of the Federal Constitution no less than before. The incorporators having agreed that they will enter upon the pursuit of a certain business, that they will divide their profits in a certain proportion, and elect under a certain system those who are actively to manage the conduct of their business, the state cannot subsequently impair this contract, whether the persons carry out their venture on a partnership basis, or whether they incorporate and thus enter into a further con-

tract as a group or association with the state; if they incorporate, the only effect is that the state has now two contracts which it cannot impair where in a partnership it would have had but one. In short, just as the state cannot impair a contract of partnership or any other contract between individuals, so it cannot impair a contract among stockholders or incorporators, and this independently of any principle of the Dartmouth College Case at all. Of course, it may legislate with respect to the corporate contract without necessarily impairing its obligation. It may enact or authorize amendments which are merely auxiliary to the purposes of the corporation, and such amendments may be accepted by a majority of the stockholders with the effect of binding all the stockholders whether assenting or not.⁶⁴ So it may decree or authorize insignificant and immaterial changes in the corporate design,⁶⁵ just as it may in the case of all contracts. But when the amendments proposed are fundamental, radical, or vital, the assent to such amendments by the stockholders must be unanimous, for any dissenting stockholder is either relieved by such unauthorized amendment from liability on his stock subscription, or, if he chooses, he may enjoin his fellow corporators from adopting it and from attempting any fundamental change in the original purpose of the association. He can insist that there be no consolidation with another corporation without his assent, that the funds of the corporation shall not be devoted to a

⁶⁴ Thompson on Corporations, vol. i, sec. 68: "This rule does not extend so far as to prevent the legislature from enacting amendments to a charter in furtherance of the original design, on the application of the corporation or of a majority of the members. . . . The mere grant of auxiliary powers to enable the corporation the better to carry out the original design, does not constitute such a radical and fundamental change in the objects and purposes for which the original company was chartered, as places the amendment within the category of statutes impairing the obligation of contracts. Instead of impairing the obligation of the contract expressed in the charter, it aids and effectuates it" (citing many cases).

⁶⁵ *Banet v. Alton and Sangamon R. R. Co.*, 13 Ill. 513 (1851); *Fry's Executor v. Lexington and Big Sandy R. R. Co.*, 2 Metc. (Ky.) 314 (1859); *Cross v. Peach Bottom Railway Co.*, 90 Pa. St. 392 (1879); *Peoria and Rock Island R. R. Co. v. Preston*, 35 Iowa, 115 (1872); *Chattanooga, Rome and Columbus R. R. Co. v. Warthen*, 98 Ga. 599 (1896).

different purpose than that originally agreed upon and stated in the charter, that they shall not be subjected to a different method of management, nor be divided in a different proportion among the stockholders.⁶⁶ And none of these changes can be made any the less invalid by reason of the fact that they are sanctioned by legislative authority, since the state cannot impair the obligation of the contract among the stockholders. In all of these cases the dissenting stockholder may well say, and with entire judicial approval, "*Non hæc in fœdera veni.*"

Here we have the ground upon which, it is suggested, the Dartmouth College decision not only might but should have been placed—the ground upon which it not only was a possible and justifiable decision, but would have been a proper and necessary one. The facts of this historic case were, that by the original charter of Dartmouth College granted by the Crown in the year 1769, twelve persons, therein named, were incorporated by the name of "The Trustees of Dartmouth College." Under the charter these trustees had authority to fill all vacancies which might arise in their own body. By an act of the legislature of New Hampshire passed in 1816 the charter was amended, the number of trustees being increased to twenty-one. The appointment of the nine additional members was vested in the Governor of the state, and a board of overseers was created, consisting of twenty-five persons (all of whom were executive officers of the states of New Hampshire and Vermont), who were to have the power to control the most important acts of the trustees, including the appointment of all officers of the college. The Governor and Council of New Hampshire were to fill all vacancies which might occur in the board of trustees prior to its first meeting. A majority of the trustees

⁶⁶ *Clearwater v. Meredith*, 1 Wall. 25 (1863); *Hartford and New Haven R. R. Co. v. Croswell*, 5 Hill (N. Y.), 383 (1843); *Knoxville v. Knoxville and Ohio R. R. Co.*, 22 Fed. Rep. 758 (1884); *Black v. Delaware and Raritan Canal Co.*, 24 N. J. Eq. 455 (1873); *Manheim, Petersburg and Lancaster Plankroad Co. v. Arndt*, 31 Pa. St. 317 (1858); *Lauman v. Lebanon Valley R. R. Co.*, 30 Pa. St. 42 (1858); *State v. Greer*, 78 Mo. 188 (1883); *Tucker v. Russell*, 82 Fed. Rep. 263 (1897).

of the college refused to accept this amended charter, and brought suit for the corporate property, which was in the possession of a person holding by authority of the Act of 1816. The question involved was the constitutionality of the Act of 1816 under the Federal restriction upon the impairment by a state of the obligation of contracts.

Instead of sustaining the artificial position that the charter constituted a contract between the state and the corporation, was there not here, in fact, another contract expressed in the charter which the state undoubtedly was without power to impair? Had not the trustees agreed among themselves that they were to be twelve in number and no more? That they were to fill vacancies arising in their own body? That they were to have full and sole control over the affairs of the corporation? That they were to be the owners of the corporate property in trust for the corporate purposes—*viz.*, the foundation and maintenance of an institution for the education of such young men as might seek the instruction which it offered? What right, then, had the state of New Hampshire to annul, amend, or alter this contract, a contract entered into presumably before the granting of the charter and merely expressed subsequently in the charter as a statement of the organization and purposes of the corporate body? Did the state gain any power over this contract, to which it was not a party, simply by licensing the association thus organized to enter upon its proposed undertaking in a corporate capacity? By giving to the association the franchise to exist as a corporation, it could not acquire the right to violate a contract which the Constitution of the United States had forbidden it to impair. Had the trustees of Dartmouth College never incorporated, but conducted the college under the form of a partnership or unincorporated association, the state certainly could not have impaired such contract of partnership. It could not have said to the trustee partners: "You have agreed that you shall manage your affairs in a certain manner and under a certain system; we now decree that you shall manage them in a different manner and under a different system. The twelve of you have agreed to be partners in this enter-

prise; we enact that there shall be twenty-one partners, and we shall name the other nine whom you must allow to enter into your association, and we shall name new partners in case any of you resign or die. We shall also appoint a body of strangers to control your acts and supervise the management of your own enterprise." The mere statement of such a proposition shows its inherent absurdity, and if the state could not have taken this position in the case of such a partnership, it could not have done so in the case of an association which has obtained the license of incorporation. What the Dartmouth College decision in fact held was that this incorporation created a *second* contract, a *contract between the association and the state*, and that the state could not change the scheme of management or any other of the charter provisions, because to have done so would have been to impair this second contract. It is contended, for reasons set forth in the first part of this paper, that the relationship between the state and the association arising from the act of incorporation is in no sense a contractual relation, and that the true contract was the one existing between the incorporators as expressed in the charter,—the contract dealing with the scope and nature of the corporate enterprise and the management of the corporate property and affairs,—a contract existing independently of the act of incorporation. The Dartmouth College Case did not deny the existence of this contract: it ignored it. *But what it is important for us to note is that, if the Dartmouth College decision be correct, there are two distinct contracts the obligation of which cannot constitutionally be impaired by the state, and it remains for us to consider whether a power reserved to revoke or amend the one has or can have any effect over or in regard to the other.*

The Dartmouth College Case held that a charter of incorporation is a contract between the state and the corporation, the obligation of which cannot be impaired by the state. To meet this decision the states, as we have seen, adopted in their constitutions and general statutes clauses reserving to themselves, in the case of all subsequently granted charters, the right to repeal or amend them. We have already

shown that the state can reserve such a right, not as a sovereignty, but only as a party to a contract into which it itself has entered. Can the reserved power to alter or repeal be a power to alter or repeal a contract to which the state is not itself a party? Can the state constitutionally reserve to itself such a power? Suppose that a state were to pass an act, or adopt a clause in its constitution, which purported to reserve to the state the right to alter, amend, or annul all contracts subsequently entered into between private persons. Would such an act be constitutional? Mr. Justice Story says (Commentaries on the Constitution of the United States, Vol. II, Secs. 1383-1384) in answer to the argument that "If the legislature should provide by a law that all contracts thereafter made should be subject to the entire control of the legislature, as to their obligation, validity, and execution, whatever might be their terms, they would be completely within the legislative power, and might be impaired or extinguished by future laws, thus having a complete *ex post facto* operation," that this is not true, because such a law would not enter into and form a part of all contracts thereafter made. "Although the law of the place acts upon a contract," he says, "and governs its construction, validity, and obligation, it constitutes no part of it. . . . To such an extent the law acts upon contracts. It performs the office of interpretation. But this is very different from supposing that every law applicable to the subject matter, as a statute of limitations or a statute of insolvency, enters into the contract and becomes a part of the contract." As a matter of fact, Mr. Justice Story has not been sustained in these statements by the courts. The law of the place does enter into the contract and form a part of it. "It is settled," says Mr. Justice Swayne in *Von Hoffman v. City of Quincy*, 4 Wall. 535 (1866), "that the laws which subsist at the time and place of the making of a contract and where it is to be performed enter into and form a part of it, as if they were expressly referred to or incorporated in its terms. This principle embraces alike those which affect its validity, construction, discharge, and enforcement." And the same Justice says, in substantially the same language, in *Walker*

v. *Whitehead*, 16 Wall. 314 (1872): "The laws which exist at the time and place of the making of a contract, and where it is to be performed, enter into and form a part of it. This embraces alike those which affect its validity, construction, discharge, and enforcement." And this is said to be an "axiom in our jurisprudence."⁶⁷

But although Story would seem to be incorrect in the reasons which he assigns for his opinion, his conclusion itself is unquestionable. No state can pass a general act providing that contracts (to which it is not itself a party) shall be subject to any future laws which it may pass, and by such general act hope to avoid the inhibition in the Constitution against the impairment of the obligation of contracts, by the argument that any subsequent law cannot impair the contract, since the contract was made from the beginning subject to this reserved power and therefore embodied as one of its terms the possibility of revocation or amendment by the state. The reason why such an act would be held unconstitutional is not, perhaps, so much because of any theoretically logical reason compelling that view of the problem, but rather because it would be in practice a manifest evasion of the impairment of the obligation of contracts clause in the Constitution, an evasion rendering that clause a dead letter simply by the introduction of such a nullifying clause in the constitution of every state—a clause reserving over contracts a power which is denied to the state by the Federal Constitution. It is true that if the state passes an act relating to contracts,—for example, prescribing the rate of interest to attach to money due under the contract, or providing for exemption laws, or regulating the time and manner of performance,—such provisions all enter as terms of contracts subsequently entered into within that jurisdiction. But where the state passes an act not prescribing definite terms or regulations, but merely reserving the right subsequently to enact such regulations, *it is not thereby enacting a law, but is reserving a power*—a power forbidden to it by

⁶⁷ To the same effect is Mr. Justice Miller, "Lectures on the Constitution of the United States," lecture xi, page 531.

the provision of the Constitution which forbids the impairment of the obligation of contracts.

Let us consider as an example the case of *Goenen v. Schroeder*, 8 Minn. 387 (1863), in which the state of Minnesota passed an act allowing for the redemption of mortgages "one year or such other time as may be prescribed by law." Subsequently an act was passed increasing the time for redemption to three years, and the question was whether this act was constitutional with reference to mortgages executed between the time of the passage of these two acts. The court held that it was not. "It is an attempt," said the court, "to reserve to the legislature powers which it does not otherwise possess." If the original act had provided for a redemption of one year, a subsequent act changing the redemption period to three years would clearly have been invalid. How then could the state reserve to itself the power to make such a subsequent change in the redemption period? To say that the mortgagor and mortgagee entered into the contract knowingly subject to this reservation of power on the part of the state is manifestly a begging of the entire question, because the parties had no choice in the matter, and therefore had to submit to this provision of the state only if the law in question was valid—that is, only if the state had the constitutional power to create for itself this reserved authority.

We arrive, therefore, at this conclusion—that the state, in reserving to itself the power to amend or annul a contract to which it is a party, not only *does* not thereby reserve the right to amend or revoke a contract to which it is not a party, but that it *cannot* constitutionally reserve such a power, because to do so would be to create for itself by its own fiat a power which the Constitution of the United States says that it shall not possess. The state can reserve the power to annul or alter contracts into which it has itself entered only, as has been already pointed out, on the same principle that any private party to a contract can reserve a similar power. It reserves the power as a party to the contract and not as a sovereignty; the reservation is a term of the contract stipulated for by one of the parties thereto.

But the state cannot reserve a power to amend other people's contracts any more than can a private individual.

When we apply the results thus reached to the subject under investigation, we see at once to what conclusion such an application will lead. The question is: Does the state in incorporating an association, and at the same time reserving to itself the right to repeal or amend the charter, gain thereby the right to annul or amend the charter among the incorporators—a contract into which they have entered independently of the state's grant of corporate franchises? The answer is that it does not, and the chief reason for the answer is that it cannot. As far as the charter is, under the Dartmouth College decision, a contract between the state and the corporation, the state may alter or revoke it. If the Dartmouth College decision was unfortunate, its effects have been wholly avoided by the reserved power clauses, which bring the state back to the position it would have occupied had the Dartmouth College Case been decided the other way. But so far as the charter is merely an embodiment of a contract entered into among the stockholders, and into which they might have entered just as well had they been forming a partnership or an unincorporated association without asking any franchises or privileges from the state, the state cannot impair its obligation, could not have impaired its obligation even if there had never been a Dartmouth College Case. No reserved power can give to the state that right. The state cannot reserve the right to change the contract of the corporators *inter se* any more than it can reserve a general right to change all private contracts, and it makes no difference that the terms of the corporators' contract may be set forth in the charter which the state reserves the right to alter or repeal. Clear thought will not be misled by this circumstance. The franchises, the privileges, the exemptions granted by the state in the act of incorporation are all at the mercy of the grantor if the power to repeal be reserved; the internal management of the corporation, the rights of the corporators *inter se*, questions of the scope of the enterprise, distribution of the assets, regulation of the corporate affairs—all these are beyond the power

of the state to modify whether there be or be not a reserved power of revocation or amendment of the charter.⁶⁸

Leaving for a moment the theoretical analysis of the problem, and considering the history of the reserved power clauses in the state statutes and constitutions, are we not brought to the same conclusion as to the intended scope of the powers thus reserved? Why and when were these clauses introduced into our jurisprudence? Was it not, in the main, after the Dartmouth College Case, and to meet the decision there rendered, that the state could not impair its contract with the corporation? Was it not because of the fear that the state could not control or recall the franchises which it had granted? Was there any apprehension of danger arising from the fact that the contract of the stockholders as to the nature and management of the corporate affairs was beyond state control? On the contrary, the fear of state interference with private contracts had dictated Art. I, Sec. 10, of the Federal Constitution. What these reserved power clauses were intended to accomplish was the prevention of the grant to corporations of irrevocable franchises. They were to prevent irrevocable gifts of privileges by the state, not to place under state control rights, powers, and contractual obligations which had not been given by the state. So that whether we study the problem from an historical or from a legal standpoint, the same result is attained—namely, a confirmation of the contention that the reserved power gives to the state no right over those features of corporate existence which are not dependent upon the charter of incorporation for their creation and legal status.

Coming, now, with these considerations in view, to examine the decisions in the reported cases, it must be admitted at the outset that they are almost all contrary to the argument here presented. In but a few of them is the question

⁶⁸ The corporators may, of course, agree *inter se* that a majority of the stockholders should have the power to change the contract of association in any of its terms, or that the state should have such power, the corporators being bound by the state's acts. But this would not be giving to the state any rights or power which *it* could enforce.

so much as discussed; in fewer, if any, is it adequately considered. This is the more remarkable both because of the importance of the subject and because of the eminence of the tribunals and jurists who have been called upon to express their opinion in regard to it. The decision adverse to the views above advanced is usually reached upon the basis of one of two statements, both of which, it is submitted, are erroneous. One is that "If the charter, or an existing constitutional provision or general law, reserves to the legislature a plenary right of alteration or repeal, then the co-adventurers, by accepting the charter or the general enabling act and organizing under it, consent that future legislatures may exercise that right; and it seems to be an untenable view that they may repudiate that consent and fly in the face of future legislation which takes place under a right thus reserved."⁶⁹ The other is that "In my judgment the reservation is to be interpreted as placing the state legislature back on the same platform of power and control over the charter containing it as it would have occupied had the constitutional restriction about contracts never existed."⁷⁰

The first of these arguments amounts, in substance, to this: that if a charter is subject to a power reserved in the state to alter or repeal it, every incorporator enters into the contract with his fellow incorporators knowingly subject to such reserved power, and therefore he cannot later be heard to complain if the power be exercised so as to change this contract. But this argument would justify the constitutionality of every law to which it might in the reason of things be capable of application. In one sense every person must deal with reference to the existence of legislative enactments, but submission to the law is not a voluntary act; if an act be otherwise unconstitutional, the mere fact that persons have contracted apparently under the force and sway of its authority will not make it any the less objectionable. The true question is, Has the state the constitutional right

⁶⁹ Thompson, Commentaries on the Law of Corporations, vol. iv, sec. 5417.

⁷⁰ Dissenting opinion of Mr. Justice Bradley in the Sinking-Fund Cases, 99 U. S. 700 (1878), page 748. See also *Detroit v. Detroit and Howell Plankroad Co.*, 43 Mich. 140 (1880).

to compel its citizens, if they wish to enter into a contract, to enter into it subject to a power reserved over the contract? If it can do so in the case of a contract among corporators, it can do so in that of a partnership contract. It may reserve the right to alter or annul all contracts thereafter entered into, and justify such reservation by the argument that since the contract was entered into subject to this reserved power, no subsequent exercise of the power can be said to impair the contract. We have seen that such an attempted reservation of power would be unconstitutional and void, that it would be the attempted creation of a forbidden power, and not a law entering into contracts as one of the terms thereof. It is, therefore, difficult to understand the force of the argument that a state may impair the obligation of the contract existing among the corporators because they have incorporated their association subject to the state's right of revocation or amendment. Moreover, it may be said, in further reply to this argument, that if the stockholders incorporate with knowledge of the reserved power, they have knowledge also of the fact that the state is forbidden by the Constitution to impair the obligation of contracts. As has been well said in reference to a somewhat different phase of this subject: "It is said that the company, having accepted its charter with full knowledge of the fact that the legislature had retained the right to alter and amend it, must be regarded as waiving the protection of any constitutional provision, and consenting in advance to any amendment the legislature might see fit to make, and, therefore, it is bound thereby as matter of contract. It must be remembered, however, that while the company, when it accepted its charter, must be regarded as having done so with notice of the fact that the legislature reserved the right to amend, yet it, at the same time, had notice of the several provisions of the Constitution placing limitations upon the legislative power, and therefore it had a right to assume that the legislature could and would only exercise the reserved right to amend within the limitations prescribed by the Constitution. Hence it cannot properly be said that the corporation, by accepting its charter with no-

tice of the reserved right to amend, consented that the legislature might make *any* amendment to its charter, but only such as it could make within the limitations prescribed by the Constitution. It could not assume, or even anticipate, that the legislature would violate the law of its existence, and undertake to do that which the people, in their sovereign capacity, had forbidden it from doing.”⁷¹

The second argument above stated as seeking to justify the state's control over the contract of the corporators *inter se* also may be said to beg the question—to be the statement of a result rather than the reason therefor. Is it true that the reservation clauses restore the states to the plane of sovereignty which they would have occupied had there been no clause in the Federal Constitution forbidding the impairment of the obligation of contracts? The Constitution says that the states shall not impair any contracts. Does the reservation in contracts to which the state is a party of the power to alter or annul them give to the state the right to annul or amend all contracts, including those to which it is not a party? Evidently not. All that the reserved power accomplishes, and all that it constitutionally can accomplish, is to restore the power of the state to the plane which it would have occupied had the Dartmouth College Case held that a charter of incorporation does not constitute a contract between the corporation and the state. It was meant to counteract that decision and to relieve the state of the limitations placed by it upon the right to alter the state's own contracts; it was intended to give to the state the right to repeal or amend acts of incorporation in the same way and to the same extent that it can repeal or amend all of its other acts or statutes. The reservation clauses do not nullify Art. I, Sec. 10, of the Constitution, but only the special interpretation given to that section by the Dartmouth College decision.

In the light of these principles, let us examine the cases which have dealt with this problem, and let us consider first

⁷¹ Dissenting opinion of Mr. Justice McIver in *Railroad Co. v. Gibbes*, 27 S. C. 385 (1887).

those which represent the opinion of the Supreme Court of the United States. In *Miller v. The State*, 15 Wall. 478 (1872), the facts were that the legislature of New York in 1851 passed an act enabling the city of Rochester to subscribe for and hold stock in the Rochester and Genesee Railroad Company (a corporation subject to the reserved power) to an amount not exceeding \$300,000, and in case the company should elect to receive its subscription the Common Councils of the city were authorized to nominate and appoint one director of the company for every \$75,000 of capital stock held by the city. The railroad company accepted the subscription of the city on these terms to the amount of \$300,000. In 1865 the legislature enacted that the Common Councils of Rochester should thereafter nominate and appoint one director of the company for every \$42,857.¹⁴ of capital stock held by the city, thus giving to the city the right to appoint seven instead of four of the directors of the company. The question involved was that of the constitutionality of this Act of 1865. There was no doubt that, under the facts of the case, the city of Rochester had become one of the stockholders of the company under a definite agreement with the corporation as to the powers which it was to have as such stockholder. The Supreme Court of New York sustained the act,⁷² saying, per Judge Welles, that the case was "plainly distinguishable from the case of a contract between the railroad company and a stranger in relation to a matter having no connection with, or reference to, the organization of the company—for example, a contract between it and an individual for the purchase of a locomotive engine. In such a case there is a legal contract between two persons, an artificial and a natural one, the obligation of which no state legislation could impair. But the case under consideration is where the legislature undertakes, in the exercise of its reserved powers, to alter fundamentally the articles of association or charter of the railroad corporation. This power I have shown, I think, it possesses." The decision thus reached was reversed in the

⁷² *People ex rel., etc., v. Hills*, 46 Barb. (N. Y.) 340 (1866).

appellate court, but upon another point, the main question not being considered.⁷³ In the Supreme Court of the United States the act in question was sustained because of the reserved power,⁷⁴ with an unsatisfactory joint dissenting opinion of ten lines by Justices Bradley and Field. How the reserved power to repeal or amend the charter of the railroad company could authorize an act of the state giving to a stockholder the right to elect seven directors instead of the four for which its subscription had originally contracted is apparently hopelessly beyond logical or historical justification.⁷⁵

In *Close v. Glenwood Cemetery*, 107 U. S. 466 (1882), in an opinion by Mr. Justice Gray, the same result was reached. A cemetery company had been incorporated by act of Congress in the District of Columbia, its charter being made expressly subject to the reserved power of Congress to alter or repeal it. The company, as incorporated, was to be managed by a president and three other officers elected annually by the proprietors. By a later act it was provided that the management of the company should thenceforth consist of a board of five trustees to be annually elected, three by the proprietors of cemetery lots upon which a burial had been made, and two by the original proprietors; it was further provided that of the gross receipts arising from the future sale of lots one-fourth should be paid annually by the trustees to the original proprietors and the rest be devoted to the improvement and maintenance of the cemetery. The original proprietors objected to this act and the Supreme Court was called upon to pass upon its constitutionality. The position might have been assumed that

⁷³ *Idem*, 35 N. Y. 449 (1866).

⁷⁴ *Miller v. The State*, *supra*.

⁷⁵ It is not clear whether, in the case of *City of Louisville v. University of Louisville*, 15 B. Monr. (Ky.) 642 (1855), the University of Louisville's charter was subject to a reserved power. If so, that case is contra to *Miller v. The State*. An amendment to the charter of the city of Louisville gave to the city, one of the donors of the university, the power, to the exclusion of other donors, of electing trustees of the university. The court held that, though a part of the funds were granted by the city, the charter constituted a contract by which the donors, the trustees, and the state were bound, and the obligation of which could not be impaired by subsequent legislation of the state.

Congress was not prohibited from impairing the obligations of contracts, and therefore the question of the reserved power did not arise. But this was not contended, it apparently being assumed that in the absence of this expressly reserved power the subsequent act of Congress would have been invalid. The court sustained the constitutionality of the act "within the principle affirmed by this court in the case of the Holyoke dam,⁷⁶ that a power reserved to the legislature to alter, amend, or repeal a charter authorizes it to make any alteration or amendment of a charter granted subject to it which will not defeat or substantially impair the object of the grant or any rights vested under it, and which the legislature may deem necessary to secure either that object or any public right"—a complete ignoring of the real question lurking in the case.

The latest decision of the Supreme Court involving the point under consideration, and in complete harmony with the preceding cases, is *Looker v. Maynard*, 179 U. S. 46 (1900). In that case the articles of association of a certain insurance company provided that each shareholder should be entitled to one vote for directors for every share of capital stock held by him, and that a majority of all the votes cast should determine the elections. Under the power reserved in the charter of the company to alter or amend it, the legislature of Michigan, which had incorporated the company, passed an act allowing the system of cumulative voting, a system intended to give minority stockholders representation on the board of directors by allowing each shareholder to cumulate all of his votes upon one or more directors instead of voting each share for each of the number of directors to be chosen. This would not have been an authorized method of voting under the original articles of association. The court held the act constitutional on the statement (curiously enough suggesting the essential question but not raising the expected doubt in regard to it in the minds of the court) that "remembering that the Dartmouth College Case (which was the cause of the general introduction into the

⁷⁶ 15 Wall. 500 (1872).

legislation of the several states of a provision reserving the power to alter, amend, or repeal acts of incorporation) concerned the right of a legislature to make a change in the number and mode of appointment of the trustees or managers of a corporation, we cannot assent to the theory that an express reservation of the general power does not secure to the legislature the right to exercise it in this respect." It might well be asked, "Why not?" Why is it a necessary result that the reserved power, because inserted in the laws of the various states to overcome the principle of the Dartmouth College decision that a charter constitutes a contract between the state and the corporation, succeeded in the sense that it gave complete control to the states of the corporators' contracts? It is boldly suggested that if the Dartmouth College Case were to arise to-day, it should, notwithstanding the reserved power clauses, be decided exactly as it was in fact decided in 1819, only on other grounds than those on which the opinion rested. It is likewise suggested that the only possible method of evading the result of the Dartmouth College Case is to repeal that section of the Federal Constitution which forbids the impairment of the obligation of contracts, and that nothing short of such repeal can give to the state any control over the charters or articles of association of corporators in so far as these represent their contracts *inter se*.

The fact that in *Looker v. Maynard* the act of the state in question merely authorized the stockholders to vote cumulatively and did not compel them so to do is evidently immaterial; in fact, it makes the opinion more questionable as a correct exposition of legal principles. It is clear that the state cannot put into the power of a majority (or any number less than all) of the stockholders to do, in this respect, what it cannot itself do directly.⁷⁷ If it cannot itself directly impair the contract of the corporators, still less can

⁷⁷ *Vice versa*, however, if the state can constitutionally impose an amendment compulsorily upon a corporation, there would seem to be no substantial reason why it cannot do so in the shape of a permission or offer to the majority or any other number of incorporators. See on this point note concerning *Gardner v. Hope Insurance Co.*, 9 R. I. 194 (1869), in the first part of this paper.

it authorize some of them at their pleasure to change or impair it as against their fellows. Making the act permissive instead of mandatory renders it all the more remote from the original purpose which the reserved power clauses were intended to accomplish. "The legislative reservation is in the nature of a police power designed for the protection of the public welfare, and where such protection becomes necessary, the law-making power may act without consulting either the interests or will of the company, and in such case it may well be that not only the company but its stockholders must submit to the legislation thus imposed upon them," says Mr. Justice Gordon in *Cross v. Peach Bottom Railway Company*, 90 Pa. St. 392 (1879), and continues: "Where, however, this legislation results from the motion and for the benefit of the corporation, the case is different; for when an alteration in the charter is made on the suggestion of the company itself, the Act of 1849 has nothing to do with the case; the legislature always had such power. The reservation in the act just named was only intended to enable the legislature to act without the consent and against the will of the corporation."

Following or anticipating the views and authority of our highest national tribunal, the decisions in most of the state courts are to the effect that the state may, under its reserved power of amendment or revocation of charters of incorporation, regulate and control, either compulsorily or by way of permission to some of the stockholders, the scheme of management of the corporation; that it may change the number and method of election of the directors and other officers, arrange and at its will change the proportion of control over the management and assets that each of the incorporators is to have, dictate changes in the amount and kinds of the capital stock of the company, and alter the scope and nature of the corporate enterprise. Thus changes in the method of voting among the stockholders or the forced introduction of new corporators to voting privileges have been sanctioned in *Hyatt v. Esmond*, 37 Barb. (N. Y.) 601 (1862), in *Commonwealth v. Bonsall*, 3 Whart. (Pa.) 559 (1838), in *Harper v. Ampt*, 32 Ohio St. 291 (1877) (*dictum*), in

Cross v. West Virginia Central and Pennsylvania Railway Co., 35 W. Va. 174 (1891), and in *Gregg v. Granby Mining and Smelting Co.*, 164 Mo. 616 (1901).⁷⁸ The only cases contra to these are to be found in the jurisdictions of New Jersey and Kentucky. In *the Matter of the Election of Directors of the Newark Library Association*, 64 N. J. L. 217 (1899), the original charter of the library association had provided that each stockholder was to have one vote for each share held by him not exceeding five shares, and one vote for every five additional shares. The charter was subject to the reserved power, and by a subsequent act the legislature gave to the stockholders one vote for each share held by them. The court held that the act was unconstitutional, saying, per Mr. Justice Van Syckle: "The power reserved by the legislature in the Act of 1846 to alter, suspend, and repeal relates to those matters which concern the public, and not to the mode of controlling the affairs of the stockholders *inter sese*. The legislature may alter or repeal the charter and extinguish the corporate existence of the association, but it is without power to take away from the shareholders the property which they have acquired during its existence, and the Act of 1846 does not reserve the power to affect or change the rights of the incorporators as between each other. The method of voting prescribed in the charter is part of the contract between stockholders. It relates to the manner of controlling the association and its property represented in their shares as between themselves. It in nowise affects the public, and it is a contract which cannot be impaired by legislation." In *Orr v. Bracken County*, 81 Ky. 593 (1884), the same result, on somewhat similar facts, was reached, although the New Jersey cases alone give a clear exposition of the reasons dictating this conclusion.⁷⁹

⁷⁸ The cases all admit that the legislature could not, in the absence of a reserved power of amendment, authorize a majority of the stockholders to adopt the system of cumulative voting if the minority stockholders dissent. See *State v. Greer*, 78 Mo. 188 (1883).

⁷⁹ In *Smith v. Atchison, Topeka and Santa Fe R. R. Co.*, 64 Fed. Rep. 272 (1894), a change to cumulative voting, authorized by the legislature, was held invalid as being an improper exercise of the reserved power, where there was an express limitation on that power that its

In questions concerning legislative changes in the internal organization of the corporation and in the amount and kind of its capital stock the great weight of authority similarly follows the position taken by the Federal Supreme Court. Some of these cases rest on the doctrine that the legislature may, even without any reserved power of alteration, make immaterial changes in the organization of the corporation, or changes subserving the original purpose and intent of the corporation, and that the changes in question in these cases come under this class. Others of them rest on the frank admission that the legislation complained of would not be sustainable but for the reserved power, which is held to give practically complete control over the corporate organization and affairs. In *Curry v. Scott*, 54 Pa. St. 270 (1867), an act was sustained as against the dissent of a minority stockholder, allowing the directors of a railroad company to issue a preferred stock the holders of which were to have the right to vote at all elections, and in addition to the dividend first payable to them to share equally in all remaining dividends with the common stockholders of the company.⁸⁰ In *New Haven and Derby R. R. Co. v. Chapman*, 38 Conn. 56 (1871), the state authorized the city of New Haven to subscribe to the capital stock of a railroad company and to appoint two directors therein, although the original charter had provided that the stockholders were to choose their own directors as soon as a certain amount of the capital stock had been subscribed; this amount had been subscribed and the company had organized and selected its directors. The court held that the change effected by this act of the state did not release a stockholder from liability

exercise should "in nowise conflict with any right vested in such corporation by its charter." The decision was placed on the ground that the right to vote stock on the non-cumulative plan had been repeatedly held to be a vested property right, and, therefore, the proposed change could not be made without the consent of all the stockholders.

⁸⁰ Nothing is said in the case about the reserved power of the state, but the company was incorporated under the general Railroad Act of 1849 in Pennsylvania, and was therefore subject to the reserved power provided for in section 20 of that act.

to the company on his stock subscription.⁸¹ In the important cases of *Berger v. United States Steel Corporation*, 63 N. J. Eq. 809 (1902), and *C. H. Venner Co. v. United States Steel Corporation*, 116 Fed. Rep. 1012 (1902), the question involved was the constitutionality of an act of the state of New Jersey authorizing a corporation by an approving vote of two-thirds in interest of each class of stockholders to redeem and retire its stock. A stockholder of the United States Steel Corporation who disapproved of this action applied for an injunction against the two-thirds majority to restrain them from retiring the preferred stock of the company. The injunction was refused. In the New Jersey case the principle of *In re Newark Library Association, supra*, was admitted, but the court said, by way of *dictum*, that the reserved power clause in the Act of 1896, under which *Berger v. United States Steel Corporation* arose, was much broader in its scope than the Act of 1846 which had determined the former case;⁸² the decision itself, however, was placed upon the ground that the provisions of the original charter justified the retirement of the stock in question, and that the question was not dependent, therefore, upon the validity of the subsequent act of the legislature. The Federal case, upon exactly the same facts, rested its decision solely upon the reserved power of the state, citing and following *Looker v. Maynard, supra*. In several cases

⁸¹ The decision was placed on the ground that the change was not one which essentially altered the nature and character of the corporation. The extent of the state's power under its reserved right of amendment of the charter was not discussed.

⁸² It is difficult to see why. The language of the Act of 1846 was that "the charter of every corporation which shall hereafter be granted by the legislature shall be subject to alteration, suspension, and repeal in the discretion of the legislature." The Act of 1896 provided, in addition to these words, that "this act may be amended or repealed at the pleasure of the legislature, and every corporation created under this act shall be bound by such amendment; . . . this act and all amendments thereof shall be a part of the charter of every corporation heretofore or hereafter formed hereunder, except so far as the same are inapplicable and inappropriate to the objects of such corporation." It is doubtful whether this phraseology conveys more power to the state in law than the other, but even if so intended and so expressed, the question is not, as has been pointed out, what power the state seeks in its constitution or statutes to reserve over the contract of the incorporators *inter se*, but what amount of power it constitutionally can reserve.

the reserved power has been held to justify authority given by the state to a majority or other number less than all of the stockholders to increase or reduce the capital stock as compared with that originally agreed to by the incorporators in their articles of association; in such cases, for example, as *Joslyn v. Pacific Mail Steamship Co.*, 12 Abb. Pr. Rep. N. S. (N. Y.) 329 (1872); *Buffalo and New York City R. R. Co. v. Dudley*, 14 N. Y. 336 (1856), and *Troy and Rutland R. R. Co. v. Kerr*, 17 Barb. (N. Y.) 581 (1854).⁸³ A more fundamental change in the corporate organization was that sustained in *Jackson v. Walsh*, 75 Md. 304 (1892), where the same kind of legislation was attempted as in the Dartmouth College Case,—a provision for a greater number of trustees, most of whom were to be officials of the state government,—and the validity of this provision was upheld as being a valid exercise of the reserved power.⁸⁴ And as final types of this class of cases may be cited *Grobe v. Erie County Mutual Insurance Co.*, 169 N. Y. 613 (1899), and *Nazro v. Merchants' Mutual Insurance Company of Milwaukee*, 14 Wisc. 295 (1861), in which insurance companies which had been mutual companies were authorized to convert themselves into joint-stock companies, in the former case provided the president and three-fourths of the directors so desired, although the charter originally had provided that the assent of two-thirds of the incorporators was necessary for this purpose, and in the latter case provided the trustees of the company wished to make the change, although the charter had not provided for the possibility of any such conversion of the organization and purpose of the corporation.⁸⁵

⁸³ Contra: *Zabriskie v. Hackensack and New York R. R. Co.*, 18 N. J. Eq. 178 (1867).

⁸⁴ Contra: *Sage v. Dillard*, 15 B. Monr. (Ky) 340 (1854); not so much, however, on the ground that the state had no power over the contract of the incorporators *inter se*, as that "the power to alter or amend a contract, in our conception, is to change it as between the original parties, and such others only as have been permitted, by their mutual consent, to come into the enjoyment of its benefits and privileges; not to compel one of the parties to operate in conjunction with others, and share with them the privileges and benefits of the contract."

⁸⁵ In *Nazro v. Merchants' Mutual Insurance Co. of Milwaukee* the remarks of the court on the reserved power were *dicta*, inasmuch as

There are a number of cases in which, in harmony with the general principles of the preceding examples of the perverted application of this doctrine, legislation has been upheld as valid which in other and various ways changed the relation of the stockholders to one another by giving to some of them as against the others more property in the distribution of assets or more rights of various kinds than the original articles of association had secured to them. Thus in *County Judge of Shelby County v. Shelby R. R. Co.*, 5 Bush. (Ky.) 225 (1868), a railroad company having exhausted its funds, and work on its construction being thereby suspended, the legislature amended its charter by authorizing the citizens of the county to subscribe to a certain amount of additional stock, and by providing that the original stockholders should not be entitled to certain conditional interest on their stock as had been stipulated for in the original articles of association. The court held the act constitutional under the reserved power. The decision is of less value as an authority in that it does not appear in the case that any of the original stockholders objected to the legislation reducing their right to interest on their stock. Again, in *Bailey v. Trustees of Power Street Methodist Episcopal Church*, 6 R. I. 491 (1860), a church association was incorporated, the act providing that the trustees could tax pewholders, provided a majority of the latter assented thereto. Under a power of amendment reserved in the act the legislature later altered the charter so as to allow the trustees to impose taxes on the pewholders without the necessity of any assent on their part. The act was sustained as a

the defendants were estopped under the particular facts of the case from claiming that the subsequent act of the state was invalid. Contra to these cases is *Schwarzwaelder v. German Mutual Fire Insurance Co.*, 59 N. J. Eq. 589 (1899), in which the court said, also by way of *dictum*, that "although the act under which the company was organized is subject to amendment, alteration, and repeal by the legislature, yet such amendment, alteration, or repeal can be effected only by the legislative power of that body, and its legislative power does not extend to the enactment of a law which impairs the obligation of a legal contract previously made. We are, therefore, of opinion that the defendant company has no power to transform itself into a joint-stock company against the will of any member who acquired the right of membership before the Act of 1899 was passed."

proper exercise of the reserved power. As a general rule, however, it is but fair to say that the courts have hesitated in upholding legislation which, under the guise of the reserved power, arbitrarily changes the method of distribution of corporate assets among the stockholders. The reluctance of the courts in these cases is apparently caused, not so much by appreciation of the argument that the state cannot, even under a reserved power, impair the obligation of the contract among the incorporators, as by a desire to avoid the violation of vested property rights. This is shown in the case of *Fisher v. Patton*, 134 Mo. 32 (1895), in which the by-laws of a building and loan association provided that when the assets of the association were sufficient to make each share worth in cash the sum of \$200, the directors should pay to each stockholder that amount for each share owned by him on which no loan had been made, and should then dissolve the company. The legislature, acting professedly under its reserved power of amendment, subsequently passed an act providing that in paying out these shares the "free or unborrowed shares shall in no case receive more than the face value of the shares less the average premium paid by the borrowers of the association up to date." Under this act the plaintiff, one of the shareholders, would have received for each of his shares \$158 instead of the \$200 provided for in the original by-laws of the company, and he brought a bill in equity praying an injunction to restrain the directors from proceeding under the act. The injunction was granted. The court admitted that the legislature had the power, in general, to amend the charter and by-laws made thereunder, but "we do not concede that such power of repeal can affect contracts existing at the time the amending act is passed. The amendatory act cannot affect vested rights, and plaintiff's rights are vested. This association, so far as any stockholder not consenting to the amendatory act is concerned, must be held to the agreement and contract made, which guaranteed to each stockholder, the owner of shares not pledged, \$200 in cash on each share of stock owned by him before or at dissolution." The same principle was involved, and the same decision reached upon the

same reasoning, in *Hill v. Glasgow R. R. Co.*, 41 Fed. Rep. 610 (1888),⁸⁶ where an act, passed under the reserved power, provided that the proceeds from the sale or lease of the company's railroad should, after payment of the corporate debts, be first applied in payment of certain municipal bonds which had been given in exchange for stock of the company issued to the municipality. "If the legislature had, under the reserved powers, repealed the charter," said the court, "and given the assets and property of the company, after the payment of its debts, to only two of its stockholders, designated by name, can it admit of any question that such legislation would have been unconstitutional and void, so far as it undertook to dispose of the surplus corporate property? We think not. After the payment of debts, corporate assets belong and must be distributed equally and ratably among the stockholders therein, as the beneficial owners thereof. This equality of ownership and right of ratable distribution in surplus assets of the corporation, acquired before amendment or repeal of the company's charter, cannot be defeated or impaired by such amendment or repeal. It is a valid right of property, which does not fall within the power to deal with the privileges and franchises of the corporation. The legislature could not, by repeal or amendment of the charter, bestow all the surplus property of the corporation upon certain stockholders to the exclusion of others; nor could it lawfully direct that such corporate property or funds should be applied to the payment of the indebtedness of a portion of the stockholders of the company."⁸⁷

⁸⁶ It is to be noted that the reserved power in this case was qualified by a provision that "whilst privileges and franchises so granted may be changed or repealed, no amendment or repeal shall impair other rights previously vested."

⁸⁷ See also *Oldtown and Lincoln R. R. Co. v. Veazie*. 39 Me. 571 (1855). The charter of a railroad company required a minimum subscription of eleven thousand shares. The defendant subscribed for one thousand shares. Before the eleven thousand shares were subscribed for, the legislature reduced the minimum to eight thousand shares. In an action by the company to recover assessments levied on the defendant's shares it was held that this act released the defendant from liability on his stock subscription, as the original minimum of eleven thousand shares to be subscribed was a condition precedent to

By far the most important and apparently most unjustifiable cases in which the courts have overlooked the argument contended for, that the state's reserved power over the charter does not and cannot give to it the right to alter

be filled by the corporation before the defendant's shares were to be liable to assessment. The court said that "It is the charter only and the rights and liabilities of the corporation and of its corporators, as such in consequence thereof, that can be varied by an act of the legislature, and not the private contracts made between the corporation as one party and of its corporators as the other."

It has already been pointed out that the legislature may authorize some immaterial changes in the charter of a corporation which will not release dissenting stockholders, even where there is in the charter or in the laws controlling it no reservation of the power to alter or repeal it. This is on the theory, apparently, that every contract is entered into with reference to the possibility of slight changes to be effected therein on the part of the legislature—in other words, that legislation with reference to or affecting a contract does not necessarily impair it. Many cases in which the opinion of the court rests the decision upon the right of the legislature under the reserved power may be explained and justified as changes in the charter which the state might have made even in the absence of a reserved power. Such cases include those in which the subsequent legislation of the state authorizes a change in the name of the corporation, as in *Phinney v. Trustees of Sheppard and Enoch Pratt Hospital*, 88 Md. 633 (1898); or extends the time for the beginning or the completion of the undertaking for which the company was chartered, as in *Agricultural Branch R. R. Co. v. Winchester*, 95 Mass. 29 (1866), *Poughkeepsie and Salt Point Plankroad Co. v. Griffin*, 24 N. Y. 150 (1861), *Union Hotel Co. v. Hersee*, 79 N. Y. 454 (1880); or authorizes a change of location of the principal office or place of operations of the company to another state, as in *Park v. Modern Woodmen of America*, 181 Ill. 214 (1899), *Bryan v. Board of Education of the Kentucky Conference of the Methodist Episcopal Church, South*, 151 U. S. 639 (1893); or authorizes a modification of the route of a railroad company, as in *Pacific R. R. Co. v. Renshaw*, 18 Mo. 210 (1853), *Pacific R. R. Co. v. Hughes*, 22 Mo. 291 (1855), *Story v. Jersey City and Bergen Point Plankroad Co.*, 16 N. J. Eq. 13 (1863); or authorizes a receiver who has taken charge of the assets of an insolvent mutual insurance company to make the assessments on the premium notes of the policy-holders that the directors of the company might have made under the charter of incorporation, as in *Hyatt v. McMahon*, 25 Barb. (N. Y.) 457 (1857); or grants to the corporation additional powers tending better to carry out the original purposes of the company, as in *Northern R. R. Co. v. Miller*, 10 Barb. (N. Y.) 260 (1851), *Sprigg v. Western Telegraph Co.*, 46 Md. 67 (1876) (a decision which, however, is questionable, because among the additional powers granted seems to have been the power to consolidate with and to lease other lines, as to which see discussion *infra*).

It is clear also that the stockholders cannot plead a release of the obligations on their contract *inter se* by changes in the charter which, though material, the legislature has the right to make under its reserved power—for example, an increase in the liability of stockholders to creditors of the company. See *South Bay Meadow Dam Co. v. Gray*, 30 Me. 547 (1849).

or impair the charter so far as it represents a contract among the incorporators, are those in which legislatures have been allowed to change, or to authorize some of the incorporators to change, the basic purpose and nature of the enterprise for which the company was chartered. It would seem to be clear, beyond the necessity of proof, that where the incorporators have contracted among themselves to enter into a railroad venture, and have applied to the state for a charter for this purpose, the state should not, merely because of the power reserved to repeal or amend the charter, be allowed to compel the incorporators to change their business from that of railroading to that of a general department store; or that where the incorporators have pledged themselves to the building and operation of a railroad between points A and B and have received a charter to enable them to do this, the state should not be permitted to compel them, or to authorize some of them to compel the others, to change the enterprise to the construction and maintenance of a railroad between points C and D or between points A and C. And yet the states have frequently employed the reserved power to authorize the majority of the stockholders in a corporation to change the scope and nature of the corporate enterprise—in other words, have sought to give to some of the parties to a contract to which the state is not a party the right to change that contract against the dissent of the other parties thereto—a most curious perversion of the logical and historical purpose of the reserved power clauses! In the case of railroads, the majority of the incorporators have been allowed to take advantage of legislative authority to change the termini of the road from those named in the charter, and dissenting stockholders have been held not to be released thereby from the obligations contained in their contracts of subscription to the stock of the company.⁸⁸ So the majority stockholders have been given permission to sell all of the property and assets of the corporation,⁸⁹ and to invest

⁸⁸ *Buffalo and New York R. R. Co. v. Dudley*, 14 N. Y. 336 (1856); *Schenectady and Saratoga Plankroad Co. v. Thatcher*, 11 N. Y. 102 (1854); *Troy and Rutland R. R. Co. v. Kerr*, 17 Barb. (N. Y.) 581 (1854).

⁸⁹ *Allen v. Ajax Mining Co.*, 77 Pac. Rep. (Mont.) 47 (1904).

part of the capital of a railroad company in a subscription to the stock of another road.⁹⁰ The argument in most of these cases is that the corporators, by becoming stockholders in a corporation whose charter is subject to the reserved power, impliedly consent thereby to any changes which the legislature of the state may make or authorize therein. Some of them rest on the less objectionable assumption that the changes authorized are not radical or fundamental—an argument which would imply that the state might have effected the same changes had there been no express reservation of power at all.

That this latter doctrine is not explanatory, however, of the real position of the courts on this question is to be seen in those cases, not few in number, in which the right of the state is upheld to authorize, with less than a unanimous consent of the stockholders, the consolidation of a corporation subject to the reserved power with other corporations. If there is any change in a company which the state, in the absence of a reserved power, could not authorize a mere majority of the corporators to effect, it is this. The cases are numberless and uniform in holding that a dissenting stockholder may enjoin his fellow stockholders from changing the enterprise by consolidating with other corporations, and thus embarking the corporate property in an undertaking other than that in which they had originally agreed to invest it, and it is immaterial for this purpose whether or not the state has authorized such action, since the state cannot impair the obligation of the stockholders' contract.⁹¹

⁹⁰ *White v. Syracuse and Utica R. R. Co.*, 14 Barb. (N. Y.) 559 (1853).

⁹¹ *McCray v. Junction R. R. Co.*, 9 Ind. 358 (1857); *Clearwater v. Meredith*, 1 Wall. 25 (1863); *Lauman v. Lebanon Valley R. R. Co.*, 30 Pa. St. 42 (1858). In the last-named case the court, per Chief-Justice Lowrie, says: "Then what valid objection can a dissenting stockholder of a private corporation have to such an arrangement as the one now proposed? He may object that it is a violation of the contract of association by which he and his associates agreed to become one corporate company for a given purpose; that he united in the association for one purpose, then agreed on, and now the majority are diverting their capital to a different purpose. This is a violation of chartered contracts, not the supposed one between the government and the corporators, but the one between the corporators themselves. He may object that his co-corporators have no power to make a new

Yet under the reserved power of alteration or amendment of the corporate charter the courts have allowed this to be done.⁹² Says the Supreme Court of California in *Market Street Railway Company v. Hellman*, 109 Cal. 571 (1895): "The objection that the proceedings under which the consolidation was had were violative of the constitutional rights of non-consenting stockholders does not call for extended comment. . . . In England there is no restriction on the power of Parliament to amend a charter. . . . In this state, where the power is expressly reserved to the legislature by our constitution, the right should equally exist. The contract of the stockholders was made in view of the existence of our constitutional provision, which entered into and formed a part of the charter as effectually as did the statutes under which the corporations were organized." And in a very recent case, *McKee v. Chautauqua Assembly*, 130 Fed. Rep. 536 (1904), the court says, to the same purport: "Such changes were sanctioned by the members in advance. Every member who enters into such an association is aware of the reservation of the power of the legislature and of the possibility of its exercise, and must trust to the wisdom and justice of the legislature that the power will not be abused;

contract for him, and thereby constitute him a member of a new and different corporation; for it is of the very nature of a contract relation that it can be instituted only by the real parties to it; unless it be a mere constructive contract, which is only a convenient form or fiction of law, invented to enforce a corresponding legal duty. He may object that even the legislature cannot authorize this, for by doing so they would authorize the destruction of one private contract, and the compulsory creation of another in its stead, and would take away the remedy by due course of law which the dissenting stockholder is entitled to because of the departure or diversion of the association from its agreed purposes, and would, besides this, change the essential nature of contracts, which even legislative power cannot do, and much less legislative authority, . . . It is plain enough that a dissenting member cannot thus be forced into a new corporation, and that his property in one corporation cannot be taken from him and the stock of another imposed upon him by way of compensation, by the act either of the legislature or of his co-corporators, or of both combined."

⁹² *Durfee v. Old Colony and Fall River R. R. Co.*, 87 Mass. 230 (1862); *Bishop v. Brainerd*, 28 Conn. 289 (1859); *Hale v. Cheshire R. R. Co.*, 161 Mass. 443 (1894); *Market Street Railway Co. v. Hellman*, 109 Cal. 571 (1895); *Hanna v. Cincinnati and Fort Wayne R. R. Co.*, 20 Ind. 30 (1863); *McKee v. Chautauqua Assembly*, 130 Fed. Rep. 536 (1904).

and those who become members contract subject to the reservation of power, and the courts are bound to read their agreement with the legislative condition.”

If these cases be correct, we are indeed confronted with grave possibilities in legislation. Many of the states have recently passed consolidation acts,—acts permitting corporations to consolidate when a majority of the stockholders in each company consents thereto. Thus in Pennsylvania the Act of May 29, 1901 (P. L. 349), allows any two corporations to merge or consolidate, and the company born of such consolidation is to have all of the property, rights, franchises, and privileges thitherto possessed by either of the constituent companies. If this act be valid as to existing corporations, a minority stockholder may wake one morning to find that the stock which he had bought in a railroad company has become, by consolidation, stock in a mining company or in a mercantile enterprise. True, some provision is made for dissenting stockholders in that the company formed by the consolidation may, at its option, buy the stock of such dissenting stockholders, or pay to them the damage sustained by them as a result of the consolidation. But even this relief does not afford protection, because the option gives to the corporation the power practically to compel the dissenting stockholders to take stock in the new company. Is such legislation always to be sustained by the courts, as it has been in the cases which have been cited and considered? Are all stock investments to be placed at the mercy of the legislatures by a power which was intended to give to the state control merely over the corporate franchises, not to privilege some of the corporators to change their contract with their fellows? Are the states to continue to exercise this power over private contracts—a power which the Constitution in both letter and spirit forbids to them? There are but three cases in all the reports which, in the principles they enunciate, hold out promise of a more rational and saner exposition of the law.⁹³ In *Zabriskie v. Hackensack*

⁹³ See also *dicta*, however, to the same effect in *Snook v. Georgia Improvement Co.*, 83 Ga. 61 (1889); *Cross v. Peach Bottom Railway Co.*, 90 Pa. St. 392 (1879), and *Mills v. Central R. R. Co. of New*

and *New York R. R. Co.*, 18 N. J. Eq. 178 (1867), a railroad company was incorporated for the purpose of constructing and operating a railroad from Hackensack, New Jersey, to the Peterson and Hudson River Railroad. The charter was subject to the state's reserved power of amendment, and, acting thereunder, the legislature passed an act authorizing the company to extend its road northwardly to Nanent, on the line of the Erie Railway in the State of New York. A majority of the stockholders voted to adopt this extension of the road; a dissenting stockholder applied for an injunction to restrain the corporation from thus extending its route. The court granted the injunction, and said, in speaking of the state's reserved powers of amendment of the charter: "The object and purpose of these provisions are so plain, and so plainly expressed in the words, that it seems strange that any doubt could be raised concerning it. It was a reservation to the state, for the benefit of the public, to be exercised by the state only. The state was making what had been decided to be a contract, and it reserved the power of change, by altering, modifying, or repealing the contract. Neither the words, nor the circumstances, nor apparent objects for which this provision was made, can, by any fair construction, extend it to giving a power to one part of the corporators as against the other which they did

Jersey, 41 N. J. Eq. 1 (1856). In *Mowrey v. Indianapolis and Cincinnati R. R. Co.*, 4 Biss. (U. S.) 78 (1866), the court intimates that the state could not authorize a consolidation of two corporations without the unanimous consent of the stockholders, but it is believed that a close reading of the case will show that the decision does not extend so far; it merely construes the act in question to require a unanimous assent of the corporators in order to consolidate. The famous *Pennsylvania College Cases*, 13 Wall. 190 (1871), are not in point. They deal rather with the question as to how far the legislature can, under the reserved power, alter a contract existing between the corporation and a third person. The opinion contains, however, the broad *dictum* that "charters of the kind may certainly be altered, modified, or amended in all cases where the power to pass such laws is reserved in the charter or in some antecedent general law, nor can it be doubted that the assent of the corporation is sufficient to render such legislation valid, unless it appears that the new legislation will have the effect to change the control of the institution, or to divert the fund of the donors to some new use inconsistent with the intent and purpose for which the endowment was originally made." By "assent of the corporation" the court evidently means the assent of a majority of the corporators.

not have before. *It was to avoid the rule in the Dartmouth College Case, not that in Natusch v. Irving,*⁹⁴ *that the change was made.* The words limit the power to that object. . . . The only construction to be given is, that the legislature may alter, not that the stockholders may as between each other." Again, in *Kenosha, Rockford and Rock Island R. R. Co. v. Marsh*, 17 Wisc. 13 (1863), the same principles were advocated and sustained. A railroad company had been chartered to build a railroad from Kenosha to Beloit in the state of Wisconsin. Subsequently the legislature authorized a change of the terminal point from Beloit to the Wisconsin-Illinois state line, and also authorized the company to consolidate with a railroad company incorporated in Illinois. These changes were adopted by the company. In an action on a stock subscription the defendant contended that these alterations in the original scope and purpose of the company's enterprise released him from liability, and the court upheld this contention, although the charter of the company was subject to the reserved power of the state. "This power," said the court, "was never reserved upon any idea that the legislature could alter a contract between a corporation and its stock subscribers, nor for the purpose of enabling it to make such alteration. It was solely to avoid the effect of the decision that the charter itself was a contract between the state and the corporation, so as to enable the state to impose such salutary restraint upon these bodies as experience might prove to be necessary. . . . In all cases where charters are changed, the right to bind stock subscribers who do not assent seems to me to derive no additional support from the fact that the power of amending the charter had been reserved, but to depend essentially upon the question whether the change is of such a character that it may be deemed so far in furtherance of the original undertaking, and incidental to it, as to be fairly within the power of the corporation to bind its individual members by its corporate assent, or whether it is such a departure from the original purpose that no member should

⁹⁴ See *supra*, first part of paper.

be deemed to have authorized the corporation to assent to it for him. . . . An amendment of this kind, merely authorizing the substitution of a new enterprise for the old, has precisely the same effect that it would have had if there had been no power reserved to amend the charter. The legislature does not profess to make it obligatory. They grant it as a power to be accepted if the company chooses to accept it, otherwise not. This is just what they might have done if the power of amendment had not been reserved. And it seems to me that the question whether an individual subscriber was bound or not by the corporate assent should be determined by the same principles in either case." And, finally, in *Dow v. Northern R. R. Co.*, 36 Atl. Rep. (N. H.) 510 (1887), there is an elaborate opinion by Chief-Justice Doe as to the constitutionality of an act authorizing a railroad company to lease its entire road for ninety-nine years without there being a unanimous vote of the stockholders approving such a lease. The act was held to be invalid, and this for the reason that the disposition in this way of all of the assets and plant of the corporation was held to work a radical, fundamental change in the corporate enterprise, and therefore could be enjoined by a dissenting stockholder, even though the charter of the company was subject to the power on the part of the state to alter or repeal it, because this reserved power did not and could not give to the state the power to alter the contract of association of the corporators.

What is contended, then, in this paper is, briefly summarized, this: That the reserved power clauses were inserted in the constitutions and general statutes of the states only in order that the states might retain power over corporations in so far as the grant of franchises—that is, the contract between the state and the corporation—is concerned, being intended to give to the states control over the corporation in the nature of a supervisory police power, and to prevent a legislature from giving away irrevocable property rights in the nature of exemptions from public duties. That the reserved power was not introduced to enable the state, either directly or by way of permission given to some of the corporators as against the others, to

alter the contract of association existing among the stockholders of the company, even though that contract might be formally expressed in the charter over which the power was reserved. That whatever, however, may have been the *intention* of the reserved power clauses, the state has not the constitutional *power* to reserve to itself a right to alter or repeal the contract of the corporators any more than it could reserve such a power over the contracts of partners, of unincorporated associations, or of private contracts in general. That, therefore, although it may be admitted that the state, without thereby releasing dissenting stockholders, can make immaterial changes, changes which are not radical or important, in regard to the charter contract even in so far as it represents the contract among the corporators, yet this power derives no additional force from the reserved power clauses, but exists independently of them; and whatever changes of this kind cannot be made where there is no reserved power of amendment or revocation of the charter cannot be made by the state where such a reserved power exists. That the state cannot gain power over a contract over which it otherwise would have none merely because such contract is, by an accident of history and legal procedure, formally embodied in an instrument over which, in a different aspect, the state can legally reserve rights of amendment or repeal; for, if it were otherwise, the states could acquire for themselves any otherwise forbidden powers, merely by having them, or the subjects which they are intended to concern, inserted in some form in the charters of incorporation thereafter granted. In short, that the stockholders are, as a group, subject in their corporate capacity to the reserved power of the state, but that their contract among themselves is as much under the protection of the Constitution forbidding the impairment of the obligation of contracts as is any other contract. Therefore the state may, under the reserved power, say to a corporation, "We enact certain amendments qualifying your original privileges;" but it cannot say, "We enact amendments changing the organization and nature of the enterprise of your company as originally determined upon by your mem-

bers;" or to some of the stockholders, " We give to you the privilege, if you desire to use it, of changing the contract into which you have entered with your fellow corporators."

If these contentions be correct, almost the entire law on the subject of the control of the states over corporations must be rewritten. It is of importance that it should be so rewritten, for it is submitted that the law, as it now stands, is illogical and historically incorrect, and, further, that under it no investments in the stock of any corporations can safely be made, for the entire organization and purpose of a corporation may at any time be changed by legislative enactment notwithstanding the protests of minority stockholders. Even policy, therefore, does not dictate in this case the necessity of fallacious reasoning. There is no apparent reason why the states should have any more power to annul or alter corporators' contracts *inter se* than to revoke or amend any other contracts. If the people of the United States think differently, they may find means to accomplish their desire, but it is submitted that those means are to be found only in an amendment to the Federal Constitution limiting in this respect the impotence of the states to impair the obligation of contracts. It is not believed that any such amendment would be desirable, but that, on the contrary, it would be in the highest degree impolitic.

Horace Stern.

(To be concluded.)