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State Power Over Corporate Charters

CORPORATIONS

By Keith Bishop

In the first half of the 18th century, colonial New England was shaken by a storm of religious fervor that was to become known as the first Great Awakening. Twenty-year old Samson Occom, like many of his contemporaries, was inspired by this "strange concern" among the people to seek a Christian education. In 1743, he went to school under the tutelage of the Reverend Eleazar Wheelock. According to Occum, "I went up thinking I should be back in a few days. When I got there, he [Wheelock] received me with kindness and compassion, and instead of staying a fortnight or three weeks, I spent four years with him." After leaving Wheelock's school, Occom began work as a schoolmaster, preacher and a judge on Long Island. In these respects the trajectory of Occum's life was not an unusual one for his time. Occom, however, was different, leading him toplay a critical role in the events leading to one of Justice John Marshall's most famous opinions, *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819).

Occom was not your typical New England Puritan divine. He was a native American, a descendant of the famous Mohegan chief, Uncas. Inspired by the educational success of Occom, Wheelock started a school for native Americans in Lebanon, Connecticut. Eventually, Wheelock decided to enlarge the school and found a college for both European and native American students. Wheelock then persuaded Occom to sail for England to raise funds for the planned college. Occom went in 1766 and spent a year and half preaching hundreds of sermons around the country. He saw King George III and the King donated money to the cause. In Dec. 1769, the King issued a charter incorporating 12 persons as "The Trustees of Dartmouth College." The charter provided for a college "for the education and instruction of Youth of the Indian Tribes in this Land...and also of English Youth and any others." The charter granted the trustees the right to govern the college and to fill any vacancies among their members. The college was named for the Right Honorable William, Earl of Dartmouth who had been one of the contributors to the founding of the school. The charter specified that "our well beloved Eleazar Wheelock" was to be its first president and a trustee. Although the charter mentioned Occom's education by Wheelock and Occom's fund raising trip to England, it granted Occom no offices in the new college.

The foregoing history would be of little interest to most lawyers but for the actions of the New Hampshire legislature taken nearly a half-century after the founding of Dartmouth College. On June 27, 1816, the New Hampshire legislature passed an act entitled "An Act to amend the charter and enlarge and improve the corporation of Dartmouth College." This legislation would have converted Dartmouth College into a state university by adding nine trustees, conferring upon the state's executive the power of appointment of the additional trustees and creating a board of overseers. The incumbent trustees rejected these changes and brought an unsuccessful action in state court to recover the corporate property.

The trustees' appeal to the U.S. Supreme Court was argued by Daniel Webster, who presented the issue as: when the state grants a corporate charter can it later change it? Chief Justice John Marshall, who delivered the opinion, had no trouble concluding that the royal charter was a contract. This conclusion is crucial because the question then became whether the charter was the type of contract protected by Article I, Section 10 of the U.S. Constitution, which forbids a state from passing any law "impairing the obligations of contracts." The court concluded that Dartmouth College's charter was indeed the type of contract protected from state legislative acts. But was King George's charter impaired by the New Hampshire legislation? The Supreme Court said yes.

The *Dartmouth College* decision was a cause of concern for the states. They worried that if they were powerless to amend corporate charters, corporations might become too powerful and threaten the exercise of governmental regulation. The states responded by reserving the right to alter, amend or repeal corporate charters. Thus, the idea of the "reserve clause" was born. States went so far as to include a reserve clause in their own constitutions. For example, Article IV, Section 31 of California's 1849 Constitution authorized the formation of corporations under general laws and provided that general laws could be altered from time to time or repealed. This provision continues to the present day in Article 20, Section 5 of the current California Constitution. When the California legislature enacted current General Corporation Law in 1975, it included in the very first section of that law an express statement that it could be amended or repealed at any time. That section, by its terms, also applies to the Nonprofit Corporation Law and to the laws governing special types of corporations in Part 3 of Title 1 of the Corporations Code.

But what about other types of legal entities such as partnerships, limited partnerships and limited liability companies? Surely, the relationships established by these laws are no less contractual in nature than those of a corporation. When the California Legislature adopted the Revised Limited Partnership Act and the Uniform Partnership Act of 1994, it included reserve clauses in both acts. This approach is supported by the commentary to the Uniform Partnership Act, which refers to the *Dartmouth College* case by name and states that the purpose of the savings clause is "to avoid any possible argument that a legal entity created pursuant to statute or its members have a contractual or vested right in any specific statutory provision and to ensure that the State may in the future modify its enabling statute as it deems appropriate and require existing entities to comply with the statutes as modified."

Thus, it is surprising to find that the California Legislature failed to include reserve clauses in either the Uniform Limited Partnership Act of 2008 or the Beverly-Killea Limited Liability Company Act. These omissions are especially glaring because the Legislature clearly knew about reserve clauses and had a history of using them. In fact, the upcoming repeal of the Revised Limited Partnership Act to take effect on Jan. 1, 2010 would be constitutionally questionable had the Legislature not included a reservation clause when it adopted that act. Other states, such as Delaware, presently include reserve clauses in their limited partnership and limited liability company laws.

The failure to include a reserve clause can have real impacts. In 1963, a minority group of stockholders of Alaska Airlines was able to elect several of its nominees to the board. The next year, the Alaska Legislature amended its business corporation law to allow corporations to prohibit cumulative voting in its bylaws. Within months, Alaska Airlines amended its bylaws to prohibit cumulative voting. The minority stockholders sued arguing that the state of Alaska could not amend its statutory grant of cumulative voting because the legislature had failed to reserve the power to amend, alter or repeal the corporation law applicable to Alaska Airlines. The Supreme Court of Washington concluded that the *Dartmouth College* case "would be applicable, and that the 1964 statute, as so construed, would be unconstitutional." *State v. Alaska Airlines, Inc.*, 413 P.2d 352 (1966). The court, however, avoided this unhappy result by finding that the Alaska Legislature had intended the 1964 amendment to apply only to those corporations created after enactment and those created under circumstances in which the Legislature had "specifically reserved the power to amend, repeal, or modify the statutes under which they were organized." Because Alaska Airlines predated the 1964 amendment and was organized under a law without a reserve clause, it had no statutory authority under the 1964 amendment to adopt a bylaw amendment eliminating cumulative voting.

Because the California Legislature has failed to reserve the power to amend or repeal either California's current limited partnership and limited liability company acts, any future changes may be constitutionally suspect if they impair existing contracts. Consequently, these acts may be frozen in time by Article 1, Section 10 of the U.S. Constitution. Even if the Legislature adds a reserve clause, this could not, as the Washington Supreme Court concluded, be constitutionally applied to any preexisting limited partnership and limited liability company whose partners or members do not consent to the change.

The legacy of Occom is an important one. He was a key actor in the founding of what was to become a respected Ivy League college. In doing so, he set in motion a chain of events that culminated in Justice Marshall's famous opinion to the *Dartmouth College* case. Unfortunately, the California Legislature apparently has forgotten the *Dartmouth College* case and Samson Occom's unexpected legacy.

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