

Plans for a Modernized Incorporation Law

Among other interesting projects of reform undertaken by the State Bar, a comprehensive revision of the California general corporation laws is now being prepared for submission to the next legislature. In order that Californian enterprises may be encouraged to incorporate as domestic corporations under the laws of this state rather than resort to the more liberal facilities offered by other states, it is necessary that our laws be brought into line with modern corporate methods. The Uniform Business Corporation Act tentatively approved by the Commissioners on Uniform State Laws, the new Ohio Corporation Act of 1927, and the reports of the Committee of the Ohio Bar Association are being particularly studied and followed. Other modern acts from which great help may be obtained are those of Delaware, Maryland, Florida and Nevada.¹

Among the various topics as to which great improvement is possible, there may be mentioned restrictions on corporate powers and the confused doctrine of *ultra vires*, the rules as to surplus available for dividends and the inadequate statutes in regard to non-par stock.

Certain features in our laws which do not conform to the ideas of the present day and which must be considered in the plans of revision have been pointed out in the report of a sub-committee as follows:

1. Corporate existence is limited and may only be extended for a period of fifty years;

2. There is an unlimited proportional stockholders' liability for debts of business corporations, unknown in other states;

3. No distinction is permitted as to voting rights in different classes of stock;

4. Different classes of stock issued by the same corporation must either be all of no par value or all with par value;

5. A foreign corporation having preferred stock with a par value, and common stock with no par value, can qualify to do business in this state, while a domestic corporation having such a stock structure cannot be organized under the laws of this state;

6. Fully paid stock of a California corporation is assessable by its board of directors without limit. It is not entirely clear under the law of this state whether a corporation can, if so provided in its articles of incorporation, issue non-assessable stock;

¹ See Ballantine, "Legislative Developments in Corporation Law," 15 California L. Rev. 422 (1927).

7. Under Article XII, section 3, of the constitution, directors of a corporation are jointly and severally liable for embezzlement or misappropriation by officers of the corporation;

8. There are no provisions in the California law for the consolidation, merging or reorganization of ordinary business corporations, or for the protection of minority stockholders in the event of such consolidation, merging or reorganization;

9. The constitution of the state contains many provisions governing internal management of corporations with the result that as corporate requirements or needs change from time to time the laws applying thereto can be changed to meet these needs only by constitutional amendment.

In general, the sub-committee suggests that Article XII of the constitution, relating to corporations, be amended by the repeal of sections 3, 4, 7, 9, 11 and 14, and that section 12 should be either repealed or amended. Article XII, sections 1, 2, 5, 6, 8, 10 and 13 may be allowed to remain as at present.

The most important question will arise over Article XII, section 3, which provides for the individual proportional liability of stockholders for all debts and liabilities of the corporation. This liability is further covered in section 322 of the Civil Code. The only other state which still provides for superadded individual liability of stockholders in ordinary business corporations is Minnesota. The California form of proportional stockholders liability is a unique curiosity in corporation law. There can be little question that this peculiar liability operates as a deterrent to the investment of capital in California corporations. It also frequently falls with great harshness and injustice upon particular stockholders.

Senate Constitutional Amendment No. V (Cal. Stats. 1927, p. 2394) provides for the creation of "limited liability" corporations using the word "Limited" as the last word of the corporate name, in which the stockholder shall be subject to such liabilities as may be provided by the legislature. Presumably this liability would be limited to the amount, if any, unpaid on the shares held by them, except in banks, trust companies, insurance companies and building and loan associations, where a double liability might be imposed as in national banks. This amendment should be supported at the coming election as a step in the right direction. But it does not go far enough, and much trouble and expense will be necessary to give existing corporations the benefit of it by amendment of articles and change of corporate name. The only satisfactory solution will be the

repeal of section 3 except as to debts existing and liabilities of shareholders and directors incurred at the date of the adoption of the amendment.

Article XII, section 12, provides that every stockholder shall have the right to vote the number of shares owned by him, or to cumulate his votes.

It ought to be possible to create preferred stock without voting power as long as dividends are paid, and to give such stock the exclusive voting power in event of non-payment of dividends. This is a just protection to preferred stockholders, and is very commonly done under the statutes of other states. It is one of the frequent reasons for resorting to incorporation in other states.

The necessity of giving each shareholder a vote, combined with the shareholder's individual liability, has led the Supreme Court to hold that the par value of all classes of stock must be the same, and that par value shares cannot be combined with non par shares. This is a very unfortunate restriction on the elasticity of stock structures.

Probably a fairly complete revision of our present corporation laws may be made without waiting for the amendment of our constitutional provisions affecting stockholder's liability, the right to vote and the necessity of having shares of the same kind or par value. It is expected that a draft of the proposed law and also necessary constitutional amendments will be submitted at the annual meeting of the State Bar for recommendation to the 1929 session of the legislature.

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