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CORPORATIONS—AMENDMENT OF CORPORATE CHARTERS—POWER OF THE LEGISLATURE TO AUTHORIZE CHANGES IN INTRACORPORATE AFFAIRS—In 1819, in the leading *Dartmouth College* case,[1] Justice Story suggested that a state might easily retain control over its corporations by the simple expedient of reserving the power to alter, amend,

[1] Trustees of Dartmouth College v. Woodward, 4 Wheat. (17 U. S.) 518 at 712, 4 L. Ed. 629 (1819).

or repeal the charter.[2] The states were quick to accept the suggestion, but the real extent of this reserved power has never been definitely ascertained. A minority of the state courts,[3] led by New Jersey, have held that this reserved power extends only over the contract between the state and the corporation; whereas a great majority have adopted the view that it extends over the contract between the corporation and the stockholders and the contract among the stockholders as well, so long as the exercise of the power does not impair vested rights or defeat or impair the object of the grant.[4] But when it comes to defining a vested right those courts have split on nearly every situation that has arisen.

A recent case in the Delaware Court of Chancery, *Keller v. Wilson & Co., Inc.*,[5] brings up the question of the power of the state, within a general reservation clause, to authorize the majority of the stockholders of a corporation to adopt an amendment which they had no power to adopt at the time of the incorporation. This case, taken with the earlier Delaware decision in *Davis v. Louisville Gas & Electric Co.*,[6] strongly intimates that the state has the power to authorize the impairment of a vested right. The right which the dissenting stockholder lost in the *Keller* case was the right to receive $21.75 per share of accrued and unpaid dividends on preferred stock. Twelve years before [7] the same chancellor had held that same right to be vested. This case, then, squarely presents the problem of when the state has gone beyond its legislative power in authorizing changes in corporate charters against the will of a minority of the stockholders.[8] No court has ever precisely defined that point, but it is submitted that the underlying approach of the courts to each situation has been uniform.

The proposition upon which the argument is based may be stated in two ways, both of which reach the same result in the end:

[2] The same suggestion was made in Wales v. Stetson, 2 Mass. 143 (1806).

[3] Zabriskie v. Hackensack & New York R. R., 18 N. J. Eq. 178 (1867); Garey v. St. Joe Mining Co., 32 Utah 497, 91 P. 369 (1907); Snook v. Georgia Improvement Co., 83 Ga. 61, 9 S. E. 1104 (1889). Cf. Stern, "The Limitations of the Power of a State Under a Reserved Right to Amend or Repeal Charters of Incorporation," 53 UNIV. PA. L. REV. 73 (1905).

[4] Morris v. American Public Utilities Co., 14 Del. Ch. 136, 122 A. 696 (1923); Allen v. Ajax Mining Co., 30 Mont. 490, 77 P. 47 (1904); Winfree v. Riverside Cotton Mills, 113 Va. 717, 75 S. E. 309 (1912); Close v. Glenwood Cemetery, 107 U. S. 466, 2 S. Ct. 267 (1883). The cases are collected in Curran, "Minority Stockholders and the Amendment of Corporate Charters," 32 MICH. L. REV. 743 at 747-750 (1934).

[5] (Del. Ch. 1935) 180 A. 584.

[6] 16 Del. Ch. 157, 142 A. 654 (1928).

[7] Morris v. American Public Utilities Co., 14 Del. Ch. 136, 122 A. 696 (1923).

[8] It should be pointed out that in the Davis case and the Keller case the corporate charters contained a right reserved to the corporation thus to comply with subsequent statutes, but the opinion of the Keller case strongly indicated that the court would have held the same way regardless.

(1) The reserved power of the state to alter and amend is, in effect, merely a branch of the police power of the state, and its only active limitation is the due process clause of the Fourteenth Amendment; or

(2) The limitations of the "contracts clause" of the federal Constitution upon the reserved power of the state to alter and amend is, in effect, precisely the same as that which the due process clause of the Fourteenth Amendment imposes upon any other legislative act of the state. Which of these is accepted will depend on the view that is taken regarding the nature of the police power—is it the sovereign power of the state to govern and control as stated in *Nebbia v. New York*,[9] or is it something less than that?[10] In either event the result is the same; and though this may not seem to get one much farther toward an intelligent forecast of the court's decision in a given situation, it should at least serve to simplify the attack on the mass of conflicting decisions as to what constitutes a vested right, and moreover to provide a justification for that apparent conflict.

It has always been conceded that the contract between the state and the corporation regarding the power of the corporation to act and to do business with the general public is subject to police regulations by the state legislature in the interests of public health, safety, morals, and the general welfare.[11] That power cannot be impaired by contracts between private individuals nor can it be bargained away by the state.[12] Generally speaking, the extent of such regulation is limited by a balance between the advantages to be derived by the public from a particular exercise of that power as compared with the individual rights taken away;[13] and a regulation which was once declared beyond the power of the legislature may today because of changed circumstances be well within due process.[14] As the conditions of modern life and business and the consequent requirements for the general welfare change, the power of the state in a given situation increases or decreases. It must be ad-

[9] 291 U. S. 502 at 524, 54 S. Ct. 505 (1934).

[10] Cf. Brown, "Due Process of Law, Police Power, and the Supreme Court," 40 HARV. L. REV. 943 (1927).

[11] Beer Co. v. Massachusetts, 97 U. S. 25 (1877); Noble State Bank v. Haskell, 219 U. S. 104, 31 S. Ct. 186 (1910); Treigle v. Acme Homestead Assn., 181 La. 941, 160 So. 637 (1935); 31 COL. L. REV. 1163 (1931); 32 COL. L. REV. 476 (1932). See also, Chicago & Alton R. R. v. Tranbarger, 238 U. S. 67, 35 S. Ct. 678 (1914).

[12] 2 COOLEY, CONSTITUTIONAL LIMITATIONS, 8th ed., 1237 (1927); Stone v. Mississippi, 101 U. S. 814, 25 L. Ed. 1079 (1879).

[13] Noble State Bank v. Haskell, 219 U. S. 104, 31 S. Ct. 186 (1910); Brown, "Due Process of Law, Police Power, and the Supreme Court," 40 HARV. L. REV. 943 (1927).

[14] Block v. Hirsh, 256 U. S. 135, 41 S. Ct. 458 (1920); Marcus Brown Holding Co. v. Feldman, 256 U. S. 170, 41 S. Ct. 465 (1920).

mitted that the courts have not generally discussed the state's power over the corporate contract inter sese along traditional lines of police power and due process, but it is submitted that the same considerations of balancing the equities between public and private interests have governed the courts in deciding whether a particular right of a stockholder is so vested that it cannot be taken away or impaired.[15]

Since the question directly involves the construction of the federal Constitution, it is imperative first to examine the decisions of the United States Supreme Court on the subject. Probably the most quoted passage is found in *Looker v. Maynard*,[16] in turn a paraphrase of many earlier statements, where it was said that the effect of the reserved power

> "is, at the least, to reserve to the legislature the power to make any alteration or amendment of a charter subject to it, which will not defeat or substantially impair the object of the grant, or any right vested under the grant, and which the legislature may deem necessary to carry into effect the purposes of the grant, or to protect the rights of the public or of the corporation, its stockholders or creditors, or to promote the due administration of its affairs." [17]

Clearly this is language of vested right of contract which cannot be impaired by state law, but it must be remembered that when the problem first arose in 1819 there was no constitutional limitation of due process on the states. The Court at that time recognized that there must be some limitation on the state's power to govern and control the corporations it set up, and the only applicable one was that "No State shall . . . pass any . . . Law impairing the Obligation of Contracts. . . ."[18] The Fourteenth Amendment was not adopted until 1868, and it was fully twenty years before it was finally decided that the due process clause limited the legislative powers of the state on matters of substantive law.[19] It was only natural that the language of the Court would follow that of the earlier decisions; [20] and it is notable that the

[15] The same theory was advanced in 31 COL. L. REV. 1163 at 1168 (1931): "The tendency of the courts to discover a vested right has varied directly with the practical importance of the interest destroyed by the alteration and inversely with the advantages of the change." Cf. also 7 N.Y. UNIV. L. Q. REV. 487 (1929).

[16] 179 U. S. 46, 21 S. Ct. 21 (1900).

[17] 179 U. S. 46 at 52, 21 S. Ct. 21 (1900).

[18] United States Constitution, Art. 1, § 10. See Stern, "The Limitations of the Power of a State Under a Reserved Right to Amend or Repeal Charters of Incorporation," 53 UNIV. PA. L. REV. 1 at 2 (1905), where the author said, "There is but little doubt that, had the fourteenth amendment then formed a part of the Constitution, Chief Justice Marshall would have sought protection for the corporations under that amendment, rather than under the clause forbidding states to impair the obligation of contracts."

[19] Corwin, "The Supreme Court and the Fourteenth Amendment," 7 MICH. L. REV. 643 (1909); Greenwood v. Freight Co., 105 U. S. 13, 26 L. Ed. 961 (1881).

[20] Cf. Sherman v. Smith, 1 Black [66 U. S. 587, 17 L. Ed. 163 (1861)], affirm-

most recent Supreme Court cases involving the control of the state over the contract inter sese were decided in 1904 [21] and 1907.[22] Nevertheless, as far back as 1872 [23] the Court justified a New York statute changing the number and the manner of electing the trustees of a corporation under the reserved powers, saying that since the organization of the corporation changed circumstances had "made new legislation necessary to the ends of justice." In effect, the extent of the reserved power over the internal affairs of the corporation was decided simply on the basis of necessity and expediency in the interests of all concerned.[24]

The states in turn, when left to apply the "glittering generalities" of the Supreme Court to concrete questions, found it best to adopt the same principles of balancing the good sought to be attained by the amendment over against the individual advantages thereby taken away. This fact is forcibly presented in *Yoakum v. Providence Biltmore Hotel Co.*,[25] where the court pointed out that "special circumstances" have entered into the decisions of the courts: "corporate needs, expediency, the plaintiff appearing as a professional obstructionist, a dominant public interest." [26] The court then went on to say that in that case there was no showing of a public interest nor even that the corporation would function better.[27] In *Lord v. Equitable Life Assurance Society*,[28] the New York Court of Appeals decided two points: first, that the state could authorize an amendment providing that new classes of stockholders could be enfranchised, and, second, that the holders of the old voting rights in the society could not be altogether deprived of their right to vote. Stating these results in terms of vested rights, the right to vote and to have some voice in the control of the society is a vested right which cannot be impaired, whereas the right to have the sole control of the society is not a vested right and can be taken away. Putting it in terms of the police power and the Fourteenth Amend-

ing In the Matter of Oliver Lee & Co.'s Bank, 21 N. Y. 9 (1860), wherein a constitutional amendment in New York which increased a stockholder's liability in the circulating notes of the bank was held valid under the reserved power.

[21] Wright v. Minnesota Life Ins. Co., 193 U. S. 657, 24 S. Ct. 549 (1904).

[22] Polk v. Mutual Reserve Fund Life Assn., 207 U. S. 310, 28 S. Ct. 65 (1907). Subsequent decisions of the Supreme Court have all involved the contract between the state and the corporation.

[23] Miller v. State of New York, 15 Wall. (82 U. S.) 478, 21 L. Ed. 98 (1872).

[24] It was this decision that formed the basis for holding in Looker v. Maynard, 179 U. S. 46, 21 S. Ct. 21 (1900), that a Michigan statute authorizing corporations to adopt cumulative voting did not "defeat or substantially impair" vested rights.

[25] (D. C. R. I. 1929) 34 F. (2d) 533.

[26] Ibid. at 546.

[27] Elsewhere in the opinion Judge Letts stated that the state has no power to impair the obligations of contracts to which it is not a party. If this is to be taken at its face value, it is clearly not the law.

[28] 194 N. Y. 212, 87 N. E. 443 (1909).

ment, to take away all voting rights deprives the individuals of too great a contract right without a commensurate public advantage and is not due process, whereas merely to admit new voters does not. In the course of the opinion the court said that the state

> "can regulate investments, methods of administration, and details of procedure in the interests of the public and of all concerned. The public is interested in the proper management of a company with such enormous assets as the defendant possesses, because, if for no other reason, these assets were mainly derived from the public. . . ." [29]

There is also a well-settled rule that the state may authorize an amendment, without impairing vested rights, when the same result could have been reached under the original charter, though in a more devious manner. In *Hinckley v. Schwarzschild & Sulzberger Co.*,[30] for example, it was held that the state could authorize the corporation to create a prior issue of preferred stock by a two-thirds vote rather than by a unanimous vote. Although this clearly cuts down the rights of the former stockholder to share in the corporate income, it was justified on the ground that the corporation already had the power to issue bonds and the effect on the old stockholders would be practically the same. Similarly, it is held that an issue of no-par stock may be authorized if the corporation has the power to change the par value of its outstanding stock.[31] The rationale of such decisions is that the stockholder is really not injured, or in terms of the police power, his interests are too minute to be of importance in the balance against the public interest.

What, then, is the public interest and how far does it extend? We may fully agree with the Supreme Court of Utah,[32] with Morawetz [33] and Cook,[34] and with other so-called strict constructionists, that the reserved power only extends so far as "the welfare and convenience of the public may require." [35] But at the same time we may advocate that the state's power of control extends just as far as its

[29] 194 N. Y. 212 at 237, 87 N. E. 443 (1909). In Attorney General v. Looker, 111 Mich. 498 at 506, 69 N. W. 929 (1897), the court stated that the nature of the corporation is important. "Is it a corporation in which the public is interested? . . . Is it not true that their [insurance companies'] incomes are largely drawn from the public, and that the proper or improper management of the company's affairs affects the public as well as the stockholders?" Then follows the bald statement that no vested rights are impaired.

[30] 107 App. Div. 470, 95 N. Y. S. 357 (1905).

[31] Grausman v. Porto Rican-American Tobacco Co., 95 N. J. Eq. 155, 121 A. 895 (1923).

[32] Garey v. St. Joe Mining Co., 32 Utah 497, 91 P. 369 (1907).

[33] 2 MORAWETZ, PRIVATE CORPORATIONS, § 1097 (1886).

[34] 2 COOK, CORPORATIONS, 8th ed., § 501 (1923).

[35] Garey v. St. Joe Mining Co., 32 Utah 497 at 509, 91 P. 369 (1907).

public interest requires. And if we add the proviso to be careful not to step too heavily on the toes of dissenting stockholders without good reason, we have the statement of *Looker v. Maynard*.[36] In a recent case in New Jersey,[37] the supreme court there upheld under the reserved power a retroactive statute regulating the right of withdrawal from a building and loan association. The court said that the reserved power was the police power, and justified its holding on the ground that the recent economic disorder made the legislation necessary to enable the corporation to keep afloat with a large supply of frozen assets and a panicky public. This decision carries us one step farther than the cases involving insurance companies [38] in showing that the public is directly interested in the welfare and financial success of corporations generally. More and more the business and economic structure of the country is being consolidated in the hands of corporations, and an economically sick corporation whose internal structure is inadequate to meet the demands of the business world is doing no one good.

An examination of the statutes regarding the incorporation of general corporations is also instructive in showing the extent to which the states have thought fit to control the corporations and the consequent extent of the public interest. Clearly such control is no more justified before incorporation than after unless there is a public interest involved.[39] The general corporation law of New Jersey in 1855 covers but six pages in Nixon's *Digest*,[40] and the special act setting up the Hackensack and New York Railroad in the following year is not much longer.[41] Neither one attempts to regulate the internal affairs of the corporation to any great extent. But compare with these the New Jersey general corporation act of 1910 [42] covering 149 sections and 80 pages, or more modern acts in Delaware [43] and Ohio,[44] equally long and equally concerned with the problems of internal management and corporate finance. Another important feature of many modern acts is

[36] Looker v. Maynard, 179 U. S. 46, 21 S. Ct. 21 (1900).

[37] Fornataro v. Atlantic Coast Building & Loan Assn., 10 N. J. Misc. 1248, 163 A. 240 (1932).

[38] Attorney General v. Looker, 111 Mich. 498, 69 N. W. 929 (1897); Lord v. Equitable Life Assur. Soc., 194 N. Y. 212, 87 N. E. 443 (1909); Looker v. Maynard, 179 U. S. 46, 21 S. Ct. 21 (1900); Wright v. Minnesota Mut. Life Ins. Co., 193 U. S. 657, 24 S. Ct. 549 (1904); Polk v. Mutual Reserve Fund Life Assn. Co., 207 U. S. 310, 28 S. Ct. 65 (1907).

[39] Though if a public interest is found, then the power before incorporation might be much more extensive, since the individual's right would only be freedom to contract rather than an existing contract right.

[40] N. J. Laws (Nixon 1855), 138-143.

[41] N. J. Acts (1856), 340-350.

[42] N. J. Comp. Stat. (1910), 1592.

[43] The amendments in Del. Laws (1929), 366-400 are illustrative.

[44] 2 Ohio Gen. Code (Page 1926), §§ 8623-8743, and as amended in 1929, Ohio Gen. Code (Page Perm. Supp. 1935), § 8623.

the section providing for the paying off of stockholders who dissent from certain acts of the majority.[45] In effect, this is simply a recognition by the state that in certain circumstances the stockholder should be protected from complete deprivation of his economic rights, and it is pointed directly at the due process clause.

Moreover, the analysis made by two recent writers on the subject [46] and the conclusions that they drew differentiating between vested and non-vested rights directly bear out the proposition with which we started. Dodd distinguished between those amendments which affect the enterprise as a whole and those which involve the individual rights of the dissenting stockholder. Cades drew the line between amendments which merely affect the management and control of the corporation and those which affect the beneficial interest of the stockholder. Each of these was an attempt to state where the courts have drawn the line so far, as if the law were crystalized today; yet in each it is clear that the deciding factor is the practical extent of the individual interest that is taken away from the stockholder. Curran,[47] though not attempting a general distinction between vested and non-vested rights, justified many decisions on much the same principles of public interest and private loss.

So far the writer has purposely refrained from discussing the recent decisions in Delaware. The real basis for the result reached in the *Keller* case is found in *Davis v. Louisville Gas & Electric Co.*[48] In that case the court freely admitted the threefold nature of the corporate charter, and it also admitted that the power of the state is limited to subjects which concern the public interest and welfare; but it concluded that the

> "problem of financing corporate needs is so vital to the continuance in existence of corporations created under this act, the matter of stock, its kinds, classifications and relative rights, is so intimately associated with that problem, that it is difficult to escape the conclusion that the character of the statutory regulations defined by the Legislature for the meeting of that problem might

[45] Ohio Gen. Code (Page Perm. Supp. 1935), §§ 8623-8672; 58 N. Y. Consol. Laws (McKinney Supp. 1935), §§ 38, 12, discussed in Matter of Silberkraus, 250 N. Y. 242, 165 N. E. 279 (1929). The Ohio Act of 1929 is analyzed by Dodd, "Amendment of Corporate Articles Under the New Ohio General Corporation Act," 4 UNIV. CIN. L. REV. 129 (1930); and see, Levy, "Rights of Dissenting Shareholders to Appraisal and Payment," 15 CORN. L. Q. 420 (1930).

[46] Dodd, "Amendment of Corporate Articles Under the New Ohio General Corporation Act," 4 UNIV. CIN. L. REV. 129 at 160 (1930); Cades, "Constitutional and Equitable Limitations on the Power of the Majority to Amend Charters so as to Affect Shareholders' Interests in the Corporation," 77 UNIV. PA. L. REV. 256 at 259 (1928).

[47] Curran, "Minority Stockholders and the Amendment of Corporate Charters," 32 MICH. L. REV. 743 (1934).

[48] 16 Del. Ch. 157, 142 A. 654 (1928).

> very well be regarded as affected with a public interest and concern. . . ."[49]

Further, the court pointed out that the state is interested in seeing that the corporation has power to meet its business and financial needs. It is unfortunate that the court in the *Keller* case refused to discuss the point there raised that the individual rights destroyed in that case were of much greater importance and dignity than those under consideration in the *Davis* case.[50] The court appears to group all such rights under the general phrase "financing corporate needs," with little or no regard to the particular private interest involved. The emphasis was shifted from the inviolable liberty to contract and to secure the fruits of one's contracts against all odds, to the increased public interest in keeping corporations alive. But the question still remains whether there is any public necessity today great enough to justify the sweeping away of all accrued and unpaid dividends. That is a very substantial right, and one which the dissenter undoubtedly relied on to a great extent when he first invested his money in the corporation.[51]

If, then, the extent of the general reserved power to amend is to be measured wholly by a balance between public interest, necessity, and the general welfare on one side, and the private right taken away on the other side, then all of the distinctions between mandatory and permissive changes, or between the contract of the state with the corporation and the contract inter sese, become merely questions of degree and factors to be weighed in the balance. And if it be argued that a majority can thus be given power to secure the corporate funds for their own benefit, it is enough to point out that such an act would clearly be not in the public interest, and further that equity will always protect against such action.[52]

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[49] 16 Del. Ch. 157 at 166, 142 A. 654 (1928).

[50] In the Davis case the right taken away was the right to redeem the preferred stock and to receive all surplus dividends, a four to one advantage over the preferred stock.

[51] The court in the Davis case said that the Delaware general reservation clause writes into the corporation charters all future amendments which the legislature may make. If this is to be construed as meaning that there is no limit at all on the legislative power—and the perfunctory treatment in the Keller case rather indicates that it is to be so construed—then Delaware definitely stands alone in its interpretation of the state's powers.

[52] 13 FLETCHER, CYCLOPEDIA CORPORATIONS, perm. ed., § 5811 (1932); Dur-