Washington Law Review

Volume 47
Number 1 *Symposium: The Location of Electricity-Generating Facilities*

10-1-1971

A Page of History

Lehan K. Tunks
University of Washington School of Law

A PAGE OF HISTORY*

Lehan K. Tunks†

THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES, 1780-1970. By James W. Hurst.** Charlottesville, Va.: The University of Virginia Press, 1970. Pp. 191. $6.50.

There is much to be learned from the crowded and only occasionally repetitive paragraphs of this little book which is derived from three lectures delivered at the University of Virginia in 1969. The fact upon which its theses are built is that law makers created the corporate concept and have devoted much attention to it in the past 190 years. What the law makers have brought forth over so long a period must be worth evaluating as to means and ends.

The ends of corporate organization are measured against Professor Hurst's preference for law which is both useful and furnishes maximum reinforcement for that human conduct which responsibly considers the welfare of other human beings within as well as without the corporate entity. Thus, utility and responsibility together are the criteria against which the "legitimacy" of corporate law is to be judged.

Professor Hurst's particular concern is with state enabling acts. Action taken by the law makers, as he reads it, leads to the conclusion that the general business incorporation enabling acts and their administration by public officials are of the greatest utility for large business organizations functioning through a hierarchy capped by strong leadership. Indeed, for these corporations, highly satisfactory treaties with the states in which they choose to incorporate can be written largely to the businessmen's order as Articles of Incorporation. Enabling act law and administration is less useful for those wishing to

---

* "Upon this point [whether a federal estate tax were a 'direct tax' and thus required to be apportioned among the states according to population in each under article one, section nine of the Constitution] *a page of history is worth a volume of logic.*" New York Trust Co. v. Eisner, 256 U.S. 345, 349 (1920) (Holmes, J.) (emphasis added).

† Professor of Law, University of Washington. A.B., 1935, University of Nebraska; J.D., 1938, Northwestern University; J.S.D., 1947 Yale University.

** Vilas Professor of Law, University of Wisconsin. No doubt Professor Hurst has intensively worked longer than any other American legal historian, helping educate more American legal historians, than any other present member of a University law faculty in the United States. His especially influential works include THE GROWTH OF AMERICA LAW: THE LAW MAKERS (1950).

function as an incorporated partnership (close corporation). In both instances, however, this law is inadequate to enforce the author's concept of responsibility. With respect to enabling acts, corporate law only escapes illegitimacy if supplementary legislation, such as the federal securities laws, is considered a part of its frame of reference.

What were the forces by which law makers came to omit regulatory measures of early charters and enabling acts? Professor Hurst explains that the failure is due to the combination of vigorous businessmen and the absence of law makers seeking the union of good business, economic growth and social well-being.

If this has been a fair statement of the writer's position, it is apparent that conscientiously to reach such a conclusion requires the sifting and weighing of a large number of legal considerations. Although there may be some phenomena, such as required cumulative voting, which he has weighed and does not mention, Professor Hurst does manage to question and analyze a large percentage of the elements comprising the legal structure of the corporation. The author writes carefully about every element he mentions, relating each to the legitimacy criteria he advocates. This review will deal very selectively with his detailed presentation. It will also present an aside on historical method, offer one suggestion for further research, and speculate on what should now be the desired goal in the light of the conclusions his work supports. Hopefully, this review demonstrates throughout that looking backward accurately is a more useful part of developing the law than merely remembering the past in order to avoid being "condemned to repeat it."[1]

The reader will find implicit in the book a caution against comfortably narrowing the frame of reference of "corporation law." An appropriate elasticity requires, if the problems of responsibility are to be dealt with as well as the law permits, consideration of the positive law concerning such matters as public utilities, antitrust, and collective bargaining. Though each of these is technically applicable without regard to the form of business association, they are greatly occupied with corporate affairs. The point is important for those who wish the satisfaction of delivering complete client service on present corporate issues.

Professor Hurst divides his discussion of the development of "cor-

1. G. SANTAYANA, REASON IN COMMON SENSE 284 (1905).

poration law" into three periods of time. In the early stages, it was a not very distinct part of a *mélange* of law dealing with municpal government, charitable and religious foundations, and companies formed for political tasks as well as for profit. By the middle of the nineteenth century, the "private corporation aggregate" had emerged, containing the seeds of what became the familiar problems of internal division of powers and earnings, and of the modes of finance which the general business corporation enabling acts subsequently left so largely to the realm of private law making. This development assisted in the establishment of large and powerful corporations to execute the economic development of the private sector. It became increasingly more difficult to protect the interests of those affected by the corporation solely by employing the rights and remedies permitted by the state enabling acts. Perhaps it was the outbreak of the various industrial codes under the National Recovery Act of the economically depressed 1930's which visibly marked the beginning of large-scale resort to federal and, later, state regulatory law affixing responsibility in corporate matters. At each subsequent point, new sources of law relevant to the corporate condition began to flourish. Yet, despite this peripheral development, the enabling acts remained relatively free from the regulatory provisions necessary to meet Professor Hurst's responsibility requirement.

One Hurst thesis which warrants comment is that state enabling acts, whether or not so intended by state legislators, effectuate a policy of concentrating the control of wealth in corporate form among corporate insiders. This argument is supported by reference to successive legislative elimination of early enabling act limitations on the amount of capital and the types of assets corporations could hold, on corporate purposes and powers, and the removal of the requirements of preemptive rights and public reporting.

Eventually, only skeletal requirements for obtaining certificates of incorporation were left. By the careful exercise of the power granted by modern enabling acts to draw by-laws to the order of the board of directors, the corporate framework comes closer than any other form of business association to giving those in control a vehicle to drive as rapidly as they can. The author finds few additions to this legislation which have fostered responsibility to either an oppressed intra-corporate group or the public. Only the explicit power to make philanthropic gifts and the statutory appraisal rights of dissenters to such funda-

mental changes as the sale of substantially all corporate assets, mergers, or consolidations are noted as approaching the responsibility criterion.

Courts have similarly favored the archetypical business effort set forth above, both by statutory interpretation and by entirely judge-made law. Examples furnished by Professor Hurst include: entering only the face value of low par stock rather than the amount received therefor by the corporation as capital items requiring any protection; reducing capital protection by allowing dividends to be paid from current earnings as long as insolvency is not induced even though capital is impaired; and yielding to critics of the "trust fund cushion for creditors" theory of corporate capital protection on the grounds that such a doctrine is inconsistent with trust law itself. Procedurally, courts and legislators reacted to suits of objecting shareholders seeking to bring controlling interests to account by requiring plaintiffs to have been shareholders at the time of the alleged wrong or to have inherited shares meeting those conditions and by requiring the posting of a bond at the commencement of the suit for the expenses of successful defendants. In the same spirit, corporations have been permitted to pay defense expenses of officers and directors even though the eventual judgment may be rendered against them.

To assist in selecting law makers and legal means for effectuating future public policies for corporations, historians might investigate further to ascertain whether state legislators and administrators have, in the enabling act area, consciously *intended* to implement substantive policy which encourages the concentration of wealth in a few corporate insiders. Contemporary periodicals with such features as *Fortune* magazine's "500 Corporations" seem to confirm such a result. Professor Hurst admits that he relied heavily on secondary authority in writing this book; the paucity of state legislative records and reliable contemporary accounts confines the historian very largely to inferences from the evidence preserved in statutory enactments and appellate court opinions. There is one related study to which he does not refer. Professor Edward R. Hayes was able to note differences between certificates of incorporation requested and those allowed during a limited period of time in one jurisdiction.[2] His account suggests that adminis-

2. Hayes, *Authorization and Issuance of Capital Stock by the Iowa Corporation* (pt. 2), 39 IOWA L. REV. 608, 613-14, 633-34 (1953).

trative approval of self-written certificates was neither automatic nor an ideal "administrative brake." It might pay investigators to study such administration in the more commercial states.

From the book reviewed here, one cannot fail to be impressed by the effect of the set of assumptions, which might be called "attitudes of lawmakers," concerning *means*. It takes an historian to trace their slow development and leave the reader with the inference that they are not likely to change rapidly. From "corporate enabling act law," to which the larger share of the text of this book is devoted, perhaps the lesson is that legislation well crafted over generations to meet a particular need builds a massive intolerance to serving other needs. The reader becomes persuaded that, even should federal incorporation for interstate business be required, "corporate enabling act law" is not a likely means for achieving any future public purpose except, perhaps, to enable business to organize and operate its sub-cultures for profit. As needs for legal means to effectuate public policies may emerge, it does not seem realistic to expect the enabling acts to be the mechanism by which corporate analogues, for example, of government ombudsmen and "freedom of information" acts, might be made parts of the larger corporate subculture.[3] A functional subject-matter selection of other means is more likely.

3. An example of such a rejection follows. To meet labor's need, New Jersey in 1920 amended its corporation enabling act to permit directors to be elected from non-stockholding labor, although other directors were then required to be shareholders elected by shareholders. Entrepreneurs of corporations seldom saw fit to use this provision in initially obtained certificates. Later on in corporate life, labor almost never sought to bargain for it. Other ways of sharing the power in which labor was interested were superior to incurring any schizophrenic management responsibility, while still having responsibility for observing existing, and negotiating new, collective bargaining contracts. Having lapsed into desuetude, the provision for employee-directors elected by employees was omitted in the 1968 revision. *Compare* N.J. STAT. ANN. §§ 14-9-1(d), 14-7-2 (1939), *with* N.J. STAT. ANN. § 14A-8-1 (1969). *Cf.* Brooks, *The Marts of Trade (the Anti-Corporation)*, THE NEW YORKER, Oct. 9, 1971, at 138.