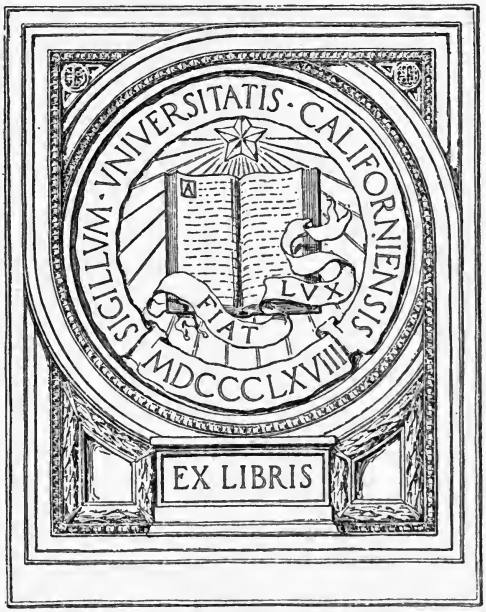
FORMATION OF CALIFORNIA CORPORATIONS



NOTES ON FORMATION

AND

ORGANIZATION OF BUSINESS

CORPORATIONS

UNDER THE LAWS OF CALIFORNIA

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CALIFORNIA CORPORATIONS

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FORMATION AND ORGANIZATION

CLASSIFICATION.

Under the English practice, the term "corporation" is reserved for what we understand as "public corporations", while the term "company" includes all the various forms of private corporations conducting business for profit. The Civil Code divides corporations into public and private and defines private corporations as "all those formed or organized for purposes other than the government of a portion of the state."[1] A majority of the organizers must be residents of California,[2] and actual residence so as to be subject to the process of the local courts is intended, not citizenship or domicile. Our more recent legislation uses the term "company" with the meaning used in English practice, and in the Corporate Securities Act it is defined to include "all private corporations, associations, joint stock companies and partnerships of every kind,"[3] and also participating business trusts. The Railroad Commission is given jurisdiction of all public utilities, which include common carriers and all public service pipelines, gas, electric, telephone, telegraph, water and warehouse companies.[4] The Superintendent of Banks is given jurisdiction of commercial banks, savings banks and trust companies, except those acting solely as trustees under deeds to secure the repayment of money.[5] The Bureau of Building and Loan Supervision is given jurisdiction of savings and loan corporations and land and building corporations.[6] The Insurance Commiss-

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1 Civil Code, Section 284.
2 Civil Code, Section 285.
3 Statutes, 1919, page 231.
4 Public Utilities Act as amended; Stat. 1919, page 493.
5 Banking Act of 1909 as amended; Stat. 1919, page 656. Civil Code, Section 290a.
6 Statutes, 1911, page 6.

ioner is given jurisdiction of the various classes of insurance corporations. Aside from ordinary business corporations, the Commissioner of Corporations has jurisdiction of homestead corporations,[7] mining corporations,[8] cemetery corporations,[9] colleges and seminaries of learning,[10] co-operative business corporations,[11] industrial loan companies,[12] trust companies acting as trustees under deeds to secure the repayment of money,[13] and mutual water companies having a capital stock. Companies expressly excepted from his jurisdiction are: companies within the jurisdiction of the Railroad Commission, of the Superintendent of Banks, of the Insurance Commission, of the Bureau of Building and Loan Supervision; non-profit corporations, such as chambers of commerce, religious, social and benevolent corporations, societies for the prevention of cruelty to children and animals, agricultural fair corporations; non-profit co-operative agricultural associations; non-profit co-operative corporations organized under the laws of this state; and banking associations and other corporations organized under acts of Congress of the United States.[14] Private companies for profit organized under state law naturally divide themselves into the four classes of *public utilities,* subject to the jurisdiction of the Railroad Commission; *moneyed corporations,* subject to the jurisdiction of the Superintendent of Banks, the Insurance Commissioner or the Bureau of Building and Loan Supervision; *industrial loan companies* and *general business corporations,* subject to the jurisdiction of the Corporation Commissioner; and *corporations not for profit,* such as social and quasi-governmental purposes, operating without supervision. A logical step would be to combine

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7 Civil Code, Section 557.
8 Civil Code, Section 584.
9 Civil Code, Section 608.
10 Civil Code, Section 649.
11 Civil Code, Section 653a.
12 Statutes, 1917, page 658.
13 Civil Code, Section 290a.
14 Statutes 1919, page 231.

the moneyed corporations under the supervision of a single Commissioner, and to provide for a classification of the corporations under the jurisdiction of the Corporation Commissioner into agency or closed joint stock corporations and open stock business corporations. and expand the mining corporation into an exclusive class dealing with wasting assets or other speculative promotions.

The Corporation Act of 1850 vested the corporate powers in the stockholders, with authority to delegate them to a board of directors or trustees.[1] Corporations organized under it were substantially joint stock companies of the English type.[2] The Corporation Act of 1853 vested the corporate powers in a board of directors so that it did not derive its authority from the stockholders,[3] and the powers of corporations organized under this Act are to be construed by the principles applicable to English municipal corporations, as they consolidated with the guilds and extended their operations to business affairs. The two forms existed with many modifying amendments until they were combined into a single system[4] by the Civil Code of 1872 and most of the vagrant provisions dealing with the participation of stockholders in the management of the business, the regulation of its affairs[5] and the election of officers[6] are to be traced to this joint stock source. The joint stock contract form of corporation had become firmly established and continues to manifest itself in decisions of our courts hard to reconcile with present statutory provisions. Where no rights of creditors are involved[7] and the stock is issued with no present intention of selling to the public[8] and all subscribers and stockholders consent, the courts are inclined to recognize the right of the stockholders to issue shares

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1 Statutes 1850, page 347.
2 Chater v. S. F. Sugar Refining Co., 19 Cal. 220, 246.
3 Statutes, 1853, page 87.
4 Smith v. S. F. & N. P. Ry. Co., 115 Cal. 584, 590.
5 Civil Code, Section 354, subd. 6.
6 Civil Code, Section 318.
7 Whitten v. Dabney, 171 Cal. 621.
8 Turner v. Markham, 155 Cal. 562.

for any consideration upon which they may agree.[9] The corporation is regarded as the agency of the stockholders managing their property, to which it holds the legal title for purpose of convenience,[10] and the stock certificates are regarded as evidence of the proportion in which the co-tenancy is divided. It would tend greatly to clarity in our law if this class of closed stock corporations were distinguished by statute from general business stock corporations and, following the English practice of registration, its shares allowed to be transferred only by registry in the office of the Commissioner of Corporations. The shares of stock in such corporation should not be issued to represent property conveyed to it where the beneficial interest is retained in the stockholders and the corporation could then properly be authorized to convey such property or distribute the proceeds to its stockholders under the sanction of the Commissioner of Corporations[11] without violating the fundamental concepts of capital stock. The Act of 1917 authorizing shares without nominal or par value[12] classifies corporations as to form of organization without limitation as to class of business except public utilities which are authorized to organize in this form by a separate act.[13] The War Tax Law of 1918 introduced an innovation by creating the "personal service corporation," where the "income is to be ascribed primarily to the activities of the principal owners or stockholders who are themselves regularly engaged in the active conduct of the affairs of the corporation and in which capital (whether invested or borrowed) is not a material income producing factor; not including any corporation fifty per centum or more of whose gross income consists either of gains, profits or income derived from trading as a principal, or of

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9 Whitten v. Dabney, 171 Cal. 621.
10 MacDermot v. Hayes, 175 Cal. 95, 114; Sargent v. Palace Cafe Co., 175 Cal. 737; Garrettson v. Crude Oil Co., 146 Cal. 184.
11 Civil Code, Section 309.
12 Statutes 1917, page 1321.
13 Statutes 1917, page 1367.

gains, profits, commissions or other income derived from a government contract or contracts made between April 6, 1917, and November 11, 1918, both inclusive."[14]

PURPOSES AND POWERS.

A corporation is a creature of the law[1] having a life stated in its articles of incorporation not to exceed fifty years,[2] which may be extended for a period not exceeding fifty years from the date of such extension by the vote or written consent of stockholders representing two-thirds of its capital stock,[3] and may be formed by the voluntary association of three or more persons, a majority of whom must be residents of this state, in the manner provided by law,[4] for any purpose for which individuals may lawfully associate themselves[5] and having powers and duties of natural persons,[6] to sue and be sued,[7] to make and use a common seal and alter the same at pleasure,[8] and to purchase, hold and convey real estate as the purposes of the corporation may require, but not to hold such real estate for longer than five years, except such as may be necessary for carrying on its business,[9] unless it is organized for the purpose of dealing in real estate,[10] and not then if a majority of its stock is owned by aliens who may not become citizens by naturalization,[11] and may not issue bills for circulation as money;[12] nor take property by last will and testament;[13] nor engage in business other than that expressly authorized in its

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14 War Revenue Act, 1918; Secs. 200 and 218.

1 Civil Code, Section 293.
2 Civil Code, Section 290, subd. 4.
3 Constitution, Article XII, Section 7.
4 Civil Code, Section 285.
5 Civil Code, Section 286.
6 Civil Code, Section 283.
7 Constitution, Article XII, Section 4; Civil Code, Section 354.
8 Civil Code, Section 354.
9 Constitution, Article XII, Section 9.
10 Market St. Ry. Co. v. Hellman, 109 Cal. 590.
11 Statutes 1913, page 206.
12 Constitution, Article XII, Section 5; Civil Code, Section 356.

charter or by the law under which it may have been organized;[14] nor possess or exercise any powers except those enumerated and given by law or necessary to the exercise of those so given.[15]

By amendment to the Civil Code adopted in 1905, any corporation by unanimous vote of all the directors at any regular meeting is authorized to acquire and hold the lands and buildings of and in which its business is carried on, and to improve the same to the extent required for the convenient transaction of its business.[16] If this should be construed as a power, it would probably be unconstitutional as to such corporations as did not require lands and buildings for its authorized purposes; but construed as writing into the charter of each corporation the purpose to acquire lands and improve with buildings, it is valid. A distinction is to be drawn between the purposes of a corporation and its powers.[17] The fact that the powers are incidental to the purposes and are lodged in the board of directors by statute makes it important to state the fundamental purposes or business of the corporation broadly in its articles so that the required powers will be incidental to some of the purposes stated, and yet with such limitation that the board of directors may not divert the capital to speculations beyond the intent of the subscribers. The purposes stated do not fix the character of the corporation in its future activities, but merely give to the corporation capacity to engage in the business stated.[18] For instance,—a corporation whose stated purpose is to manufacture lumber and all articles of wood and which is actually engaged in that business has the implied power to operate a railroad reasonably necessary in its business, but not to operate a railroad for traffic,[19] a rail-

13 Civil Code, Section 1275.
14 Constitution, Article XII, Section 9.
15 Civil Code, Section 355.
16 Civil Code, Section 360.
17 Conference Free Baptists v. Berkey, 156 Cal. 470.
18 Allen v. Railroad Commission, 55 Cal. Dec. 110; 56 Cal. Dec. 326.
19 People v. Mt. Shasta Mfg. Co., 107 Cal. 256.

road company, upon leasing a system, may guarantee the bonds of the lessor issued for the construction of the leased system;[20] and a trading corporation may, upon transfer, guarantee the payment of obligations received from its customers and their purchasers from third parties.[21] To act as a financial agent is a proper purpose of a corporation,[22] as is the business of acting as agent for its stockholders only,[23] in which event the property conveyed to the corporation for its shares is held in trust for its stockholders except as against creditors. Since the amendment to the Civil Code in 1917, before such property or its proceeds is distributed, the permit of the Commissioner of Corporations should be obtained.[24]

CAPITAL STOCK.

Unless first authorized by the Commissioner of Corporations, directors of corporations must not divide, withdraw or pay to the stockholders any part of the "capital stock", nor reduce or increase the "capital stock", except as provided in Section 359 of the Civil Code.[1] In construing this section, the Supreme Court has not seen fit to apply the rule that words repeatedly used in the same statute will be presumed to bear the same meaning,[2] but has contsrued the term "capital stock" as first used to mean the consideration paid to the corporation for its shares,[3] although as next used it clearly refers to authorized share capital of the corporation.[4] In contemplation of law, the consideration paid to the corporation should equal the par value of the shares issued for it, and from this has grown the

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20 Low v. Central Pac. R. R. Co., 52 Cal. 53.
21 Armour & Co. v. Rosenberg & Sons, 26 Cal. App. Dec. 773.
22 Christie v. Sherwood, 113 Cal. 531.
23 Baldwin v. Miller & Lux, 152 Cal. 454.
24 Civil Code, Section 309.

1 Civil Code, Section 309.
2 McCarthy v. Board of Fire Commissioners, 26 Cal. App. Dec. 1190.
3 Tapscott v. Mexican Colorado etc. Co., 153 Cal. 664. 668; Schulte v. Boulevard Gardens Land Co., 164 Cal. 464.
4 Civil Code, Section 359.

confusion in the use of the term "capital stock" as applied indiscriminately to the consideration received by the corporation and the shares of stock issued for that consideration. When the share stock is issued at a premium the corporate surplus so created is not profits arising in the business available for dividends, nor at all divisible among the shareholders by the board of directors[5] without the consent of the Commissioner of Corporations.[6] To avoid this situation, subscribed shares should be paid for at par, and if an operating surplus in desired the amount should be donated by the subscribers in proportion to their shares after the subscription shares are issued, and the terms of the donation should be distinctly stated in the deed of gift. Where the shares are purchased the underwriting agreement or other contract of purchase should provide that the surplus obtained from such premiums may be divided among the shareholders in the discretion of the board of directors, with specific provision that it shall not be a part of the capital stock but shall be a loan to the corporation by the purchasers of the shares, returnable at the discretion of the board of directors without interest. This distinction between capital derived from premiums and other surplus accounts is avoided where the corporation is organized with shares without nominal or par value;[7] in which case the amount of the capital stated must be paid to the corporation in actual value before it begins business and must not be reduced by distribution to stockholders, but there is nothing to prevent the distribution of other addition to capital, whether acquired from premiums, donations, assessments, or by the sale of additional shares for the consideration prescribed in the articles. The language of the statute is uncertain as to whether all the authorized shares must be issued for the stated capital, but in view of the auth-

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5 Merchants & Insurers Reporting Co. v. Youtz, 27 Call. App. Dec. 889.
6 Civil Code, Section 309.
7 Statutes 1917, page 1321.

ority granted to sell shares it seems reasonable that a lesser number may be so issued, particularly as this construction aids the main purpose of the act, *viz,* the avoidance of bonus stock and watered treasury shares. Where shares preferred as to principal are authorized all of the shares must be issued for the stated capital.

SHARES AND SECURITIES.

The rights of shareholders may be classified. but no distinction is permitted between classes of stock or the owners thereof, either as to voting power or liability to creditors, and shares of different classes must all have the same par value.[1] This rule applies where shares are issued without nominal or par value if the preferred shares have a preference as to principal.[2] This leaves the corporation free to divide its shares and give any degree of preference as to income or capital assets to different classes of shares. By proper provisions incorporated in the articles, certificates and contract of sale, shares may be protected against assessment by the corporation[3] and given qualified redemption or convertible conditions.[4] While the corporation may not issue shares of stock without voting power or liability to creditors, it may issue bonds with a maturity date fixed at the expiration of the corporate charter, bearing interest payable only out of the profits, and either cumulative or non-cumulative, and such bond issue may be created at the time the corporation is organized and before the capital stock is issued beyond the necessary subscription shares. This form of unsecured debenture is useful to represent the subscriptions frequently taken to secure the location of a business considered beneficial to the community and which could not be secured without special inducements. The provision of the code that directors must not create

1 Civil Code, Section 290;
Film Producers v. Jordan, 171 Cal. 664.
2 Statutes 1917, page 1321.
3 Lum v. American Wheel Co., 165 Cal. 657;
Riverside Land Co. v. Jarvis, 174 Cal. 316.
4 Schulte v. Boulevard Gardens Land Co., 164 Cal. 464.

any debts beyond the subscribed capital stock refers to the actual creation of the debt, and a bond issue may be authorized in excess of the subscribed capital stock, provided it does not exceed the authorized capital stock, and the face value of the issued bonds does not exceed the total amount of the subscribed stock,[5] or in the case of shares without par value the amount of the stated capital.

Property is the right to use or possess things, or the right to acquire the use or possession of things. These rights are commonly evidenced by certificates issued under authority of the state, whether they be called deeds, agreements, checks, notes, bills of exchange, certificates of stock, bonds or trust certificates. The convenient dispatch of business requires that these certificates truthfully and intelligently state or give adequate notice of the rights which they represent. The partnership, the joint stock association, the participating trust, and the corporation all present efforts to assemble various forms of these property rights, possessed by many persons, combine them into a common credit force, provide for the control of this force, protect the unassociated property rights of the parties and provide for the representation of the new rights created by the assembling of this common credit force. This assembled credit force is the "capital" of the enterprise; its control is vested in a managing body; the form of protection to uncontributed rights is limited liability, and the new rights created are the profits of organizing the enterprise. The essential qualities of the certificates representing the assembled rights are that they truthfully certify to the rights represented in their respective classes and that the various rights be made and kept easily transferrable in order to make and keep fluid the capital they represent. The absence of authority to issue a security representing a right to vote and a share in the profits created by successful management, without capital in-

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5 Merced River Elec. Co. v. Curry, 157 Cal. 727.

vestment, lies at the root of the issue of most bonus securities.

The securities issued will represent either intangible or tangible rights, or a combination of the two, and the subscription agreement or contract of purchase should clearly state the character of the right to be represented. Invested capital, under the Excess and War Profits Tax Law, includes "tangible property", defined as stocks, bonds, notes and other evidence of indebtedness, bills and accounts receivable, leaseholds and other property other than intangible property; and "intangible property", defined as patents, copyrights, secret processes and formulae, goodwill, trade marks, trade brands, franchises and other like property.[1] Intangible property, *bona fide* purchased for cash, is to be included in invested capital at full value, but intangible property paid for in stock or shares on or after March 3, 1917, is not allowed as invested capital in excess of twenty-five per centum of the par value of the total stocks or shares of the corporation outstanding at the beginning of the taxable year.[2] From the standpoint of the income and excess profit tax law, it is therefore desirable in incorporating a company to take over a going business, or to exploit any property represented by intangible certificates, to issue shares for the intangibles to approximately twenty-five per cent of the total shares issued. This proceeding, however, should be followed cautiously, as where property is transferred to a corporation in exchange for its stock, the exchange constitutes a closed transaction and the former owner of the property realizes a gain or loss if the stock has a market value and such market value is greater or less than the cost or the fair market value as of March 1, 1913, (if acquired prior thereto) of the property given in exchange.[3] Incorporation papers representing to state officers that the property had been paid for by stock

1 War Revenue Act, 1918, Section 325a.
2 War Revenue Act 1918, Section 326a.
3 Internal Revenue Regulations, Article 1566.

of fair value equal to the par value of the stock will undoubtedly constitute evidence against the incorporators in any effort to show that the stock has no market value, and the stockholders may thus be required to pay an income tax based on market value of shares of stock taken at a grossly excessive value. Where agency corporations are organized, care must be taken to keep them strictly within the limits of "personal service corporations", and if this is not possible a partnership form of organization should be used. Otherwise, the parties interested may be found paying an income and excess profits tax many times greater than their competitors doing the same business. Such inequalities reach very large figures. An additional tax of $10,000 due merely to a different form of organization is not unknown in this district. Under a ruling by the Secretary of State, a California corporation with stock having a par value cannot, by amendment to its articles, change its stock to shares without par value. Until a decision is obtained permitting this change our corporations are excluded from increasing the number of such shares representing its assets without income tax on the new shares.

Certificates of Stock.

Each stockholder of the company whose stock has been paid for in full is entitled to a certificate or certificates showing the amount of the stock of the company standing on the books in his name.[1] Where stock is to be issued before being paid in full, the provision for its issue should be included in the by-laws, which should contain restrictions, purposes and conditions of its issue, and any certificate for stock not fully paid must show on its face what amount has been paid on the stock represented thereby.[2] Where different classes of stock are authorized, the certificates must also state the number of authorized shares of each class and the

1 Civil Code, Section 323.
2 Civil Code, Section 323.

nature and extent of the preferences granted the preferred stock.[3] Where stock without nominal or par value is authorized, the certificate should not designate any nominal or par value,[4] even though the articles of incorporation give the preferred shares a par value and a preference as to principal in a designated amount. Whenever the articles impose any burden upon the shares or they are issued on condition, such as the option to resell to the corporation,[5] or conditioned that they shall not be subject to assessment,[6] or that the title shall pass with the conveyance of certain real estate,[7] or whenever the by-laws impose a lien,[8] or restriction on transfer or make the shares appurtenant to land in a mutual water company,[9] or whenever the corporation has notice of the rights of third parties in the shares, a notation of any such preferences or limitations should be entered in the stock and transfer book and noted on the certificate to bind the purchaser of such shares.[10] Each certificate should be numbered, bear the signature of the president and secretary,[11] and the seal of the corporation, and be issued in numerical order from the stock certificate book and a full record of each certificate of stock as issued should be entered on the corresponding stub of the stock certificate book and the receipt of the new owner taken, with his address.[12] Certificates of stock are not negotiable instruments[13] but statements of certain facts appearing of record on the books of the corporation, certified to by its principal officers, and a true statement with full disclosure of what the books show in regard to the shares should be the controlling

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2 Civil Code, Section 323.
4 Statutes 1917, page 1321.
5 Schulte v. Boulevard Gardens Land Co., 164 Cal. 469.
6 Lum v. American Wheel etc. Co., 165 Cal. 661.
7 Riverside Land Co. v. Jarvis, 174 Cal. 326.
8 Jenninge v. Bank of California, 79 Cal. 323.
9 Civil Code, Section 324.
10 Young v. New Standard etc. Co., 148 Cal. 310.
11 Civil Code, Section 323.
12 Civil Code, Section 324.
13 O'Dea v. Hollywood Cemetery Association, 154 Cal. 72; Geary St. R. R. Co. v. Bradbury Estate Co., 56 Cal. Dec. 312.

feature. The board of directors should be authorized in its discretion to appoint a transfer agent and registrar of transfers, and in such event to require that all stock certificates thereafter issued bear the signature of such appointees. The by-laws should provide the conditions upon which a new certificate will be issued in case of loss or destruction, which usually should provide for the giving of a bond with sufficient sureties as indemnity against any loss or claim against the corporation; otherwise action must be brought in the Superior Court.[14] The statute in respect to bonds provides for the issue of a new bond only when the old one is lost or destroyed by conflagration or other public calamity.[15]

SUBSCRIPTION AGREEMENT.

Unless a copy of the proposed articles of incorporation is identified in or made an exhibit to the subscription agreement it should name the directors proposed for the first year, state the principal purpose of the corporations, the classes of securities, limit the number of shares which may be subscribed before incorporation and authorize the substitution of other persons for those named as directors, either by the particular financial interest each director represents or by a majority of the persons so named. As promoters, the persons named as directors should be authorized to prepare the articles of incorporation and the form of securities, with explicit authority to enlarge the purposes stated. General authority is not sufficient, as subscribers will not be bound to take stock in a corporation organized for purposes other than those stated in their subscription agreement.[1] The subscribers named in the articles will later adopt the by-laws and by fixing

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14 Civil Code, Section 328.
15 Civil Code, Section 329;
Brown v. Anderson etc. Dist., 28 Cal. App. Dec. 1067.

1 Marysville etc. Co. v. Johnson, 109 Cal. 192;
Hanford Mercantile Store v. Sowlveere, 11 Cal. App. 261.

the date of the annual meeting determine the period of control by the directors named in the articles, subject to the right of the stockholders to remove the board by two-thirds vote of the stock or to change the number of the board by a majority vote. Accordingly, subscriptions to shares before incorporation should be limited to the real parties in interest or their nominees, and the subscription shares prorated among them according to their several interests. Both the promoters[2] and the subscribers[3] occupy fiduciary relations to each other, and where it is contemplated that shares nominally issued to them are to be sold to others, the fiduciary relation is extended to their purchasers,[4] with the corresponding duty to make full disclosure of any special advantage; but where at the time of organization there is no intent to offer the shares to others[5] the fiduciary relation is not so extended. The most satisfactory method is to limit the number of subscription shares to the smallest number which will proportionately represent the different interests involved and for such shares to be subscribed for in cash at par, with a consent that additional shares, either open or to a fixed amount, may be sold by the board of directors without first being offered to the subscribers. In its simplest form, the subscription agreement is contained in the articles of incorporation, where all the subscribers are named as directors for the first year. This leaves the substantial terms of the agreement between the promoters to be worked out in a sales contract or underwriting plan. The subscription agreement may be executed in a number of parts, and where the subsequent parts show on their face that they are intended as a subscription for a specific number of shares in the same corporation as the first or principal subscription agreement the fact that the list of subscribers named in the first, or the exhibits

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2 Burbank v. Dennis, 101 Cal. 101.
3 Lomita Land & Water Co. v. Robinson, 154 Cal. 36.
4 California Calaveras Min. Co. v. Walls, 170 Cal. 285, 292.
5 Whitten v. Dabney, 171 Cal. 621, 624.

attached thereto, are not annexed to the subsequent parts, will not destroy the legal unity of the different parts as one agreement.[6] Original subscribers are not compelled to take stock issued to and owned by others, but are entitled to stock issued directly from the corporation;[7] but where all the stock has been issued and a part returned to the corporation as treasury stock and there is no showing but what it was a partial rescission for want of adequate consideration, it may be regarded as unissued stock for the purpose of delivery to a subscriber.[8] It is not necessary that all the subscribers sign the articles[9] and the preliminary subscriptions inure to the benefit of the corporation when it is organized[10] as contemplated in the agreement, and thereafter both the corporation and the subscribers are bound. One not named in the articles of incorporation is not strictly a subscriber, but where he enters into an agreement in the form of a subscription to pay the trustee when organized and receives shares of stock he becomes a stockholder by purchase and the corporation can sue to collect the agreed value of the shares as the real party in interest.[11] Where the subscription agreement does not provide for the time and place of payment for the shares the subscription may be collected by calls in the same manner as statutory assessments;[12] and where a note is given for the subscription it is better practice to treat the note as additional evidence of the promise to pay the subscription price and not as payment, and for the corporation to retain the certificate until the note is paid.[13] While the subscribers may withdraw from the subscription agreement prior to incorporation, subject to any con-

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6 Beedy v. San Mateo Hotel Co., 27 Cal. App. 653, 661.
7 Gray v. Ellis, 164 Cal. 481, 487.
8 Pasadena Rapid Transit Co. v. Munson, 26 Cal. App. Dec. 1072.
9 San Joaquin Land & Water Co. v. Beecher, 101 Cal. 70, 79.
10 Marysville etc., Co. v. Johnson, 93 Cal. 538, 546. 109 Cal. 192.
11 Horseshoe Pier etc. Co. v. Sibley, 157 Cal. 442, 447.
12 Los Angeles Athletic Club v. Spiers, 166 Cal. 173.
13 Ballou v. Avery, 175 Cal. 641.

tractual liability to their co-subscribers, they may not be released from their subscriptions after incorporation except by unanimous consent of their co-subscribers, unless the subscriptions are obtained by fraud or mistake.[14] Subscribers as between themselves may agree to issue the subscription shares for any agreed valuable consideration,[15] but may not issue them without any consideration,[16] or merely upon the agreement of the donee to sell the stock and turn the proceeds over to the corporation,[17] or to equalize the cost of the stock to the subscribers with that paid by later purchasers.[18] Disclosed conditional subscriptions are valid[19] but undesirable, as they leave the question open whether the conditional subscribers are entitled to join in organizing the corporation. Subscriptions upon condition kept secret from co-subscribers, such as that the subscription is not to be paid except from dividends on the shares, will be enforced free from the secret condition.[20] At the suit of the judgment creditors of the corporation the subscribers and their successors in ownership of the subscription shares will be held liable at any time in the future to pay the difference between the real value of the consideration paid to the corporation for shares and the par value of the shares,[21] unless the creditors are estopped by knowledge of the real consideration at the time they extended the credit to the corporation.[22] To impart this notice a certified copy of the permit of the Commissioner of Corporations to issue the shares should be recorded in the office of the recorder of the county of the principal place of business of the corporation.[23] A different situation, how-

14 Silicia Brick Co. v. Winsor, 171 Cal. 18, 21.
15 Garrettson v. Pacific Crude Oil Co., 146 Cal. 184.
16 Lucey Co. v. McMullen, 55 Cal. Dec. 870.
17 Cortelyou v. Imperial Land Co., 156 Cal. 373.
18 Kellerman v. Maier, 116 Cal. 416.
19 Jefferson v. Hewitt, 103 Cal. 624;
Tidewater Sou. Ry. Co. v. Vance, 31 Cal. App. 503.
20 Quartz & Glass Mfg. Co. v. Joyce, 27 Cal. App. 523.
21 Herron v. Shaw, 165 Cal. 668;
Hasson v. Koeberle, 57 Cal. Dec. 458.
22 Harrison v. Armour, 169 Cal. 787.
23 Corporate Securities Act, Section 23;
Statutes 1917, page 684.

ever, arises where, after organization, unsubscribed shares are sold at less than par but at their full market value.[24] The signing of the name of a fictitious person to any subscription agreement, or the name of any person under an understanding that the subscription is not to be complied with, is a misdemeanor.[25] The subscription must be complete before the articles of incorporation are filed, as thereafter no valid subscriptions can be made except sales first authorized by the Commissioner of Corporations.[26]

Offers to Purchase and Sales of Shares.

The plan for financing the newly organized corporation usually takes one of four forms,—that of a closed stock corporation, where it is the intention of the parties to keep the stock in a few hands; that of a distributive stock corporation, where the capital securities are underwritten by a financial house for cash at a discount; where the shares are issued for property with the intention on the part of the purchasers to resell to the public; and where the capital securities are to be sold directly to the public by the corporation for cash. In any case, the plan should be sufficiently flexible and the directors named for the first year or other managing committee be given sufficient authority to adjust the plan to meet the requirements of the Commissioner of Corporations. It is desirable that a form balance sheet be attached to the offer, setting out the capital assets and liabilities as they will appear upon acceptance of the offer, with a schedule of the distribution of the capital securities among the joint purchasers. This will enable any one interested to see whether the working capital is properly balanced against the fixed assets and what relation the commis-

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24. Lucey v. McMullen, 178 Cal. 425.
O'Dea v. Hollywood Cemetery Assn., 154 Cal. 53, 67.
25 Penal Code, Section 557.
26 Nannizzi et al. v. Caprile et al., 30 Cal. App. Dec. 135; Corporate Securities Act, Sections 3 and 25; Statutes 1917, page 684.

sion or discount bears to the exchange values. Where the securities are to find their way into the hands of the public, it is equally important that a statement of the plan of conducting the business and the experience of the intended managers who are to take active charge be set out. Where the offer is to purchase securities in part for cash and in part for a going business or undeveloped property or intangible rights, it should be so balanced as to leave the preferred stock secure against calls by creditors and assessments by the corporation, the mortgage bonds with an ample margin of underlying security, the unsecured debentures earmarked so as not to mislead purchasers unacquainted with the plan of organization, the owners of the common stock in control of the board of directors and a sufficient margin of profit to the subscribers of the enterprise and the underwriters of the securities to compensate them for the time and money expended. If any of the original subscribers are to derive any advantage upon the offer being accepted that fact should clearly appear, although the amount of their profit need not be stated. Where the offer made to the corporation is on behalf of a syndicate or other joint adventurers to which the members are contributing various forms of property, there should be a statement that the valuations of properties and securities are not representations of fact but approximations only to assist the parties in prorating the risks and rights in the organization and, if such is the fact, that certain of the members expect to realize a profit, commission or advantage upon the acecptance of the offer. The offer should by its terms remain open a sufficient time to permit of action by the Commissioner of Corporations, be made subject to his approval and state in clear language that its conditinal acceptance and the application to issue stock in accordance with the offer shall not constitute the purchasers or their assigns either subscribers or stockholders until the board of directors of the corporation formally accepts the offer and makes the sale after the permit of the Commissioner

has been issued. If there is any ambiguity as to whether or not these contract purchasers are subscribers and the offer involves a purchase of bonds, considerable confusion will arise as to whether they are included among the subscribers who must act in authorizing the bond issue or adopting by-laws.

If the preferred stock is non-participating in the profits beyond the secured preference the takers will frequently wish the privilege of converting it into common, which option will be exercised by them if the enterprise proves successful. If the preferred stock is participating the takers of the common will desire that the corporation have the option to redeem the preferred after a certain number of years. No difficulty is encountered in providing for the conversion of one class of stock into another or the payment of a bonus upon the preferred being converted into common, *provided* the bonus can be paid out of profits arising in the business. The redemption of stock with either cash, property or bonds usually involves a reduction of the capital stock considered as capital paid in and may or may not require a corresponding reduction of authorized capital stock. Where the amount paid on redemption of the capital shares does not exceed the amount paid in for it and the authorized capital stock is reduced in the same proportion, no difficulty is encountered. Where, for instance, a combination of preferred and common stock is issued for property worth less than the par value of the stock so issued and by the contract of sale the preferred stock is to be redeemed at par at the option of the holder, upon proceedings regularly taken to reduce the capital stock it might happen that all the assets would be paid out on reduction by one-half of the issued capital stock, leaving the remaining one-half outstanding representing no assets and without the creditors having been paid. The right to provide in the contract of sale for a repurchase by the corporation of the stock at the option of the purchaser, where the contract does not involve original subscription stock and the repur-

chase does not reduce the capital assets by more than the sum paid in for such stock, nor involve the rights of creditors, has been sustained;[1] but any statement that the contract for the sale and purchase may provide for the redemption or repurchase of shares out of capital stock paid in is without authority. Where the preferred stock has a preference as to assets under adequate provision in the articles and certificate, the capital stock paid in may be reduced by a corresponding reduction of authorized capital stock without prorating the reduction with the common stock; but any reduction of issued stock below the existing indebtedness of the corporation is prohibited and any reduction of the capital paid in below the proportion it bears to the remaining outstanding capital stock should be equally invalid. The power of the Commissioner to permit such a reduction is not settled.

By reason of the fact that we have no form of security which may be issued to represent a right to management and to share in the profits without capital investment nominally, at least, equal to every other share, it has been the practice in the past to issue two classes of securities for a single consideration. As the trust fund liability does not apply to bonds, shares of little market value were issued at par and bonds secured by all the assets were given as a bonus.[2] It is to the credit of the Commissioner of Corporations that he has discouraged this proceeding and "has endeavored as a matter of good business policy to limit the issue of shares to an amount approximating the reasonable value of the consideration passing to the company."[3] It would tend to truthfulness and simplicity if shares were authorized to represent voting rights, risk and profits, *with* liability to creditors and without capital investment, and another class of shares were authorized *without* liability to creditors when paid in at time of issue in money or money's worth to the

1 Schulte v. Boulevard Gardens Land Co., 164 Cal. 464.
2 McKee v. Title Insurance Co., 159 Cal. 206, 218; Williamson v. Collins, 243 Fed. 835.
3 Report of Commissioner Bellows, 1918.

amount of the par value. Until such shares are authorized, various makeshifts will continue to be employed. An amendment to the constitution along this line was defeated in 1918. The desired situation may be approximated by issuing certain shares of stock for money or money's worth equal to the par value of the stock and so as not to be assessable by the corporation, and issuing a substantially larger number of shares not fully paid, the unpaid balance being left subject to call by the board of directors. By increasing the proportion the partly paid stock bears to the fully paid, and decreasing the percentage of the par value paid in on the partly paid stock, both the control of the business and the risk of loss will be increasingly shifted to the owners of this partly paid stock. Generally it will be desirable to accentuate the distinction by making the fully paid shares preferred stock, but this is not necessary. Calls should be made on the partly paid shares until fully paid before any assessments are levied on the fully paid.[4] Where shares are issued as fully paid for property of less value than the par of the shares, care should be taken to see that the certificate of the Commissioner of Corporations recites the fact and a copy should then be recorded in the office of the recorder of the county of the principal place of business of the corporation to impart notice to creditors.[5]

Articles of Incorporation.

When a corporation has shares of stock with par value, articles of incorporation must be prepared, setting forth the name of the corporation, the purpose for which it is formed, the place where its principal business is to be transacted, the term for which it is to exist, not exceeding fifty years, the number of its directors which shall not be less than three, the names

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4 O'Dea v. Hollywood Cemetery Assn., 154 Cal. 53, 65; Imperial Land etc. Co. v. Oster, 34 Cal. App. 776.
5 Corporate Securities Act, Section 23; Statutes 1917, page 685.

and residences of those who are appointed for the first year, the amount of its capital stock and the number of shares into which it is divided and the par value thereof, the amount actually subscribed and by whom. Such corporations may, by their articles, provide for the classification of their capital stock into preferred and common; in which event the articles must contain a statement of the shares of stock to which preference is granted, the nature and extent of the preferences granted and, except as to the matters and things so stated, no distinction shall exist between the classes of stock or the owners thereof. No preference is allowed to be granted nor distinction to be made between the classes of stock either as to voting power or as to the statutory or constitutional liability of the holders theerof to the creditors of the corporation, nor any difference between the par value of the shares of the different classes.[1] Since the right of subscribers or stockholders to take at par their proportionate part of any new issue of stock is not settled by authority in this state it is well to have a definite provision in the articles and noted on the certificate, stating the right of the stockholders either to participate in such new issues of stock or the power of the board of directors to issue and sell such shares of stock without first offering them to the stockholders. While the facts required to be stated in the articles by statute and the statute constitute the charter of the corporation, it is now well settled that the stockholders may incorporate additional provisions in the articles of incorporation which being noted on the certificate will form a part of the fundamental contract between the subscribers or purchasers and their successors.

Where a corporation is organized with shares of stock without par value, the articles of incorporation must be prepared, setting forth the name, the purpose for which it is formed, the place where its principal business is to be transacted, the term for which it is

1 Civil Code, Section 390.

to exist, not exceeding fifty years, the number of its directors or trustees which shall not be less than three, and the names and residences of those who are appointed for the first year. The articles shall also set forth the amount of capital with which the corporation will carry on business, the number of shares into which it is divided and the consideration for which its shares may be issued or sold. No such corporation shall begin to carry on business or incur any debts until the amount of the capital stated in its articles of incorporation shall have been fully paid in money or in property taken at its actual value. Such corporation may thereafter issue and sell its authorized shares from time to time for such consideration as may be prescribed in the articles of incorporation, and any shares sold or issued for such consideration shall be deemed, when such consideration shall have been paid or delivered to the corporation, to be fully paid. If any of the shares be preferred stock, the articles must state the amount of each class having the preference and the particular character of such preference, and if such preferred stock or any part thereof shall have a preference as to principal the par value of each share thereof, which shall be one dollar or some multiple thereof not exceeding one hundred dollars; in which event the amount of capital with which the corporation will carry on business shall be a sum equal to the product obtained by multiplying the par value of such preferred shares by the whole number of shares that may be issued by the corporation. It is provided that no distinction shall exist between any shares or classes of shares either as to voting power or as to the statutory or constitutional liability thereof to the creditors of the corporations, and each share of stock without nominal or par value shall be equal in every respect to every other share authorized to be issued, subject only to the preference granted to the preferred stock, if any, as stated in such articles.[2]

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2 Statutes 1917, page 1321.

The name chosen for a business corporation may not include the words "trust" or "trustee" unless authorized to act in fiduciary capacities[3] and should be reserved wtih the Secretary of State prior to filing the articles, as he is not authorized to issue any certificate of incorporation to any corporation whose articles set forth the name of any corporation theretofore organized in this state, or which set forth a name so closely resembling the name of such other corporation as will tend to deceive.[4] Even if the name is approved by him and his certificate issued, if the name is so similar to that of another corporation as to create confusion and enable the later corporation to obtain the business of the prior one, an injunction will issue to restrain the second from using the name so far as is necessary to protect the first user against misrepresentation. This is an application of the same rule as to an individual using the name of another under similar circumstances.[5]

The place where its principal business is to be transacted should state the city or town and the county and state. If the principal place of business is outside of an incorporated city or town, some smaller geographical subdivision than the county, with the nearest postoffice address, should be given. Under a former statute requiring the city or town and county to be stated, the statement of the county only was held insufficient.[6] The due incorporation of any company claiming in good faith to be a corporation and doing business as such is not permitted to be inquired into collaterally in any private suit.[7]

The articles of incorporation must be subscribed by each of the persons named therein as directors for the first year and acknowledged by each of them before

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3 Civil Code, Section 290½.
4 Civil Code, Section 296.
5 Dodge Stationery Co. v. Dodge, 145 Cal. 380; Hainque v. Cyclops Iron Works, 136 Cal. 351.
6 Harris v. McGregor, 29 Cal. 125.
7 Vallejo etc. R. R. Co. v. Reed Orchard Co., 169 Cal. 560;

some officer authorized to take and certify acknowledgements of conveyances of real property.[8] The original articles of incorporation so certified and acknowledged must be filed in the office of the County Clerk of the county named as that in which the principal business of the company is to be transacted and a copy thereof, certified by the County Clerk, should be filed with the Secretary of State, who is thereupon required to issue to the corporation over the great seal of the state a certificate that a copy of the articles containing the required statement of facts has been filed in his office, and therupon the persons signing the articles and their associates and successors become a body corporate.[9] Should articles properly executed be filed with the Clerk of the wrong county, the error may be corrected by special proceedings in the Superior Court of that county.[10] A copy of any articles of incorporation filed in pursuance of the statute and certified by the Secretary of State or by the County Clerk of the county where the original articles have been filed is *prima facie* evidence of the facts therein stated.[11]

Government Fees and Charges.

The original Articles of Incorporation are filed with the County Clerk of the county in which the principal place of business is located, for the filing of which the County Clerk collects a fee of one dollar and an additional fifty cents for certifying to a copy.[1] This certified copy is then filed with the Secretary of State, who being furnished additional copies for that purpose certifies them to the organizers upon payment of his fees as follows:[2]

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8 Civil Code, Section 292.
9 Civil Code, Section 296.
10 Civil Code, Section 363.
11 Civil Code, Section 297.

1 Political Code, Sec. 4300a.
2 Political Code, Sec. 409.

For comparing and recording Articles of Incorporation (per folio)	$ .25
For issuing Certificate of Incorporation	3.00
For issuing two certified copies of Articles of Incorporation at $2.00 each	4.00
Filing Articles of Incorporation, when authorized capital stock amounts to:	
$ 25,000 or less	15.00
75,000 or less	25.00
200,000 or less	75.00
1,000,000 or less	100.00

If the capital stock is over $1,000,000, $100.00 and $50,00 additional for every $500,000 or fraction thereof.

At the same time the incorporators pay to the Secretary of State the license tax, or the proper quarterly parts thereof, for the current fiscal year, based on the authorized capital stock of the corporation as follows:[3]

$ 10,000 or less	$ 10.00
20,000 or less	15.00
50,000 or less	20.00
100,000 or less	25.00
250,000 or less	50.00
500,000 or less	75.00
1,000,000 or less	100.00
3,000,000 or less	200,00
5,000,000 or less	350.00
7,000,000 or less	500.00
10,000,000 or less	800.00
Over 10,000,000	1,000.00

When the capital stock of any corporation has no par value the filing fee with the Secretary is determined by the total capital fixed in the Articles, and the license tax is one hundred dollars. When part of the capital stock has a par value and a part has no par value, the tax is computed upon such par value stock in accord-

3 Statutes 1917, page 373, section 3.

ance with the above schedule, to which is added the sum of fifty dollars. Building and loan companies and associations and corporations having no capital stock but organized for profit are required to pay an annual license tax of ten dollars. Corporations organized and conducted solely and exclusively for educational, religious, scientific or charitable purposes, corporations which are not organized or conducted for profit, and public utility corporations taxed under Section 14 of Article XIII of the Constitution are exempt from payment of the license tax, and the Secretary of State, the State Comptroller and members of the State Board of Control are constituted the Corporation License Tax Exemption Board for the purpose of determining whether a particular corporation is exempt or not.[4] Under the stamp tax provisions of the War Revenue Act of 1918, document stamps at the rate of five cents for each one hundred dollars of capital stock issued are required to be affixed to the stock book, and at the rate of two cents for each one hundred dollars of par value of stock transferred.[5] Upon filing the application with the Commissioner of Corporations for a permit to issue securities, the applicant is required to pay fees based on the par value or face value of the securities which authority is asked to issue, as follows: on $20,000 or less, $10; for the next $30,000, one-twentieth of one per cent, or .0005; on the next $50,000, one-twenty-fifth of one per cent, or .0002; and on all applications to issue above $500,000, one-one-hundredth of one per cent, or .0001. This makes the sum of $175.00 for the first $1,000,000 of securities, if covered by a single application.[6]

Estimated expense of Incorporating Company with Capital Stock:

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4 Statutes 1917, page 373, section 6.
5 War Revenue Act 1918, section 1107, Schedule A.
6 Corporate Securities Act, section 20; Statutes 1917, page 693.

Estimated Expense of Incorporating Company with Capital Stock:

	$5,000 or less	$10,00 or less	$20,000 or less	$25,000 or less	$50,000 or less	$75,000 or less	$100,000 or less	$150,000 or less	$200,000 or less	$250,000 or less	$500,000 or less	$1,000,000 or less
County Clerk	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Notary	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50
Misc. Sec. of State	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.50	10.00	10.00	10.00
Corp. Fee	15.00	15.00	15.00	15.00	25.00	25.00	50.00	50.00	50.00	75.00	75.00	100.00
License Tax	10.00	10.00	15.00	15.00	20.00	25.00	25.00	50.00	50.00	50.00	75.00	100.00
Commr. of Corp.	10.00	10.00	10.00	12.50	25.00	35.00	45.00	55.00	65.00	75.00	125.00	175.00
Revenue Stamps	2.50	5.00	10.00	12.50	25.00	37.50	50.00	75.00	100.00	125.00	250.00	500.00
Books, Seal, Printing, etc. estimated	15.00	20.00	20.00	25.00	35.00	50.00	50.00	50.00	75.00	75.00	100.00	100.00
TOTAL	66.50	74.00	84.00	94.00	144.00	186.50	234.00	294.50	354.00	414.00	639.00	989.00

ORGANIZATION.

Prior to the Corporate Securities Act, upon the certificate of incorporation being received from the Secretary of State, a meeting of the subscribers was called which ratified the acts of the organizers, confirmed the members of the board of directors named in the Articles and adopted a code of by-laws. Under the Corporate Securities Act the order of proceeding is somewhat different,—the members of the board appointed by the Articles meet, elect a president, secretary and treasurer and apply to the Commissioner of Corporations for authority to issue the subscribed shares.[1] Nothing is said as to whether the subscribers may adopt a code of by-laws before their subscriptions are approved by the Commissioner of Corporations, but logically they should take no action until his authority to issue the subscribed shares is obtained. Then they should adopt a code of by-laws and file a written consent that shares may be sold without being first offered to the subscribers. Whether failure to adopt by-laws within the month, or to organize within the year will make the incorporators liable as partners is doubtful.[2] The directors may now initiate proceedings for the sale of shares and the creation of a bonded indebtedness. In doing so the Board should direct that an inventory and appraisement be taken of the property offered to the company for stock.[3]

No company under the jurisdiction of the Commissioner of Corporations is permitted to sell, except upon a sale for delinquent assessment, offer for sale, negotiate for sale or take for security a subscription of its own shares until it shall first apply for and secure from the Commissioner of Corporations a permit

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1 Corporate Securities Act, Section 25; Statutes 1917, page 685.
2 Williams Co. v. Ah Quin, 30 Cal. App. Dec. 531; But see Civil Code, Sections 301 and 358.
3 Hasson v. Koeberle, 57 Cal. Dec. 458.

authorizing it so to do.[4] This application is required to be in writing and verified on behalf of the corporation by an officer thereof, to the effect that the statements in the application are true of affiant's own knowledge, except as to matters therein stated upon information and belief, and that as to those matters he believes it to be true. Such application should set forth, either by statement or exhibit,—[5]

The names and addresses of each of its officers and directors, showing the investment of each in the corporations, and their experience in the business;

The location of its office;

An itemized account of its financial condition in the form of a profit and loss account;

The amount and character of its assets and liabilities in the form of a balance sheet, with explanatory notes;

A detailed statement of the plan upon which it proposes to transact business, including the plan for financing and management and items of the specific uses to which the new capital is to be put;

A copy of any security it proposes to issue;

A copy of any contract is proposes to make concerning any such security, stating the net consideration in money or property to be received by the corporation and the brokerage to be received by the corporation and the brokerage or other compensation to be paid on the transaction;

A copy of any prospectus or advertisement or other description of such securities intended for publication;

An inventory and appraisement of any property it desires to accept in payment for securities;

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4 Corporate Securities Act, Section 3; Statutes 1917, page 675.
Nammizzi et al. v. Caprile et al., 30 Cal. App. Dec. 135.

5 Corporate Securities Act, Section 5; Statutes 1917, page 677.
Regulations of Corporation Commissioner.

A copy of all minutes of any proceedings of its directors or stockholders relating to or affecting the issue of such securities;

A copy of its articles of incorporation; and

A copy of its by-laws and of any amendments thereto.

Where securities are to be issued for patents, a copy of the file wrapper of the proceedings in the patent office should be attached, together with references to similar patents. Where securities are to be issued for mining claims on government land, the application should be accompanied by copies of all instruments in the chain of title, with annual proofs of labor. If the application is to issue securities for property it should appear that the capital assets at going-business value are equal to the face of the securities representing the total of loaned capital and of stock having a preference as to principal. The appraisement of the capital assets at liquidation value should exceed by a safe margin the face value of all securities representing loaned capital, and the business should show a net average income for at least three consecutive years sufficient to meet fixed charges, dividends on preferred stock and a net income remaining equal to a similar dividend on the common stock. An historical balance sheet will present these facts in most abbreviated form. If the assets back of any class of securities fail to measure up to these requirements, the Commissioner may properly require that the particular security be deposited in escrow and transferred only through his office until the conditions are met. If there is no desire to transfer the stock to the public there is no reason why, on presenting a formal application to the Commissioner, authority to issue the stock or other securities to the parties concerned in their agreed proportions should not be allowed, but in such case, without further showing, some restriction on its transfer may be made a condition of the certificate. In the main the Act is securing to the public some measure of the protection against fraud which stock brokers long since found it necessary to

secure for themselves by rules for listing on the stock exchange and voting trust agreements to secure stability of management. Where the corporation is organized with shares having a par value no particular amount of capital need be paid in before the corporation begins doing business, but where organized with shares without par value the stated amount of capital must be first paid in.

BY-LAWS

Required by Statute.

Every corporation is required within one month after filing its articles of incorporation to adopt a code of by-laws for its government not inconsistent with the constitution and the laws of the state.[1] No penalty is prescribed for failure to do so, provided the corporation is organized within the year.[2] It is at least doubtful whether the subscribers have authority to adopt a code of by-laws before the Commissioner of Corporations has authorized their shares to be issued in accordance with the subscriptions.[3] However, if the by-laws had been signed by all the subscribers prior to their shares being issued and afterwards certified by a majority of the board of directors, they will be held binding upon grounds of estoppel.[4] By-laws must not be inconsistent with the constitution and the laws of the state;[5] nor with its charter construed as the provisions in the articles of incorporation required to be inserted by law.[6] Thus, the by-laws must not create preferences between stockholders,[7] nor change the

1 Civil Code, Section 301.
2 Civil Code, Section 358.
3 Corporate Securities Act, Section 25; Statutes 1917, page 685.
4 Vercoutere v. Golden State Land Co., 116 Cal. 415.
5 Civil Code, Section 301.
6 Peoples Home Sav. Bank v. Sadler, 1 Cal. App. 189.
7 Civil Code, Section 290.

name,[8] nor the principal place of business,[9] nor enlarge the scope of its business, nor the purposes of its organization.[10]

ADOPTION AND SCOPE.

The assent of stockholders representing a majority of the subscribed stock at a meeting called for that purpose by order of the acting president upon two weeks' notice by advertisement in some newspaper published in the county in which the principal place of business of the corporation is located; or if none is published therein then in a newspaper published in an adjoining county, is sufficient for the adoption of the original code of by-laws.[1] The general rule that a majority of a quorum may act is not applicable here. The by-laws, however, may be adopted by the written assent of the holders of two-thirds of the stock.[2] However adopted, no by-laws can be enforced against any person other than the corporation not having actual notice thereof until copied in a legible hand in the book of by-laws kept at the office of the corporation.[3] A certificate by a majority of the directors and the secretary of the corporation required by the code[4] is not made a condition of the by-laws being notice to stockholders. There is no power to delegate to the board of directors authority to adopt the original code of by-laws, but the power to amend the by-laws may be so delegated by the holders of two-thirds of the subscribed stock.[5] Old by-laws not mentioned in amended by-laws are not continued in force.[6]

It is regarded as elementary law that corporations have power to enact by-laws for their internal govern-

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8 Code of Civil Procedure, Sections 1275 et. seq.
9 Civil Code, Section 321a.
10 Constitution, Article VII, Section 9.

1 Civil Code, Section 301.
2 Civil Code, Section 301.
3 Civil Code, Section 304.
4 Civil Code, Section 304.
5 Civil Code, Section 304.
6 Murphy v. Pacific Bank, 130 Cal. 542.

ment, determining the rights and regulating the duties of the members and providing for the unforseen details which may arise in the business.[1] The term is properly confined to rules regulating the rights and duties of the stockholders between themselves and between the stockholders and the corporation,[2] in the conduct of its internal affairs. By-laws do not by themselves constitute a contract between stockholders,[3] but by reference they may form part of a contract[4] which will be binding upon purchasers of stock with notice, and this notice may be given by a notation on the certificate.[5] The authority to enact by-laws is an inherent right in the absence of positive legislation restricting it, and the enumeration, in Section 303 of the Civil Code, of certain matters which may be provided for in the by-laws has not limited the authority of the corporation to make by-laws for the management of its property, the regulation of its affairs and the transfer of its stock, as authorized by Section 354 of the Civil Code.[6] Where certificates of stock are to be issued before the stock is fully paid provision for such partly paid stock should be made in the by-laws.[7] It is well to provide in the by-laws the form of certificate to be issued, although this may be left to a resolution of the board of directors.

Enforcement and Amendment.

The by-laws may be repealed or amended or new by-laws may be adopted at the annual meeting of the stockholders, or at any other meeting of the stockholders called for that purpose by the board of directors, in either of which events an affirmative vote representing two-thirds of the subscribed stock is necessary

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1 Provident etc. Assn. v. Davis, 143 Cal. 257.
2 Cheney v. Canfield, 158 Cal. 348.
3 Cheney v. Canfield, 158 Cal. 348.
4. Riverside Land Co. v. Jarvis, 174 Cal. 325.
5 Jennings v. Bank of California, 79 Cal. 323.
6 Peoples Home Savings Bank v. Sadler, 1 Cal. App. 195. Bornstein v. District Grand Lodge, 2 Cal. App. 627.
7 Civil Code, Section 323.

or the written assent of the holders of two-thirds of the subscribed stock is sufficient. The amendments cannot be enforced until copied or the repeal stated, with the date thereof, in the manner required for the original by-laws. The power to repeal and amend by-laws and adopt new by-laws may be delegated to the board of directors, but the power once delegated may be revoked only by the affirmative vote of two-thirds of the stock at a *regular* meeting of the stockholders.[1] Attention is called to the use of the words "annual meetings" for the adoption of by-laws, and the use of the words "regular meetings" for the revocation of the authority delegated to the board of directors, so that the authority once delegated to the board cannot be recalled, either by amendment in writing signed by the holders of two-thirds of the stock or by vote at a special meeting. Where authority is given to the directors to alter or amend the by-laws or to adopt new by-laws, it should be limited so as to prevent their altering or annulling a by-law imposing a valid limitation on the mode of exercising their powers or prescribing the manner of transacting business, or prescribing the duties of the board of directors. Violation of the by-laws may be penalized not to exceed in any case one hundred dollars for any one offense.

Stock and Transfer Books.

The stock and transfer books of the corporation should be kept at the office of the company which should be fixed by a provision in the by-laws[1] at a street number at the principal place of business stated in the articles of incorporation[2] or certificate changing the principal place of business regularly certified and filed.[3] In the stock and transfer book must be kept a record of all stock issued, the names of the stock-

1 Civil Code, 304.
2 Civil Code, Section 303.

1 Constitution, Article XII, Section 14.
2 Civil Code, Section 290, subd. 3; Chapman v. Doray, 89 Cal. 54.
3 Civil Code, Section 321a.

holders alphabetically arranged, the installments paid and unpaid, the assessments levied and paid or unpaid, a statement of every alienation sale or transfer of stock made, the date thereof, by whom and to whom.[4] The names and amounts of subscriptions to capital stock made to the corporation should be identified on the stock and transfer book so as to dinstinguish them from sales and transfer to subsequent purchasers, as the identity of shares is not lost by transfer or splitting up into different certificates or combining different shares of different issues under a single certificate.[5] Whether the purchaser of one issue may be required to take shares of a different issue is at least doubtful.[6] Provision should also be made on the stock and transfer book for noting the rights of non-stockholders in the shares, as a pledgee has a right to have the fact of his pledge noted on the stock books,[7] and where the corporation has notice that a stockholder holds his stock as trustee for another it should refuse to register a transfer until it is satisfied that the trustee has power to make the transfer;[8] but the mere fact that the certificate is issued in the name of the ostensible owner followed by the word "trustee" is not notice of the rights of third parties.[9] Possession of a certificate by one not named therein is no evidence of ownership,[10] but the owner may be estopped where he endorses the certificates in blank and places them in the possession of a third party who pledges them without authority,[11] and the corporation must transfer shares even though they are subject to attachment

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4 Constitution, Article XII, Section 14;
Civil Code, Section 378.
5 Ramage v. Gould, 176 Cal. 746.
6 Bell v. Bank of California, 153 Cal. 239;
Bank v. Wickersham, 99 Cal. 655, 661.
7 American Trust & Banking Co. v. Union Security Co., 29 Cal. App. Dec. 729.
8 MacDermot v. Hayes, 175 Cal. 95;
Young v. New Standard etc. Co., 148 Cal. 310.
9 Fletcher v. Kidder, 163 Cal. 769;
Northwestern Portland Cement Co. v. Atlantic Portland Cement Co., 174 Cal. 308.
10 Nicholls v. Reid, 109 Cal. 632.
11 Fowles v. National Bank of California, 167 Cal. 653.

by levy of a garnishment on the corporation[12] or where assessments have been levied and not paid.[13] The by-laws should provide how the secretary should proceed upon a demand for a transfer and the issue of a certificate, as he is penalized in the sum of four hundred dollars if he refuses to make the transfer and issue the certificate[14] and liable if he issues a false certificate,[15] and the corporation is liable for the value of the shares in conversion.[16] The corporation is entitled to a reasonable time within which to make an independent investigation or institute an action for interpleader where there are rival claims.[17] If the transferee declines to accept a certificate with a notation showing all claims of which the corporation has notice against the shares represented by the new certificate, the secretary should not decline to issue a clean certificate but should report the matter to the executive officers and the board of directors for instruction, the right to make the notation on the certificate in such cases being unsettled.[18] Where the shares of stock are owned by parties residing out of the state, the president and secretary or board of directors may require satisfactory evidence that the non-resident owner was alive at the date of the transfer.[19] Shares of a married woman may be transferred by her without the consent of her husband and in the same manner as if she were unmarried.[20] Within these limitations the corporation has power to make by-laws for the transfer of its stock.[21] Under this provision it is competent for the company to protect itself against imposition or accident.[22] The corporation will be held to have waived the provision of the by-laws restricting transfer where

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12 Ramage v. Gould, 176 Cal. 746.
13 Craig v. Hesperia Land & Water Co., 113 Cal. 7.
14 Civil Code, Section 324.
15 Civil Code, Section 316.
16 Ralston v. Bank of California, 112 Cal. 208, 213.
17 Spangenberg v. Nesbitt, 22 Cal. App. 274.
19 Ramage v. Goul, 176 Cal. 746.
19 Civil Code, Section 326.
20 Civil Code, Section 325.
21 Civil Code, Section 354, subd. 6.
22 Weston v. Bear River etc. Co., 5 Cal. 189.

it transfers stock into the name of the transferee without requiring a compliance with the restrictive provisions of the by-laws.[23]

Any corporation organized in this state for the purpose of mining or carrying on mining operations is authorized to establish and maintain agencies in other states of the United States for the transfer and issuance of their stock in accordance with the provisions of its by-laws,[24] but it is probable that this section is unconstitutional as special legislation, as there is no more apparent reason why corporations organized for the purpose of mining should be permitted to have transfer agencies outside of the state than any other corporations, and particularly as the authority is not limited to those engaged in the business of mining.[25] Irrigation and domestic water companies may make their shares appurtenant to land by recording a certified copy of a by-law so providing.[26] Co-operative companies may authorize a division of profits among non-stockholders.[27]

The board of directors should be authorized in its discretion to appoint a transfer agent and registrar of transfers, and in which event to require that all stock certificates thereafter issued bear the signature of such appointees. Although the constitution and civil code both require that corporations keep a stock and transfer book, the usual form of keeping the stock transfer records with the stub of the certificate as the book of original entry, with a journal and ledger, is not a true transfer book, which requires that the attorney in fact of the transferror shall exercise his power by making a transfer over his own signature as attorney in fact on the transfer book. The course properly followed is for the secretary or assistant secretary actually making the entry to fill in his name as the attorney in fact of the transferror before making

23 Underhill v. Santa Barbara etc. Co., 93 Cal. 300.
24 Civil Code, Section 587.
25 Krause v. Durbrow, 127 Cal. 681.
26 Civil Code, Section 324.
27 Civil Code, Section 653a.

the transfer and then make the assignment on the transfer book in the name of the transferror. Assignments in blank are sufficient to pass the title as between the parties.[28] No transfer of stock standing in the name of a decedent or in trust for a decedent should be made without written consent of the State Controller.[29]

RECORDS AND INSPECTION.

All corporations for profit are required to keep a record of all their business transactions, a journal of all meeting of their directors, members or stockholders, with the time and place of holding the same, whether regular or special, and if special its object, how authorized, and the notice thereof given. The record must embrace every act done or ordered to be done, who were present and who were absent, and if requested by any member, director or stockholder the time shall be noted when any member entered the meeting or obtained leave of absence therefrom, and upon a similar request the ayes and noes must be taken on any proposition and the record taken thereof. Upon a similar request the protest of any member, director or stockholder to any action or proposed action must be entered in full.[1] If for any reason there is not present a majority of the subscribed stock or no election had at any regular or called meeting of the stockholders and it adjourned from day to day or from time to time, the fact of such adjournment and the reasons therefor should be recorded in the journal of proceedings of the board of directors.[2] Corporations for profit must keep all such other records as the by-laws prescribe.[3] It is only the records of the corporation required to be kept that are evidence, and this record is

28 Ashton v. Zeila Mining Co., 134 Cal. 410.
29 Inheritance Tax Act, Sec. 13, Stat. 1917, p. 893.

1 Civil Code, Section 377.
2 Civil Code, Section 312.
3 Civil Code, Section 378.

only *prima facie* evidence as between the members of the corporation.[4] Since the president and secretary are required to furnish under oath a financial statement upon the written request of not less than ten per cent of the stockholders presented not less than two weeks prior to the time of the annual election of the directors, the by-laws should require that the financial books of the corporation should be kept in such manner as to have the facts required readily available. Such statement must show the authorized capital stock, the amount of capital stock subscribed, the amount of capital actually paid in, the assets, surplus and undivided profits, the amount paid to employees, the names and addresses of all officers and directors of the corporation, the amount of mortgages, bonded or other indebtedness, and the amount of the last annual, semi-annual or quarterly dividend, and a general summary of the business transacted by the corporation since the last preceding annual meeting.[5] The books required to be kept by the constitution must be open for inspection by every person having an interest therein and by legislative committees.[6] The stock and transfer books required to be kept by the Civil Code must be open to the inspection of any officers, *bona fide* stockholders, member or creditor of the corporation.[7] One holding a single share of stock duly registered in his name on the books of the corporation but in fact held in trust for another is liable to pay assessments and to creditors, and for that reason would seem to have an interest in the corporation,[8] but he may not be a *bona fide* stockholder. The records of the business transactions and journal of the meetings of directors and stockholders are open to the inspection of any legislative committee, board, commission or officer of the state of California whose duty it is to examine and

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4 Fletcher v. Kidder, 163 Cal. 771.
5 Civil Code, Section 302a.
6 Constitution, Article XII, 771.
7 Civil Code, Section 378.
8 Civil Code, Section 377.

inspect the same, and of any director or *bona fide* stockholder thereof; provided, however, that the board of directors may by unanimous vote deny such examination and inspection to a stockholder who demands the same with intent to use to the injury of the corporation the information to be acquired thereby.[9] Evidently such a one puts himself out of the class of *bona fide* stockholders as contemplated by the statute. This last provision was enacted in 1917 without repealing the provision of the Penal Code in force since 1872 that "every officer or agent of the corporation having or keeping an office in this state, who has in his custody or control any book, paper or document of such corporation and who refuses to give a stockholder lawfully demanding during office hours to inspect or take a copy of the same or any part thereof reasonable opportunity so to do, is guilty of a misdemeanor".[10] The Attorney-General or District Attorney, whenever and as often as required by the Governor, may examine the books, papers and documents belonging to any corporation or appertaining to its affairs and condition.[11] The legislature or either branch thereof may examine the safes, books, papers and documents belonging to any corporation or appertaining to its affairs and condition and compel the production of all keys, books, papers and documents by summary process to be issued on application to any court or judge thereof, under such rules and regulations as the court may prescribe.[12] The Commissioner of Corporations has the right of inspection and may require the attendance of witnesses and the production of books and papers of any corporation authorized by him to issue securities.[13] The State Controller and Inheritance Tax Attorneys have the right

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9 Civil Code, Section 377.
10 Penal Code, Section 565.
11 Civil Code, Section 382.
12 Civil Code, Sect ion 383.
13 Corporate Securities Act, Section 17; Statutes 1917, page 681.

of inspection but information obtained by them must be held as confidential.[14]

STOCKHOLDERS MEETINGS.

The annual meeting of the stockholders should be held at the office of the corporation at its principal place of business as fixed in the articles of incorporation[1] or certificate changing the principal place of business,[2] and the by-laws should designate the street number of such office and the date and hour of the meeting, the designation of the day and place being insufficient.[3] If the by-laws do not prescribe the time of the annual election it is fixed by statute for the first Monday of June of each year.[4] The by-laws may provide when the election may be held in the contingency that it does not take place on the day appointed.[5] Whether the by-laws may dispense with notice by publication of the time and place of the annual meeting for the election of directors,[6] or whether notice of such meeting must be given by order of the acting president on two weeks notice by advertisement in some newspaper published in the county in which the principal place of business of the corporation is located, or if none is published then an a newspaper published in an adjoining county, is open to dispute.[7] In a recent opinion, Division One of the District Court of Appeal for the First District stated that an election of directors at an annual meeting of the stockholders of a corporation was illegal and void where the meeting was held without notice by advertisement as provided by Section 301 of the Civil Code, notwithstanding the by-laws of the corporation expressly dispensed with

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14 Inheritance Tax Act, Sec. 12, Stat. 1917, p. 892.

1 Civil Code, Section 90, subd. 3.
2 Civil Code, Section 321a.
3 San Buenaventura etc. Co. v. Vassault, 50 Cal. 534.
4 Civil Code, Section 302.
5 Civil Code, Section 303, subd. 1;
Civil Code, Section 314;
Saline Valley Salt. Co. v. White, 177 Cal. 343.
6 Civil Code, Section 303, subd. 1.
7 Civil Code, Section 310; See also, Section 302.

the giving of notice in that manner.[8] In the case referred to this opinion was *dicta,* as the by-laws provided the day of the month of each year on which the meeting should be held for the election of directors without specifying the hour, and also provided that no notice of the annual meeting need be given. The question has been raised in the Supreme Court by the record in at least three cases, but not passed upon. In two, the court apparently considered a notice by mail as required by the by-laws to be sufficient. [9] In the other, the by-laws required publication for ten days instead of two weeks, but the meeting was held invalid on other grounds.[10] In this state of the law it is advisable to have the by-laws require notice by advertisement in a newspaper for at least two weeks as provided by the statute[11] in the absence of a by-law on the subject. Notice may be waived by all the stockholders, but such waiver must be by written consent on the records of the meeting or by waiver in writing theretofore signed, presented at the meeting and made a part of the records, and the waiver canont be made by ratification thereafter, although individual stockholders may be estopped by participating in the meeting but will not be by mere attendance,[12] even where the meeting is held outside of the state. [13] The by-laws may dispense with notice of regular meetings except the annual meetings for the election of directors,[14] but it is unusual to have any other regular meetings. At a regular meeting the power of the directors to amend the by-laws may be revoked if occasion requires.[15]

In view of the fact that the transaction of the busi-

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8 Guaranty Loan Co. v. Fortanel, 29 Cal. App. Dec. 657.
9 Pennington v. Pennington Sons, 170 Cal. 114;
Saline Valley Salt Co. v. White, 177 Cal. 341, 344.
10 Dolbear v. Wilkinson, 172 Cal. 366.
11 Civil Code, Sections 301, 303.
12 Civil Code, Section 317;
Dolbear v. Wilkinson, 172 Cal. 366.
13 Ellsworth v. National etc. Builders, 33 Cal. App. 1, 2.
14 Civil Code, Section 303, subd. 1.
15 Civil Code, Section 304.

ness of the corporation with third persons is lodged in the board of directors,[1] that the notice and manner of holding the annual meeting for the election of directors is fixed by statute,[2] that the business to be transacted at a regular meeting is substantially confined to amending the by-laws,[3] and the filling of vacancies in office (which in practice is left to the board of directors), it is inadvisable to provide in the by-laws for waiving notice of the holding of regular meetings of stockholders and it is much simpler to consider as special meetings all meetings of stockholders other than the annual meeting for the election of directors. Where no other provision is specially made by law, the by-laws may[5] and should provide for the time, hour, day and month of each year, the number of the street address or room of building at the city and county in the state of California named in the articles of incorporation or certificate changing the place ,and the length of time the notice shall be given and the manner of giving the notice to stockholders.[6] If provision is made for mailing the notice, care should be taken to require the secretary to mail the notices enclosed in envelopes without any note thereon for return within the length of time notice is required to be given, as in the event the mailed notice is not received by the stockholder addressed the mailing with such a return note will be insufficient.[7] Notice in writing is waived by attendance at the meeting or by notice and waiver in writing which is presented and made a part of the records.[8] The by-laws may not dispense with notice of the time and place and the notice should designate the nature of the business to be transacted at a special meeting.[9]

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1 Civil Code, Section 305.
2 Civil Code, Sections 301, 303.
3 Civily Code, Section 304.
4 Civil Code, Section 318.
5 Civil Code, Section 303, subd. 1.
6 Civil Code, Section 319.
7 Healton v. Morrison, 162 Cal. 668, 674.
8 Civil Code, Section 317.
9 Dolbear v. Wilkinson, 172 Cal. 369.

VOTING AND REPRESENTATION.

Every stockholder has the right to vote in person or by proxy the number of shares of stock owned by him,[1] and only the stockholders actually present in person or by proxy should be allowed to vote.[2] Every person acting at a meeting in person or by proxy or by representation must be a member thereof or a stockholder having stock in his own name on the stock books of the corporation at least ten days prior to the election.[3] The corporation is not authorized to close its stock books for transfer of stock either for ten days or any lesser time prior to an election.[4] The stock and transfer book is required to contain an alphabetical list of stockholders,[5] which constitutes the voting list. This may lead to peculiar situations. The transferror cannot vote, for he is no longer a stockholder; the transferee within the ten days cannot vote, under the express provision of the statute, but if he transfers his shares to one who has been a stockholder of record for ten days the shares may be voted. The constitutionality of this provision has never been passed upon, although it has been referred to a number of times.[6] If the analogy of qualified electors at a political election is to be applied, then the provision requiring a stockholder to be such of record for ten days prior to an election is void as an attempt by the legislature to require qualifications in addition to those of the constitution.[7] Since 1905, the qualification of stockholders is to be determined by the stock books.[8] This

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1 Constitution, Article XII, Section 12;
Civil Code, Section 307.
2 Civil Code, Section 321b.
3 Civil Code, Section 312.
4 Civil Code, Section 324.
5 Civil Code, Section 378.
6 Wright v. Central California C. W. Co., 67 Cal. 532;
Krause v. Durbrow, 127 Cal. 681;
Smith v. S. F. & N. P. Ry. Co., 115 Cal. 590.
Royal Con. Mining Co. v. Royal Con. Mines, 157 Cal. 737.
7 Spier v. Baker, 120 Cal. 375.
Bergevin v. Curtz, 127 Cal. 86.
St. Helena v. Merriam, 171 Cal. 134.
8 Civil Code, Sections 312, 378;
Middleton v. Arastraville Mining Co., 146 Cal. 224.

rule, however, should not be so construed as to permit stockholders of record but in fact holding in trust for the corporation itself to vote the shares of stock so held.[9]

All elections must be by ballot and every stockholder has the right to vote for as many persons as there are directors to be elected, or to cumulate his shares and give one candidate as many votes as the number of directors multiplied by the number of his shares of stock shall equal, or to distribute them upon the same principle among as many candidates as he shall think fit and those receiving the highest number of votes shall be declared elected.[10] It necessarily follows that all the directors must be elected on one ballot.[11] This may result in the stockholders having a minority of the shares electing a majority of the board of directors through the failure of the majority holders to distribute their votes, or one holding sufficient shares, relying upon the agreement of the others may fail to cumulate his votes and so fail of an election.[12] Elections have been held valid where the number of directors elected was less than that prescribed by the charter,[13] but such a situation is to be avoided, for there is then no real vacancy which can be filled either by the stockholders or the directors until the next annual election. Where it appears after the delivery of the ballots to the tellers, but before any canvass or result of the election is announced, that certain stockholders have failed to mark their ballots "cumulative", it is proper to permit them to correct the ballot in this respect.[14] The by-laws should prescribe a definite time during which the polls will be open for the election of directors, but where they do not the tellers may keep the polls open a greater length

9 Market St. R. R. Co. v. Hellman, 109 Cal. 588; Brewster v. Hartley, 37 Cal. 27.
10 Civil Code, Section 307. Constitution, Article XII, Section 12.
11 Wright v. Central etc. Water Co., 67 Cal. 532.
12 Dulin v. Pacific Wood etc. Co., 103 Cal. 357.
13 Porter v. Lassen etc. Co., 127 Cal. 270.
14 Zierath etc. Drill Co. v. Croake, 21 Cal. App. 222.

of time than that prescribed in the notice of the election by the board of directors without invalidating the election.[15] Upon the request of any stockholder a vote by ayes and noes must be taken and a record made thereof, and the protest of any stockholder to any action or to any proposed action must be copied in full in the journal.[16] The quorum at a stockholders' meeting is fixed at a majority of the subscribed capital stock.[17] Where a meeting of the stockholders adjourns for lack of a quorum or no election of directors is held at the time appointed the reasons therefor should be recorded in the journal of proceedings of the board of directors.[18] Where the percentage of the stock required on a proposition is fixed by statute it cannot be changed through the by-laws. A proposal to change the number of directors requires an affirmative vote of a majority of the subscribed stock.[19] An amendment to the articles of incorporation[20] or the by-laws,[21] or a proposition to increase the capital stock or bonded indebtedness,[22] or to sell or lease the property and business,[23] or to transfer foreign concessions.[24] or to extend the term of its existence[25] each require the affirmative vote of two-thirds of the subscribed capital stock.

The right to vote by proxy is conferred by the Constitution[1] and confirmed by the Civil Code, which requires every proxy to be executed in writing by the stockholder himself or his duly authorized attorney.[2] No proxy is to be valid for more than eleven

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15 Clopton v. Chandler, 27 Cal. App. 595.
16 Civil Code, Section 377.
17 Civil Code, Section 312.
18 Civil Code, Section 312.
19 Civil Code, Section 361.
20 Civil Code, Section 362.
21 Civil Code, Section 304.
22 Civil Code, Section 359.
23 Civil Code, Section 361a.
24 Civil Code, Section 364.
25 Civil Code, Section 401.

1 Constitution, Article XII, Section 12.
2 Civil Code, Section 321b.

months after the date of its execution unless the stockholder executing it shall have specified therein the length of time for which it is to continue in force, which in no case must exceed seven years from the date of the execution of the proxy, and be revocable at the pleasure of the person executing it.[3] It is expressly provided that the limitation on the life of proxies is not to be construed to prevent the execution of valid pools or voting trust agreements by the stockholder of a corporation organized for the purpose of marketing agricultural products.[4] Whether this section has aided or hindered such voting trusts is open to question, as the provision has all the earmarks of special legislation,[5] but voting trusts created at the time the stock is transferred or an interest therein acquired, where not oppressive on other stockholders or otherwise unreasonable, it is not invalid.[6] It is doubtful if the by-laws can limit the length of life of the proxy to less than seven years.[7] Many proxies are drawn in the form of powers-of-attorney which are not subject to the limitation specified, as authorized attorneys may give proxies.[8] The by-laws may not provide any different provisions for proxies by married women than apply to the proxies of unmarried women.[9] A proxy to vote the shares of the stockholder is generally considered insufficient to authorize the proxy holder to vote on matters changing the fundamental contract of the stockholders, such as extending the corporate existence or authorizing the conveyance of the business, franchises and property as a whole, but it has been held sufficient to vote for the creation of a bonded indebtedness.[10] A by-law

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3 Civil Code, Section 321b.
4 Civil Code, Section 321c.
5 Krause v. Durbrow, 127 Cal. 681.
6 Smith v. San Francisco & N. P. Ry. Co., 115 Cal. 584.
7 Civil Code, Section 321b.
Saline Valley Salt Co. v. White, 177 Cal. 343.
8 Civil Code, Section 321b.
9 Civil Code, Section 325.
10 Market St. Ry. Co. v. Hellman, 109 Cal. 597.

which provides that no proxy shall be voted by any one not a stockholder is unreasonable and invalid.[11] A guardian of a minor or insane person and the executor or administrator of a decedent are authorized to represent the shares of the ward or decedent[12] and to give proxies.[13] A pledgee or trustee may vote the shares of stock pledged or held in trust only when the pledgor or beneficial owner fails to represent the same.[14] When entitled to vote a trustee may give proxies.[15] There is no similar provision in the case of a pledgee. Within these limitations the by-laws may provide the mode of voting by proxy.[16]

DIRECTORS: NUMBER AND QUALIFICATIONS.

The number of directors should not be stated in the by-laws, as the original number is required to be stated in the articles of incorporation[1] and the holders of a majority of the issued stock may change the number without amending the articles of incorporation or by-laws.[2] The members of the board must be holders of stock[3] at the time of their election and the acquisition of stock thereafter will not qualify them.[4] A majority of the members of the board must be residents of this state[5] and the requirements of cumulated voting make an entirely new ballot necessary where more than a majority of the directors elected are non-residents. The number of shares of stock which must be held by a stockholder to qualify him as a director may be fixed by the by-laws,[6] which may make other

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11 Peoples Bank v. Superior Court, 104 Cal. 649.
12 Civil Code, Section 313.
13 Civil Code, Section 321b.
14 Civil Code, Section 313.
15 Civil Code, Section 321b.
16 Civil Code, Section 303, subd. 3.

1 Civil Code, Section 290, subd. 5.
2 Civil Code, Section 361.
3 Civil Code, Section 305.
4 Robinson v. Blood, 151 Cal. 504.
5 Civil Code, Section 305.
6 Civil Code, Section 305;
Waterbury v. Temescal Water Co., 11 Cal. App. 635

reasonable qualifications.[7] Where a director parts with all of his shares he divests himself of his title to office as a director *de jure*.[8] There is no provision of statute preventing the corporation in its by-laws making one of the qualifications of a director to be the ownership of either common or preferred shares and thus securing control of the business of the corporation to owners of one class of stock, an object prevented in another manner by the decision in *Film Producers v. Jordan*.[9] The by-laws should definitely state whether a stockholder to qualify as a director may be merely a *dummy* holder of record on the stock books, or must be a *bona fide* owner in his own right, this question in default of a by-law having been discussed but not decided.[10] The by-laws should also state definitely that an executor, administrator, guardian or trustee is not qualified as a director by virtue of his right to represent the stock of his decedent, ward or beneficiary, unless he shall have the shares transferred into his own name.

Filling Vacancies.

Whenever a vacancy occurs in the office of director, unless the by-laws of the corporation otherwise provide, such vacancy must be filled by an appointee of the board.[1] The stockholders, when assembled at a general or special meeting, regularly called, may elect officers to fill all vacancies then existing.[2] Where the number of directors is increased or diminished, there is no statutory provision for their selection.[3] The by-laws, therefore, should provide in each such case how the vacancy shall be filled[4] and in case of an increase

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7 Civil Code, Section 303.
8 Seal of Gold Mining Co. v. Slater, 161 Cal. 621.
9 Film Producers v. Jordan, 171 Cal. 664.
10 O'Neil v. Donahue, 57 Cal. 226;
Moore v. Boyd, 74 Cal. 167.

1 Civil Code, Section 305.
2 Civil Code, Section 318.
3 Civil Code, Section 361.
4 Civil Code, Section 305.

in the number of directors the election should be by the stockholders. By an abuse of this power a majority of the stock by first reducing and then increasing the number of directors can destroy the right of minority representation on the board by cumulative voting. Where a vacancy is caused by failure of the stockholders to elect the full number of members of the board of directors it is at least doubtful whether either the board or the stockholders can fill such a vacancy before the next annual election[5] except by first removing all the members of the existing board.

Powers and Duties.

The corporate powers, business and property of all stock corporations for profit organized under the provisions of the Civil Code must be exercised, conducted and controlled by a board of not less than three directors to be elected from among the holders of the stock.[1] It is apparent that this statute lodges in the board of directors the power to sue and be sued, to make and use a common seal and to alter the same at pleasure, to purchase, hold and convey such real and personal estate as the purposes of the corporation may require,[2] not exceeding the amount limited by law.[3] Where no provision is specially made the by-laws may provide for the duties of directors,[4] who must perform the duties enjoined on them by law and the by-laws of the corporation.[5] The violation by the board of any by-law with respect to dealings with third parties may subject them to the penalty provided in the by-laws, not exceeding in any case one hundred dollars for ony one offense,[6] but it cannot

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5 Porter v. Lassen Co., 127 Cal. 261, 270; Wright v. Central etc. Water Co., 67 Cal. 532.

1 Civil Code, Section 305.
2 Civil Code, Section 354.
3 Constitution, Article XII, Section 9; Civil Code, Section 360.
4 Civil Code, Section 303, subd. 4.
5 Civil Code, Section 308.
6 Civil Code, Section 308, subd. 7.

affect the validity of the act performed if within the purposes of the corporation, even though the third party was charged with notice of the by-law by reason of its being copied or stated in the book of by-laws.[7] What the board of directors does within the scope of the objects and purposes of the corporation the corporation does,[8] but officers are charged with knowledge of the mode of executing contracts required by the by-laws.[9] In dealing with the powers and duties of directors, the by-laws should be confined either to confirming the statutory powers of the board of directors, or to providing the manner of making contracts and conveyances, and the reports and records thereof to be kept by the corporation. The acts of the directors gain no validity by being authorized or ratified by the stockholders.[10] It is the directors when assembled as a board and not when acting as individuals that are authorized to exercise the power of the corporation[11] unless the owners of all the shares are present. Acts of the directors in violation of the by-laws may be ratified by the holders of the same number of shares that would be necessary to amend them.[12]

Where no other provision is specially made, a corporation may provide in its by-laws for the manner of election and tenure of office of all officers other than directors.[1] Every corporation as such has power to appoint such subordinate officers or agents as the business of the corporation may require and to allow them suitable compensation.[2] These powers of the corporation are vested in the board of directors.[3] The by-laws may provide the term of office of the president, secretary and treasurer, conditioned upon its terminating

7 Civil Code, Section 304.
8 Maynard v. F. F. Ins. Co., 34 Cal. 48, 54.
9 Colpe v. Jubilee Mining Co., 2 Cal. App. 393, 397.
10 Bassett v. Fairchild, 132 Cal. 651.
11 Gashwiler v. Willis, 33 Cal. 19;
Alta Silver Mining Co. v. Placer Mining Co., 78 Cal. 632
12 Underhill v. Santa Barbara etc. Co., 93 Cal. 512.

1 Civil Code, Section 303, subd. 6.
2 Civil Code, Section 354, subd. 3.
3 Civil Code, Section 305.

with the life of the board of directors by which they are elecetd.[4] Where the by-laws do not fix the term of office the board of directors has power to dismiss the officers summarily.[5] Where the by-laws prescribe the duties of an officer, such as the manager, and are known to him, they enter into and become a part of his contract of employment,[6] and where the board of directors does not dispute the power the by-laws may likewise confer power on officers to deal with third parties.[7] The statutory duties of one officer cannot be allotted to any other officer, but there is no provision preventing the same person holding two statutory offices; the office of president and secretary should not be held by the same person, as the statute in some instances requires both to act in relation to the same matter. The president is the only officer required by statute to be a stockholder and director,[8] but the by-laws should make the same qualification for vice-presidents.

Meetings

Where no other provision is specially made, the by-laws may provide the time, place and manner of calling and conducting the meetings of its board of directors and may dispense with notice of all regular meetings.[1] Immediately after their election the directors must organize by the election of a president, who must be one of their number,[2] a secretary and a treasurer. "Immediately" as here used does not mean instanter, but within a reasonable time,[3] and the by-laws should provide definitely the notice to be given to each newly elected director of the fact of his election and of the

4 Civil Code, Section 308.
5 Civil Code, Section 308.
5 Savings etc. Society v. Wennerhold, 81 Cal. 535.
6 San Pedro Lumber Co. v. Reynolds, 121 Cal. 79.
7 Humboldt etc. Society v. Wennerhold, 81 Cal. 528.
8 Civil Code, Section 308.

1 Civil Code, Section 303.
2 Civil Code, Section 308.
3 McVilly v. Flentge, 54 Cal. Dec. 679.

time of the first meeting; otherwise the board might be organized by a mere majority of a quorum. Meetings must be held at the office of the company or at its principal place of business.[4] Whether the office must be at the principal place of business is a much disputed question, but unless there is some real necessity to the contrary the by-laws should locate the office at the principal place of business.[5] Assessments have been held invalid where the meeting was held at a different place, although otherwise regular. Unless the by-laws fix the office of the corporation, provided it is retained at the principal place of business indicated in the articles, its location is a matter committed to the discretion of the board of directors.[6] A quorum is fixed at a majority of the directors which is declared to be a sufficient number to form a board for the transaction of business when duly assembled,[7] and unless a quorum is present and acting, no business performed or act done is valid as against the corporation.[8] No director interested in a proposition being voted upon may be counted to make up a quorum[9] unless the directors are the only stockholders, all concur and no adverse interests of creditors are involved.[10] A quorum is a majority of the entire board as it would be constituted if all the vacancies were filled, and not a majority of the board as it remains with vacancies unfilled.[11]

In the absence of a by-law, both regular meetings and special meetings can be called on the order of the president by notice in writing given to each director by the secretary, and it is only where there is no president that two directors are authorized to call the meeting.[12] The by-laws should therefore fix with cer-

4 Civil Code, Section 319.
5 Gallup v. Sacramento etc. Drainage Dist., 171 Cal. 74.
6 Seal of Gold Mining Co. v. Slater, 161 Cal. 621, 629.
7 Civil Code, Section 308.
8 Civil Code, Section 305.
9 Curtin v. Salmon River etc. Co., 130 Cal. 345, 349.
10 Sargent v. Palace Cafe. Co., 175 Cal. 737.
11 Porter v. Lassen etc. Co., 127 Cal. 270.
12 Civil Code, Section 320.

tainty the authority of the vice-president or directors to call a special meeting in the absence of the president from the office or principal place of business, and of some other person to give the notice in the absence of the secretary.[13] Where the by-laws so provide, a call by the vice-president is valid.[14] The notice of a special meeting need not specify the purpose of the meeting unless the by-laws so require.[15] When all the directors are present and sign a written consent on the records of the meeting, and if a quorum is present and those not present sign a waiver of notice which is presented at and made a part of the records of the meeting, the transactions of such meeting are valid.[16] This does not permit a ratification by waiver and consent signed after the meeting is held. Where there is any doubt as to the regularity of the call or waiver, each item of business transacted should be ratified and confirmed at a later meeting regularly called and held.

The by-laws should definitely fix the power of a quorum to adjourn a meeting and the motion should specify the hour of re-assembling[17] at a time not later than the next regular meeting; and where there is such provision, a director is charged with knowledge of the power of a quorum to adjourn a regular meeting, and if he receives notice of a special meeting he is bound to know that a quorum might adjourn and that business might be transacted at the adjourned meeting.[18] A minority of the board has no power to adjourn for any purpose.[19]

13 Curtin v. Salmon River etc. Co., 130 Cal. 345.
14 Bell v. Standard Quicksilver Co., 146 Cal. 699.
15 Seal of Gold Mining Co. v. Slater, 161 Cal. 621, 628
16 Civil Code, Section 320a.
17 Reed v. Wing, 168 Cal. 711.
19 Raisch v. M. K. & T. Oil Co., 7 Cal. App. 667.