INCORPORATION.

In these days, when legislators too often hurry to meet and yield to popular demands, without the sense of responsibility and the independent deliberation required by the theory of representative government, popular error is apt to bear fruit quickly. Danger is avoided only by the many educational influences which lead the people generally to right thinking upon matters which become subjects of popular interest. It should be, and doubtless is, one of the aims of this Review to be among such influences with respect to matters of law—not so much, perhaps, by reaching the people directly as by leading those who make the law their special study, to look at things with the eyes of common sense and to express their thoughts in common language.

The subject of corporations is, undoubtedly and for obvious reasons, one of popular interest at this time. And yet there is a deal of confusion of thought about corporations. The subject is in a sense complex and difficult. Abstruse questions arise in it. But in the main it is intelligible to common sense without very much research. There is need rather of examining what is close at hand and open to all, than of studying either the history of the past or the law of the present. Resort must be had to the statute book, since corporations are creatures of statute law. And some little reference to the past is necessary to interpret the statutes. But no more than this is needed before common sense can address itself to the main question which the subject presents, namely: What is a corporation? It is more likely to be confused than helped by searching the books for definitions. If any one doubts this, let him read the first section of "Boone on Corporations," which contains a composite definition, for the parts of which ample authority is given, and imagine himself offering this to an inquirer as an answer to the above question. It is as follows:

"A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law; and it possesses only those properties and powers which are conferred upon it by its creator. Its existence depends upon a legislative act, to which it either mediately or immediately owes its vitality. It is a collection of individuals united into one body, having perpetual succession under the corporate name, and vested by the

policy of the law with the capacity to transact certain kinds of business like a natural person; and such a union can only be effected under a grant of privileges from the sovereign power of the State."

The effort to find out what a corporation is is embarrassed by the natural tendency to consider particular corporations with which the inquirer is especially familiar, without distinguishing between those elements of character which they have in common with others, and those which are peculiar to them or to the particular class to which they belong. Obviously only those things which are common to all corporations are to be considered.

Railroad corporations, for instance, receive and exercise important prerogative franchises, perform public functions in the place of the state, and are on that account permitted to exercise the right of eminent domain, that is, the right belonging to the sovereign to take private property for public use. The holding of such franchises involves correlative duties, and may rightly be taken into account by the State in dealing with this particular class of corporations. But it would be wrong to legislate about all corporations upon grounds based upon the holding of such franchises. Ferry companies, bridge companies, gas companies and the like, have similar franchises. But ordinary business and manufacturing companies have only the franchise of corporate existence. The State grants to them, or to those who compose them, nothing but incorporation. In determining, then, the common character of corporations, as in framing laws to operate upon them all, it is well to put out of view such as have prerogative franchises and confine the attention to purely private companies having no franchise but that of corporate being.

Again, it is a prevalent idea that corporations commonly involve an aggregation of capital of considerable magnitude. It is true that corporate organization is used for the purpose of bringing together large aggregations of capital. The magnitude of the many combinations thus effected in the last twelve months is well known. But a large capital is not essential to corporate organization. As a rule the statutes authorizing the formation of corporations either state no minimum amount of capital, or put the minimum very low indeed. And in many cases incorporation does not effect any accumulation of capital whatever; as when a partnership is practically changed into a corporation by the transfer of the partnership assets to a corporation formed by the partners. Clearly, then, ideas which

attach to corporations by which very large amounts of capital are brought together, should neither be the basis of legislation against all corporations, nor affect the answer to the general question: What is a corporation?

It is often said that corporations have no souls. Is this a peculiarity of corporations as distinguished from partnerships and unincorporated joint-stock associations? In the nature of things, a large business, belonging to an association of several persons, is run by rule, and the rules sometimes work harshly. But it makes no particular difference with respect to its treatment of its employees, or its dealings with others, whether the association is incorporated or not. How many people know as to any one of the large department stores, whether it is run by a partnership or a corporation?

And there are other characteristics of some corporations which are not common to all, nor peculiar to corporations as distinguished from associations not incorporated.

In view of the sweeping nature of some proposed legislation against corporations generally, induced by a belief in the evil effects of so-called trusts, it is pertinent to throw out here a reminder that the trusts as at first organized were unincorporated associations, and were attacked because they interfered with corporate autonomy and because they escaped the supervision to which corporations were subject.

How, then, may the common character of corporations be discovered? By examining the statutes under which they are formed. These statutes might be quite different from each other. The possibilities of legislation are great. But it so happens that, in this country, at least, statutes of incorporation, whether special charters or general incorporation laws, follow the same lines; so that in essentials the products are the same. Acts for the incorporation of railroad companies, bridge companies, ferry companies, gas companies and the like, contain, besides the provisions for incorporation, what are substantially grants of prerogative franchises, and to avoid confusion they may as well be passed by. As in biology, the simplest forms best repay the search for essentials. And the simplest forms of incorporation laws are those relating to business companies which receive from the state no franchise but the right of corporate existence. And since the general incorporation laws of the several states are as a rule drawn upon substantially the same general plan, it makes little difference whether the law of one state or another is taken up.

Take, then, the joint-stock corporation law of Connecticut.

From this law, as well as any other, the essential character of stock corporations can be discovered. And it is the stock companies, rather than the companies having no stock, which are of special interest. That law enacts that any three or more persons who shall associate by written articles, giving name, purpose, location, amount of capital stock and number of shares, to carry on any lawful business, with some exceptions, shall, upon filing their articles with the Secretary of State, become a corporation. A corporation, it appears, then, is an association of persons. But there are other associations of persons for business purposes—partnerships, syndicates and other associations resting merely on contract. If any of these associations take the benefit of this joint-stock corporation law, they become corporations. What do they gain by it? In other words—and the putting of this question as really the fundamental one, greatly clarifies the subject—what is incorporation? What is it, and of what advantage is it, to become a body corporate or corporation? Suppose that a number of persons have come together to form an association for business, and the question is raised whether or not they shall file their articles and become incorporated. Will they have any broader powers as to the business they may do? Certainly not. They can engage in any lawful business, unincorporated. Incorporated, they can do nothing more. If they desire to be able to change the business upon the agreement of less than all the associates, the articles can so provide. As to the business they may do, they rather assume a restraint than gain a greater freedom, by incorporation. And they subject themselves to the burden of making reports about their business to state officials. They do not by incorporation acquire the right to use a larger capital in their business, and as to the issue of shares and the getting of additional capital in the future, the articles may provide as fully, and perhaps with less restrictions, if the association is to remain unincorporated. The statute contains convenient provisions as to organization and management, which are carried into the articles without being expressed, if the articles are filed. But like provisions may be expressed in the articles with but little more trouble, if the association is to rest on argreement merely. Speaking generally, the association, if not incorporated, may have as broad powers, as large a capital and as much freedom of action, as if it becomes a corporation. Indeed it is under less restraint and, if its associates are of one mind, it is practically unlimited, as an individual is, as to what it may do or what it may own. Its power for good or evil as

an influence in the line of business in which it operates is quite as great.

By becoming a body corporate, the association gets simply the right to be regarded, in its legal relations, as though it were a being separate from those who compose it. That is the meaning of the phrase as determined by the usages of the past. Call it an independent entity, if you please, or a legal person. The idea is graphically set forth by these names; and the names are of value in its application. Incorporation creates the right to be regarded as a separate being. The association is an association of persons after incorporation as before. The associates and their successors, that is, in a stock corporation, the stockholders, associated together, under the articles, are the corporation. But in the relations of the association with the individual stockholders and with all outsiders, it is, when incorporated, to be dealt with and regarded as an independent body.

And from this come two results: First, that the death of the associates, or the transfer of their interests does not affect the existence of the corporation; and, second, that the individual stockholders are not chargeable with the acts or omissions of the corporation, are not liable for its debts or obligations or for the wrongs which it commits, except so far as the statute may expressly provide. The first of these results is, in many cases, the sufficient inducement to incorporation, because of the convenience of having a business so organized that many can participate in its profits, that interests may be divided and sold or bequeathed without disturbing the business itself. All this may, it is believed, be accomplished by agreement. Witness the unincorporated joint-stock companies engaged in the express business. But the statutes have been carefully worked out; and if there is any omission it can be supplied by further legislation; and so it is much more convenient to reach these ends by incorporation than by agreement merely. Still, that the same continuity of the association, the same transferability of interests could be accomplished by agreement merely, is not to be forgotten when legislation is proposed, based upon what the corporation gets from the state. But what cannot be got by agreement is the irresponsibility of the associates or stockholders for the acts or omissions of the association. Theoretically, perhaps, this might be deemed possible, because all who should have dealings with the association might conceivably so agree. But practically, it is impossible to secure this result save by the action of the state. This, then, is the chief thing which the state confers by incorporation, freedom from per-

sonal liability, or, in some cases, limitation of personal liability, for the debts and wrongs for which the association is responsible. This is common to corporations of all kinds, and is peculiar to corporations. And there is nothing else of which this can be said.

A few applications of what has been said to the suggestion made at the outset, seem appropriate.

Since freedom from, or limitation of, the personal liability of the associates is the only thing common to all corporations and peculiar to them, and it comes by grant from the state, this is the chief basis of the right and the propriety of legislative regulation of the management of incorporated companies. Authorizing the associates to do business, to invite credits, without the ordinary liability of individuals, the state is bound to concern itself with the management of their capital, which is the sole reliance, or in exceptional cases, the chief reliance, of creditors. The propriety of statutory regulations looking to good management cannot be doubted, and good management means management intelligent, effective and honest. Intelligent and effective management is intended to be secured by the common provisions that the affairs of corporations shall be managed by a board of directors limited in number. Honesty in the management is intended to be secured by various provisions holding the directors responsible, as occupying a fiduciary position, in which they are placed not merely by the act of the stockholders, but by the compulsion of the law. It may well be that improvements can be made in the statutory provisions looking to these ends.

Out of the common provision that the affairs of corporations shall be managed by a board of directors, comes a legitimate basis for regulation of management in the interest of stockholders. Stockholders, as a rule, have no voice in the management save to determine by their vote at fixed periods who the directors shall be, and to make by-laws. The power to make by-laws does not permit the general management to be taken out of the hands of the board, in which it is vested by law. Hence, in matters of regulation looking to good management—management intelligent, effective and honest—it is proper that the Legislature should consider not only the interests of outsiders who are or may become creditors, but also the interests of stockholders.

In the interest of creditors or those who may become such, provisions requiring reports to be made, revealing the financial condition of corporations, find legitimate basis; but intelli-

gent legislation of this kind will require no further publicity than the purpose requires. The interests of stockholders require only private reports to them. And as to those who may think of purchasing stock, it is doubtful whether they may not best be left to the rule of *caveat emptor*, with the additional protection as to stocks dealt in on the exchanges of the regulations which such exchanges may adopt, and with, perhaps, more stringent enactments as to misleading statements in prospectuses and the like, whether issued by corporations or not. The stock of many corporations changes hands but rarely. They are private institutions, and except for the protection of creditors, there would seem to be no reason why they should be required to make their affairs public.

Statutory provisions operating upon all corporations are not justified by reasons relating to such franchises as the franchise of operating a railroad. Legislation based upon such reasons should be limited to the particular class of corporations holding such franchises.

If large aggregations of capital are an evil against which legislation should be directed, the evil cannot be reached, completely, at least, by any legislation as to corporations, either by limiting the amount of capital or by forbidding corporations of other states to do business, if their capital is excessive. The convenience of corporate organization, aside from the benefit of freedom from or limitation of personal liability, is quite evident; but it is equally evident that associations can be formed by agreement only which can do any lawful business and have any amount of capital, and which, if composed of citizens of any state, can, under the Constitution, do business in any other state without legislative permission. If legislation against this supposed evil is possible and is wise, let it proceed directly, by declaring such aggregations unlawful, whether effected through corporate organization or otherwise, rather than change the general laws as to incorporated companies, and impair the usefulness for all purposes of this particular form of organization; since the latter course cannot prevent, although it may somewhat impede, the progress of accumulation. Possibly if the problem is thus faced, it may be seen that the supposed evil is not a real evil, or is one which cannot be reached by legislation. It may appear that the tendency to aggregation, whether to be regretted or not, is natural and irresistible, is to be regulated rather than restrained, and that it can best be regulated by encouraging the use for this purpose of corporate organization which involves state supervision.

Incorporation has undoubtedly been and now is an important means of industrial progress—useful and beneficial in the highest degree. The foolishness of wholesale denunciation of corporations and of wholesale legislation against them must be obvious to any intelligent man who applies his common sense to facts open before him. Legislative efforts should rather seek to extend the usefulness of this form of organization, to encourage associations in this way to come under the supervision of the state, to further safeguard the interests of creditors and stockholders, to impose such additional regulations as to management as will more completely secure what the law now intends, but to make the burdens and restraints as light as may be done consistently, leaving corporations as much freedom and as few shackles as possible, that they may do their utmost for the general good.

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