

BRIEFING PAPER NO. 14

CORPORATIONS

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CORPORATIONS

This briefing paper is designed to assist the Convention delegates in determining whether an article on corporations should be included in the Constitution of the Northern Mariana Islands. Although two-thirds of the state constitutions contain a provision governing corporations, many experts have questioned the desirability of such a provision at all.^{1/} This paper accordingly reviews the relevant state experience, discusses the reasons that have been advanced against including such an article in recent state constitutions and considers the forms that such a provision could take if the delegates elect to propose such an article.

I. BACKGROUND AND GENERAL CONSIDERATIONS

A. Relevant Provisions of the Covenant and the United States Constitution

The Covenant does not expressly treat the subject of corporations. The delegates should be aware that the restrictions on alienation of land, required by section 805 of the Covenant, will affect the right of corporations to hold land.^{2/} Furthermore, section 505 of the Covenant provides that the laws of the Trust Territory will remain

^{1/} E.g., G. Braden & R. Cohn, THE ILLINOIS CONSTITUTION: AN ANNOTATED AND COMPARATIVE ANALYSIS p. 516 (1969) [hereinafter cited as ILLINOIS CONSTITUTION ANALYSIS]. The National Municipal League's Model State Constitution omits any reference to corporations.

^{2/} See BRIEFING PAPER NO. 12: RESTRICTIONS ON LAND ALIENATION § II(C).

in force and effect until repealed by the new Commonwealth government. Thus, corporations organized and doing business under the Trust Territory Code will be able to continue their activities in the Northern Marianas, even if the Constitution does not specifically so provide.

The United States Constitution similarly does not expressly address the subject of corporations. However, corporations have been held to be "persons" within the meaning of those provisions of the U.S. Constitution that guarantee all persons due process and the equal protection of law.^{3/}

B. Background

Corporation articles in constitutions arose in an era when there was major concern about misuse of corporate franchises and privileges.^{4/} Today, extensive case law and

3/ Pierce v. Society of Sisters, 268 U.S. 510, 535 (1925); Kentucky Fin. Corp. v. Paramount Auto Exch. Corp., 262 U.S. 544 (1923). Corporations organized outside the jurisdiction of the Commonwealth, however, will not enjoy absolute equal protection of the laws. Blake v. McClung, 172 U.S. 239 (1898). Nor is the foreign corporation a "person" within the meaning of the privileges and immunities clause. Id.

4/ Ruder, Business Regulation: Corporations, in CON CON: ISSUES FOR THE ILLINOIS CONSTITUTIONAL CONVENTION pp. 382-83 (S. Gove & V. Ranney ed. 1970) [hereinafter cited as ILLINOIS CON CON]. A primary abuse was the granting of charters by special legislative enactments, which were often induced by campaign contributions. In order to prevent the direct connection between campaign contributions and legislation benefitting the contributors, many states constitutionally forbade any corporate charter created by special act. See § II(B) below.

detailed statutory treatment^{5/} of corporate creation and management make a specific constitutional provision unnecessary in most circumstances. While some constitutional provisions are more detailed than others,^{6/} several conclusions may be drawn from analyzing the available provisions. First, the modern trend is to omit the subject entirely or treat it only generally.^{7/} Second, those constitutions that do address business corporations generally follow a standard pattern, with approximately ten subjects reappearing frequently among these provisions. These subjects usually concern either the creation of the corporate entity or certain fundamental corporate functions, and are discussed in detail below in part II. Thus, the primary purpose of a corporations article appears to be constitutional regulation of the granting of charters and direction

5/ The Model Business Corporations Act, formulated by the American Bar Association, is a detailed statute that has 152 provisions. The Model Act has been enacted in half the states. American Bar Foundation, MODEL BUS. CORP. ACT. p. ix (Supp. 1973).

6/ Compare MISS. CONST. art. VII, §§ 178-200, with ILL. CONST. art. XIII, § 6. The disparity of differing constitutional treatment is amply illustrated by Mississippi's 22 sections that provide extensive regulation, compared to Illinois' one general provision: ("SECTION 6. CORPORATIONS -- Corporate charters shall be granted, amended, dissolved, or extended only pursuant to general laws.")

7/ For example, Alaska, Hawaii and the National Municipal League's Model State Constitution do not treat the subject of corporations. Illinois, which revised its constitution in 1969, shaved its article on corporations from 15 sections to one general section, which was included in an article devoted to "General Provisions." ILL. CONST. art. XIII, § 6; ILLINOIS CONSTITUTION ANALYSIS pp. 515-35.

to the legislature regarding fundamental intra-corporate operations. The extent to which such constitutional direction is desirable ultimately depends upon weighing the possibility that the legislature may not adequately deal with the subject against the potential disadvantages of providing too much detail in the constitutional document.^{8/}

C. General Considerations

As noted above, the trend of modern constitutions is to omit any detailed treatment of corporations. This trend reflects the view that the regulation of corporations is within the competence of the legislature, and that there is little if any compelling reason to restrict legislative flexibility in this regard. It appears that the experience of states having no such provision demonstrates that legislative enactment serves to control corporations quite well. States that have revised their constitutions in recent years have concerned themselves with deletion of obsolete provisions and have avoided the addition of any new controls.^{9/}

^{8/} It should be noted, however, that the Convention need not devote a complete article to corporations but may follow the Illinois example of inserting a fairly simple provision in an article covering miscellaneous provisions, if there is one. ILL. CONST. art. XIII, § 6.

^{9/} ILLINOIS CONSTITUTION ANALYSIS pp. 515-35; A. Howard, COMMENTARIES ON THE CONSTITUTION OF VIRGINIA, vol. 2, pp. 971-1004 (1974); ILLINOIS CON CON pp. 382-90. Jurisdictions drafting relatively new constitutions -- Alaska, Hawaii, Guam, Virgin Islands and American Samoa -- have omitted references to corporations altogether.

The more detailed treatment of corporations in some state constitutions has been generally restrictive. At least one commentator has observed, "[T]he competitive nature of state corporation laws tends to put a state with unusual constitutional restrictions at a disadvantage."^{10/} This consideration may be particularly appropriate to the Northern Marianas, where the creation of a business climate that will be attractive to new investment is important.^{11/} The contrary argument is that a well-written constitutional provision lends a degree of permanence to governmental attitudes toward corporations. Such stability might engender business confidence among those considering a new site for their enterprise.

Notwithstanding the foregoing, unique considerations may be applicable to the subject of corporations organized or doing business in the Northern Marianas. To the extent such considerations are fundamental and are felt worthy of protection against legislative abuse, carefully drawn constitutional provisions may be warranted. One such issue which affects corporations is the extent to which corporations with non-Northern Marianas investors should be able

^{10/} ILLINOIS CONSTITUTION ANALYSIS p. 519.

^{11/} For example, Guam and the Virgin Islands not only omit any constitutional restrictions but provide attractive statutory tax treatment for new industry. GUAM CODE tit. LIV; VIRGIN ISLANDS CODE tit. 33, ch. 201.

to hold long-term interests in land in the Commonwealth. That subject is addressed in Briefing Paper No. 12: Restrictions on Land Alienation.

II. SPECIFIC ISSUES FOR DECISION

The threshold question before the Convention is whether the Constitution should include any provision dealing with the subject of corporations. The advantages of constitutional treatment are generally slight. Specific issues of fundamental importance in the Northern Marianas, however, may warrant an exception.

If the decision is made to provide for some provision relating to corporations, the corporation provisions may be treated in an article devoted to that subject.^{12/} Alternatively, if the provisions are not extensive, the subject may be addressed in an article devoted to miscellaneous provisions.^{13/} The extent to which one approach is to be preferred over the other depends upon the complexity and length of the provisions.

If the delegates are favorably inclined toward constitutional treatment for the subject of corporations

^{12/} E.g., NEV. CONST. art. VIII; N.M. CONST. art. XI; TEX. CONST. art. XII.

^{13/} E.g., ILL. CONST. art. XIII, § 6; MONT. CONST. art. XIII, § 1.

in the Northern Marianas, they may wish to consider the following types of provisions most commonly found in state constitutions.

A. Definition

Approximately half of the corporations articles in constitutions contain a section defining a "corporation."^{14/} The definition is usually a simple one, and care is often taken to include joint stock companies and to grant the right to sue and be sued.^{15/}

B. Creation by General Laws

Another common constitutional provision prohibits the creation of corporations by special acts of the

^{14/} E.g., IDAHO CONST. art. XI, § 16; KAN. CONST. art. XII, § 6; KY. CONST. § 208; MINN. CONST. art. X, § 1; MISS. CONST. art. VII, § 199.

^{15/} Minnesota has a typical definition:

The term "Corporation" . . . shall be construed to include all associations and joint stock companies having any of the powers and privileges not possessed by individuals and partnerships . . . and all corporations shall have the right to sue, and shall be liable to be sued in all courts

MINN. CONST. art. X, § 1.

legislature.^{16/} As discussed earlier, there was much abuse of "special grants" of corporate charters, often with monopoly power, and the proscription by constitutional provision was designed to standardize corporate formation and eliminate favors granted to campaign contributors.^{17/} In the absence of constitutional prohibition, or when a constitution expressly permits it, corporations can be created by special act without running afoul of any limitation of the United States Constitution.^{18/}

^{16/} E.g., COLO. CONST. art. XV, § 2; IDAHO CONST. art. XI, § 2; ILL. CONST. art. XIII, § 6; IOWA CONST. art. VIII, § 1; KAN. CONST. art. XII, § 1. The Missouri provision is representative:

Corporations shall be organized only under general laws. No corporation shall be created, nor shall any existing charter be extended or amended by special law; nor shall any law remit the forfeiture of any charter granted by a special act.

MO. CONST. art. XI, § 2. It is interesting that the National Municipal League's Model State Constitution, while not directly speaking to corporations, indirectly addresses this problem by prohibiting special laws "when a general act is or can be made applicable" National Municipal League, MODEL STATE CONSTITUTION art. IV, § 4.11 (6th rev. ed. 1968).

^{17/} ILLINOIS CON CON pp. 382-83. In this area, it is particularly important to draw the distinction between business corporations, creation of which by special charter is often banned, and public corporations, which often may be created only by special act. E.g., N.Y. CONST. art. X, § 5.

^{18/} W. Fletcher, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, vol. 1, § 169, p. 622 (rev. ed. 1974). It has been held that corporate creation by special act does not deny the corporation (or any other corporation) equal protection of the laws. Id. p. 623 n. 5; In re Mt. Sinai Hosp., 250 N.Y. 103, 164 N.E. 871, 874 (1928).

With regard to prohibiting special law corporations, the delegates may want to consider the disadvantages of denying the legislature the flexibility to fashion unusual entities in response to special needs. One example of a special law corporation is the Public Land Corporation authorized by the Mariana Islands District Legislature in 1975.^{19/}

C. Pre-existing Charters

Approximately one-third of the corporations articles provide that corporations formed pursuant to special grants, or corporations whose "bona fide organization was not completed, and [whose] business was not being done in good faith at the adoption of [the] Constitution, shall . . . have no validity."^{20/} This provision is apparently an attempt to eliminate the old problem of special charter corporations. The provision has been attacked as obsolete,^{21/} and its utility for the Commonwealth is questionable.

Eight states provide that corporations organized prior to the effective date of the constitution must file

^{19/} See Act 100-1975, § 3(a) (1975) in MARIANA ISLANDS DIST. CODE tit. 15, ch. 15.12, § 15.12.030. BRIEFING PAPER NO. 11: NATURAL RESOURCES § II(A) (4) (e).

^{20/} E.g., MO. CONST. art. XI, § 2; see N.D. CONST. art. VII, § 132; OKLA. CONST. art. IX, § 46; PA. CONST. art. X, § 1.

^{21/} ILLINOIS CONSTITUTION ANALYSIS pp. 516-17.

an acceptance of the constitution in order to receive the benefit of any future legislation.^{22/} This provision simply ensures notice to the corporations of such applicability. Otherwise, it is superfluous.

D. Limitation of Shareholder Liability

A number of constitutions limit the liability of any shareholder for corporate debts to the amount of stock held by the shareholder.^{23/} Unless liability is imposed by constitution, statute or corporate charter, the general rule is that stockholders are not personally liable for the debts of the corporation.^{24/} The effect of a constitutional provision of this type, then, is to prevent the imposition on shareholders, by statute or charter, of liability beyond the amount of stock each owns.

E. Consideration for Corporate Stock and Debts

A frequent provision in corporations articles is one mandating that stock and bonds be issued only for

^{22/} KY. CONST. § 190; MISS. CONST. art. VII, § 179; N.M. CONST. art. XI, § 12; N.D. CONST. art. VII, § 133; PA. CONST. art. X, § 2; S.D. CONST. art. XVII, § 3; UTAH CONST. art. XII, § 2; WYO. CONST. art. X, § 5 (corporations barred from transacting business in state until filing of acceptance of Wyoming constitution).

^{23/} E.g., IDAHO CONST. art. XI, § 17; KAN. CONST. art. XII, § 2; ORE. CONST. art. XI, § 3. Missouri's constitution of 1875 contained this provision, which was replaced in 1945 by a provision that limited liability to "the amount originally subscribed on such stock." MO. CONST. art. XI, § 8.

^{24/} W. Fletcher, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, vol. 13A, § 6213, p. 14 (rev. ed. 1961).

"money or property actually received or labor done."^{25/}

The concern here is for the issuance of fictitious or "watered" stock, and the prohibition against such issuance is for the protection of the public. The same objective can be achieved by a legislative enactment.

F. Prohibition of Ultra Vires Acts

Five states constitutionally provide that a corporation is forbidden to engage in "ultra vires" acts, activities beyond the range of those listed in the corporate charter.^{26/} This provision may be obsolete today for two reasons. First, a number of state corporate statutes provide that such corporate acts are not automatically invalid because they fall outside the reach of the charter. Instead, a court must declare that those acts are void. The lack of corporate capacity may be asserted by a stockholder, the state or by the corporation itself in litigation involving the acts.^{27/} Second,

^{25/} ARK. CONST. art. XII, § 8; see COLO. CONST. art. XV, § 9; IDAHO CONST. art. XI, § 9; MO. CONST. art. XI, § 7.

^{26/} KY. CONST. § 192; MO. CONST. art. XI, § 5; N.D. CONST. art. VII, § 137; S.D. CONST. art. XVII, § 7; UTAH CONST. art. XII, § 10.

^{27/} The language of the North Dakota constitution is straightforward: "No corporation shall engage in any business other than that expressly authorized in its charter." N.D. CONST. art. VII, § 132.

See also DEL. CORP. LAWS § 124; N.Y. BUS. CORP. LAW art. II, § 203 (McKinney 1963). These laws follow the MODEL BUS. CORP. ACT § 7.

the current statutory trend is to adopt broad provisions regarding the general powers of the corporation.^{28/} This, of course, makes rare the case of a corporation exceeding its powers.

G. Control by and Limitations of the Legislature

State corporations articles often contain provisions subjecting the corporations within the state to legislative control.^{29/} In a system that is premised

^{28/} For example, some state statutes merely state that corporations may be organized for "any lawful purpose." This language is often used as the purposes clause in the corporation's charter. See TEX. BUS. CORP. ACT art. I, §§ 3, 5. One important related provision limits the amount of real estate held by a corporation to that necessary for carrying out the corporate business. E.g., MO. CONST. art. XI, § 5. This apparently is an attempt to prevent corporations from becoming owners of vast tracts of land and expresses a preference for individual ownership. The constitutionality of this restriction was upheld by the Supreme Court in Asbury Hosp. v. Cass County, 326 U.S. 207 (1945).

^{29/} COLO. CONST. art. XV, § 3 provides:

The general assembly shall have the power to alter, revoke or annul any charter of incorporation . . . whenever in their opinion it may be injurious to the citizens of the State, in such manner, however, that no injustice shall be done to the corporators.

The last clause, of course, recognizes that in revoking a corporate charter the state must comply with the requirements of the Fourteenth Amendment. See also OKLA. CONST. art. IX, § 47; S.D. CONST. art. XVII, § 9.

on a general grant of legislative powers, the need for such a provision may be questioned since the legislature retains control over all activities within the state unless specifically precluded therefrom by the constitution.^{30/}

A related (and equally superfluous) provision specifically subjects corporations to the taxing power.^{31/}

Limitations imposed by constitutions have also included prohibition of the government's becoming a shareholder of a corporation^{32/} or its assuming corporate debts.^{33/} These latter limitations would prohibit the government from becoming a partner in an enterprise that provided essential services to the Commonwealth.

Several constitutions provide that the state's police power over corporations "shall never be abridged or so construed as to permit corporations . . . to infringe the equal rights of individuals, or the general well being of the state."^{34/} The necessity for this provision has been questioned^{35/} since in no event can a state bargain

^{30/} COVENANT art. II, § 203(c).

^{31/} MISS. CONST. art. VII, § 181.

^{32/} See, e.g., ARK. CONST. art. XII, § 7; IOWA CONST. art. VIII, § 3; ORE. CONST. art. XI, § 6; WASH. CONST. art. XII, § 9.

^{33/} See, e.g., ARK. CONST. art. XII, § 12; ORE. CONST. art. XI, § 8; WASH. CONST. art. XII, § 9.

^{34/} IDAHO CONST. art. XI, § 8; see MO. CONST. art. XI, § 3; N.M. CONST. art. XI, § 14.

^{35/} A. Howard, COMMENTARIES ON THE CONSTITUTION OF VIRGINIA, vol. 2, p. 1001 (1974).

away its police power.^{36/} Nevertheless, the revisers of Virginia's constitution retained such a provision for "emphasis."^{37/}

H. "Foreign" Corporations

More than one-third of the state corporations articles make some provision for the regulation of "foreign" corporations (i.e., entities incorporated outside the state). A common provision specifies that foreign corporations "doing business" within the state shall have an authorized "place of business" and a designated agent.^{38/} This requirement assures that foreign corporations can be sued in the local courts.^{39/} Another provision requires that foreign corporations be given no privileges other than those that may be accorded local corporations.^{40/}

^{36/} Stone v. Mississippi, 101 U.S. 814 (1880).

^{37/} A. Howard, COMMENTARIES ON THE CONSTITUTION OF VIRGINIA, vol. 2, p. 1001 (1974).

^{38/} E.g., N.D. CONST. art. VII, § 136; OKLA. CONST. art. IX, § 43 (designated agent only); S.D. CONST. art. XVII, § 6; UTAH CONST. art. XII, § 9.

^{39/} One unique provision found in Kentucky's constitution provides that a domestic corporation's consolidation with a foreign corporation does not result in Kentucky's loss of jurisdiction over the resulting corporation. The latter remains "domestic." KY. CONST. § 200.

^{40/} E.g., OKLA. CONST. art. IX, § 44; UTAH CONST. art. XII, § 6; VA. CONST. art. IX, § 5; WASH. CONST. art. XII, § 7.

Although constitutional treatment of the converse of this -- granting domestic corporations privileges not granted to foreign corporations -- is rare, Virginia's constitution specifically empowers the legislature to grant such privileges as it deems appropriate.^{41/}

^{41/} VA. CONST. art. IX, § 5. Some discrimination against foreign corporations is constitutionally permissible. The states have been held to have the authority to exclude certain types of foreign corporations altogether or admit them subject to certain conditions. See Asbury Hosp. v. Cass County, 326 U.S. 207 (1945). A state's power to regulate foreign corporations is limited, however, by the commerce clause of the U.S. Constitution. See Union Pac. R.R. v. Public Serv. Comm'n, 248 U.S. 67 (1918). See generally BRIEFING PAPER NO. 12: RESTRICTIONS ON LAND ALIENATION.