

THE POWER OF STOCKHOLDERS TO BIND A CORPORATION.

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In entering upon a discussion of the power of stockholders to bind a corporation it is necessary at the outset to gain a definite conception of what is embraced in the meaning of the term "to bind," as it is hereafter to be used.

In the first place, in its more restricted sense the word, as used in matters appertaining to the law, would seem to imply the existence of a contract to which the parties are to be bound. Were this the meaning which now is to be attached to it, the matter in question would be restricted to the power of stockholders to make contracts enforceable against the corporation. It is not intended to limit the subject in this way, but to take the word in a broader sense so as to include not only a discussion of the validity of the contracts above mentioned, but also the power of stockholders to control the affairs of the corporation in other ways, as by prescribing particular methods of carrying on the corporate affairs, by committing the company to a specific course of action, etc.

In the second place its members may by their actions bind the corporation either directly or indirectly. It is a natural consequence of the peculiar nature of this class of organizations that for the actual performance of all that they do they are obliged to resort to the employment of agents. These agents are subject to the general rules governing that class of persons, and so far as their acts are conformable to these rules they are valid and binding upon the corporation. They are appointed by the stockholders and their authority is derived from them, hence since the act of the agent is the act of the principal, the stockholders in employing them may be considered as themselves acting indirectly and as indirectly exerting through them the power to bind the corporation. It is not the object of this paper to enter into a discussion of the power of the stockholders thus indirectly to bind the corporation, as this is simply a matter of the application of the principles of agency. But apart from this indirect method there

exists in the stockholders the power directly to bind the corporation, even though in the execution of that power the intervention of agents is indispensable, and it is this power independent of its instruments that at present occupies our attention.

The consideration of the subject as thus presented naturally divides itself into three heads which will be taken up in their order:

First, the power of the individual stockholder, and of stockholders acting individually.

Second, that of the majority.

Third, that of all the stockholders acting unanimously in a corporate capacity. This last topic will be found to open up such an extensive field that justice could be done to it only in a treatise of much greater scope than this, and hence an attempt will be made merely to apply to it briefly the principles which are dealt with in the first two heads.

Before entering upon the discussion of this power as applied to corporations it should be observed that great light is thrown upon the subject by a constant reference to the principles applying to partnership and other companies. In fact to a large extent the rules that govern the partnership in this respect are equally applicable to the corporation. And where there is a diversity in them a comparison of the theories underlying the two organizations will not only explain this, but it will also assist in making clear what are the limitations upon the power in each case. Hence, in each of the three aspects in which the subject is discussed, the rules applicable to a partnership under the same circumstances are reviewed.

I.—OF THE POWER OF THE INDIVIDUAL STOCKHOLDER, AND OF THE STOCKHOLDERS ACTING INDIVIDUALLY.

Of the Individual.—It is a fundamental principle of the partnership that each member is in all matters within the apparent and legitimate scope of the partnership business the general agent of his co-partners, and the firm and all its members are liable for whatever is done by him in transacting the business of the partnership in the ordinary way. The position of the stockholder of a corporation is entirely different. He is neither the agent of the corporation nor of its members, nor are his acts or contracts, as an individual, binding on either, though made with reference to the affairs of the corporation and for its benefit.

The reasons for this difference in the powers of the members of a corporation and that of a partnership are to be found in a

comparison of the natures of the two organizations. The partnership can in no sense be viewed as having an existence apart from that of its members. Its liabilities are their liabilities. They, in short, are the partnership. The corporation on the other hand, while it, like the partnership, is made up of individuals, is an entity entirely distinct from the members that compose it. It is a legal person, endowed with powers that belong in no wise to its corporators, and which cannot be exercised by them. Its liabilities are not the liabilities of its members, except to the limited extent to which they have by their subscription assumed them. It follows then that a stockholder, acting not in a corporate capacity, should have no more power to control this separate and distinct individuality than should any other person. Nor does the fact that his interests are bound up in that entity give him this power, for by his contract of membership he has surrendered his control, except in so far as by his vote he participates in corporate matters.

A second reason for the wider power of the partner as compared with that of the stockholders is derived, not theoretically, but from the practical working of the two associations. The partnership is made up of comparatively few persons, who have united in a common enterprise with a full knowledge of one another and with confidence and reliance each in the other. Not so in the case of the corporation which from its origin contemplates a membership more or less numerous and composed of individuals whose very existence may be unknown to the others. It stands to reason, therefore, that in his contract of membership the stockholder has intended to confer upon his fellows no such powers as does the partner on entering into the partnership.

Of Stockholders Acting Individually.—The principle having thus been established that the individual stockholders cannot bind the corporation, it necessarily follows that any number of the stockholders acting individually can have no greater power in this respect. And when carried to its extreme it is a necessary consequence of this rule that stockholders owning a majority or even all the stock of the company cannot control the corporation, except when acting duly in their capacity as members of the corporation. This applies also with equal force to a single member who himself represents a majority or even all the stock.

Illustrations.—In conformity with these rules it has been held that a stockholder has no authority to release a debt due the corporation.¹ That individual members cannot transfer the corpo-

¹ Harris v. Mfg. Co., 4 Blackf. (Ind.) 267.

rate property.² Nor can they even although holding a majority of all the stock, make a valid lease or sale of such property.³ Nor can they mortgage the same.⁴ Shareholders, when not acting as a corporation, cannot convey lands of the corporation though all join in the deed.⁵ The owner of all the capital stock of a corporation does not become thereby the legal owner of its property, and cannot maintain replevin for it in his own name.⁶ In the case of *American Preserves Co. v. Norris* (43 Fed. Rep. 714), the whole ground is covered in the following words: "It is familiar law that a corporation has a personality of its own, distinct from that of its stockholders; that it is not affected in the most remote degree by contracts made by its stockholders with third parties, whether they own much or little of its capital stock, and is not bound to discharge any personal obligation assumed by its stockholders."

Having thus established the rules governing the first division of our subject we are now ready to proceed to the second.

II.—OF THE POWER OF A MAJORITY.

Its Extent.—In considering the power of a majority it will be found that it is similar in both corporations and partnerships. In the charter on the one hand and in the partnership agreement on the other are laid down in greater or less detail the general purposes and ends of the organization. In becoming a member both the stockholder and partner impliedly agree that in all that is necessary or incidental to the attainment of these purposes the majority shall have supreme authority and may bind the association. The necessity of implying such an agreement is evident when it is considered that if there were no such understanding it would be possible for one dissenting member to prevent the transaction of any business whatsoever, however thoroughly it might be included within the purposes of the association. The only course then remaining to the company would be to secure the concurrence of all the members in every matter concerning the conduct of the company. As a consequence of this in the case of a partnership the business of the firm would in all probability be frequently brought to a complete standstill and its legitimate purposes totally defeated. *A fortiori* would this be the case in the

² *Humphreys v. McKissock*, 140 U. S. 312.

³ *Hopkins v. Lead Co.*, 72 Ill. 379.

⁴ *Engleman v. Dearborn*, 141 Mass. 590.

⁵ *Wheelock v. Moulton*, 15 Vt. 519.

⁶ *Button v. Hoffman*, 61 Wis. 20.

corporation, a body composed in many instances of a great number of individuals, more or less scattered and inaccessible, and all perhaps actuated by conflicting motives and interests. To attempt to gain the unanimous consent of such a variety of constituent elements would certainly be impracticable, and for business purposes utterly impossible. Hence as the only alternative we are led to conclude that the acts of a majority, in so far as they are consistent with the charter are binding upon the corporation.

Its Limit.—From the fact that this power of the majority rests wholly upon the original contract of the members, be it a charter or a partnership agreement, it follows that in both classes of organization it must be limited in its extent by the scope of that same contract. To adopt any other view would be to hold that the dissentient stockholder would be compelled to resort to one of two courses of action, both equally unjust. On the one hand he could remain a member of the corporation and be bound by the act of the majority, thereby being made a party to an obligation which in entering into the corporation he had never contemplated assuming, which he had never agreed expressly or impliedly to assume, and which by his dissent he had even refused to assume. That such a case is extremely unjust is palpable, and the other alternative is equally oppressive. All that would remain for such a stockholder would be to withdraw from the corporation. In this way a majority could absolutely control the organization, and the existence of such a power, susceptible to so great abuses and so conducive to corruption, would open the way to the greatest injustice. Hence, we derive the general principle that *a majority of the stockholders can bind the corporation in all matters within the scope of the corporate purposes and in such matters only.*

Illustrations.—As an illustration of this general principle may be cited the leading case of *Natusch v. Irving* (2 Cooper's Chan. 358), in which Lord Eldon held that the majority of a corporation organized for the purpose of carrying on the business of fire insurance could not authorize the company to deal in marine insurance, and that the company would be enjoined from so acting at the suit of any dissenting shareholder. In the case of *Livingston v. Lynch* (4 Johns Ch. 573), an injunction was granted to restrain a steamboat company from acting through an agent whose authority, although derived from the majority, was inconsistent with the charter agreement, and the Court said: "Where it is declared in one of these (charter) resolutions, prescribing the duties of the secretary, that he was to see that the resolutions of a majority of the interest of the concern be carried into effect, it

certainly could have referred only to resolutions passed in the ordinary transactions of the concern, and in perfect subordination to all and each of those articles of the original compact." And in *Pickering v. Stephenson* (L. R. 14 Eq. 340), it is said: "* * * * The special powers, given either to the directors or to a majority, by the statutes or other constituent documents of the association, however absolute in terms, are always to be construed as subject to a paramount and inherent restriction that they are to be exercised in subjection to the special purposes of the original bond of association. This is not a mere canon of English municipal law, but a great and broad principle which must be taken, in absence of proof to the contrary, as part of any given system of jurisprudence."

In applying this general rule it will be found that the classes of cases which come under its control are several, and it will be necessary briefly to examine these in order.

By-Laws.—In the first place to facilitate the attainment of the corporate purposes it is essential that a system of by-laws should be adopted, regulating the government and business methods of the company. In so far as they are reasonable and tend to effect these purposes by-laws adopted by the majority are binding on the corporation, and their right to make them rests on the implied agreement of the shareholders in forming the company. But any such rules, inconsistent with the original agreement which is the fundamental rule of the company, or which are injurious to the interests of the concern, or are unreasonable or contrary to the general principles of the law, it is, in accordance with our rule, beyond the power of the majority to thrust upon the corporation.⁷

Appointment of Agents.—As it is necessary that in its business transactions the corporation should be represented by agents, it is impliedly agreed in the charter contract that such agents should be appointed. Hence, their appointment being within the limits of the charter powers, it is also, in accordance with our rule, impliedly agreed that the majority may select and confer authority upon such agents as may be necessary, and their choice in this matter will bind the company.

Ratification.—Not only may the majority bind the corporation by its own acts within the limits laid down in the general doctrine, but it may also exert the same power by way of a ratification of unauthorized acts of its agents. Hence, it follows that

⁷ *Bank v. Lanier*, 11 Wall. 369; *Kent v. Quicksilver Mining Co.*, 78 N. Y. 182.

an act of an agent outside of the scope of his authority may by vote of the majority be made binding upon the corporation. But it also follows that this power of ratification has the same limitations as the primary power of the majority and hence no act of an agent which is beyond the limits of the charter can be made effective.

Alteration of Charter.—To materially alter the terms of the charter is clearly an act which is beyond the purpose of the charter agreement, unless therein otherwise stipulated. Hence, our rule would prevent the acceptance of such alteration by a majority.⁸

Thus in a number of cases where railroad corporations have been authorized to extend their lines further than was contemplated in the original agreement, it has been held that such an amendment was a material alteration of the charter which could not be accepted by the majority. This also covers all that class of cases in which the consolidation of two or more corporations with the legislative authority is attempted by the majority. In fact, the majority cannot accept an amendment authorized by the legislature, even if by the same act the power so to do is placed in their hands. For to hold that legislative enactment could confer such power on any part of the stockholders would be to admit that the Legislature could impair the obligation of the contract embodied in the charter.

Transfer of all Corporate Property.—To sell out all the property and privileges of a corporation is an act which is consistent with the purposes of its charter, when it is made necessary by the condition of the concern, as where the business has become unprofitable, and hence, it is within the powers of the majority to bind the corporation by a sale under such circumstances.⁹ But a transfer effected by them while the affairs of the concern are prosperous, whether for a purpose beneficial to the stockholders or not, is invalid,¹⁰ and at the suit of a stockholder an injunction will be granted to prevent such transfer, and if it has already been completed it will be declared void and an accounting will

⁸ *Stevens v. R. R.*, 29 Vt. 546; *Hartford, etc., R. R. v. Crosswell*, 5 Hill 385; *New Orleans R. R. v. Harris*, 27 Miss. 517; *Pickering v. Stephenson*, L. R. 14 Eq. 322; *Turnpike Co. v. Phillips*, 2 Penn. Rep. 184; *Turnpike Co. v. Locke*, 8 Mass. 268; *Turnpike Co. v. Swan*, 10 Mass. 384; *Union, etc., Co. v. Towne*, 1 N. H. 44.

⁹ *Kean v. Johnson*, 9 N. J. Eq. 401; *Revere v. Copper Co.*, 15 Pick. 231.

¹⁰ *Taylor v. Earle*, 8 Hun. 1; *Albert v. Rubber Co.*, 33 Barb. 578; *People v. Ballard*, 134 N. Y. 269; *R. R. v. Allerton*, 85 U. S. 233; *Kean v. Johnson*, 9 N. J. Eq. 401.

be decreed.¹¹ In the words of the Court in *Kean v. Johnson* (9 N. J. Eq. 408), "To sell the road, to abandon the contemplated investment and embark in another scheme, whether entirely different, or only more extensive than the original contemplation as apparent on the face of the charter, is, as it seems to me, clearly contrary to the rights of the individual stockholder. If they had any rights as partners or beneficiaries it would seem to be this, that their money should be devoted to that use, and never employed in any other, nor returned to them before they desire it. The mere statement of the proposition seemed to me to prove it. No argument, however lengthened, can add to the force of the naked position."

Majority Itself an Agent.—From a consideration of the different varieties of cases, to which, as we have seen in this brief summary, the general doctrine applies, the fact becomes apparent that the majority is itself in reality simply an agent of the corporation—an agent deriving its authority from the implied agreement of the charter contract of the members, and the scope of whose powers is limited by the terms of that contract. This view of the functions of a majority has been taken in many cases, and seems to give a comparatively simple test of the extent of its powers. Accordingly it would seem a necessary consequence of the laws of agency that our rule must be qualified to a certain extent and so extended as to admit that the majority may bind the corporation in all matters within the *apparent* scope of its authority. This qualification, however, will readily be seen to be of no force as the charter determines the scope of that authority, and persons dealing with the corporation must take notice of the charter. Hence, its apparent powers can be no more than those laid down in the charter, and the terms of the latter must still be the deciding test.

As a further result of the application of the laws of agency as applied to the power of the majority, it follows that where the latter has transcended its authority its acts may still be made binding through ratification by the whole number of stockholders.

Restrictions on General Rule.—Although, as is seen from the cases already reviewed, the doctrine as stated has been thoroughly established, still in the greater number of corporations the power of the majority will be found to be actually much more strictly confined, in most cases extending only to a general oversight of the affairs of the company and to the appointment of its agents,

¹¹ *Ibid.*

while all other matters are delegated to the agents thus appointed. This limitation, however, can be easily reconciled with the general rule, for it will be found that, wherever such a restriction exists, it is invariably provided for by the express terms of the charter itself, which as we have seen must be in all cases the ultimate criterion of the powers of the majority. The majority then being but an agent itself can have no control over matters in the province of the other agents nor can it bind the corporation in matters placed by the charter in other hands. Bearing this in mind, the many decisions which hold that corporations can do no acts except through their directors, while apparently in direct opposition to the rule in question, will be seen to be in reality perfectly compatible with it. For in each of those decisions it will be found that the charter of the corporation in question contained some express stipulation imposing this limitation upon the majority. Such restrictions, therefore, instead of being, as they would at first sight appear, exceptions to the rule, are, as a matter of fact, simply the logical results of its application.

Majority a Trustee.—There remains one further limitation which arises under certain circumstances and which is not simply apparent as was the last. It is to the effect that a sale of corporate property effected by a majority to itself cannot, unless made in the utmost good faith, be valid as against a dissenting stockholder, however proper such sale might have been to any third party. This restriction is entirely independent of the doctrine expressed in our general rule and arises from the fact that the relation between the majority and a stockholder is that of a trustee to a *cestui que* trust, and the general principles applicable to that relation must control in this case. This view of the position of the majority is expressed by the Court in *Erwin v. Oregon Ry. & Nav. Co.* (27 Fed. Rep. 631), in these words: "Where a number of stockholders combine to constitute themselves a majority in order to control the corporation as they see fit, they become for all practical purposes the corporation itself, and assume the trust relation occupied by a corporation towards its stockholders. * * * The corporation itself holds its property as a trust fund for the stockholders, who have a joint interest in all its property and effects, and the relation between it and its several members is, for all practical purposes, that of trustee and *cestui que* trust."

III.—POWER OF STOCKHOLDERS ACTING UNANIMOUSLY.

Having thus disposed of the power of the individual stockholder and of the majority, there remains the final division of our

subject—the power of the stockholders acting unanimously. An act of all the members in their corporate capacity is an act of the corporation itself. Hence this division of our subject embraces simply the question as to the power of the corporation to bind itself. It is no longer a matter of the power of the stockholders, but involves the whole doctrine as to the so-called *ultra vires* acts. A discussion of this theory is entirely beyond the scope of this article. Suffice it to say that the rule applying to a majority does not extend to the action of the whole membership. While no mere majority however large may transcend the limits laid down by the charter, it is otherwise with the stockholders acting unanimously, for many of their contracts and actions will be sustained even though entirely without the scope of the charter purposes. It is readily seen why such acts should be binding in so far as they are not nullified by the intervention of other principles of law. The charter was created and exists only by the unanimous agreement of the stockholders. Hence it may be altered or entirely repudiated by any subsequent unanimous agreement on their part, and as among themselves they will be bound by any action in pursuance of such an agreement, however alien it may be to the terms of the original charter. But it is just at this point that the general principles of the law and of public policy intervene and determine which of these acts shall be deemed valid and which of no effect. The rules governing this determination can be ascertained only from a study of the doctrine of *ultra vires* powers.

It is no doubt true that for a complete discussion of the subject originally undertaken an examination into the doctrine of *ultra vires* would be necessary. But so extensive is this doctrine, and the results dependent upon it, that it should more fitly be treated as a matter entirely independent of the subject in hand. Hence, with the consideration of the first two divisions of our subject, as laid down at the outset, we may consider the discussion concluded.

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