

**NOTES ON FORMATION AND  
ORGANIZATION OF BUSINESS  
CORPORATIONS UNDER THE  
LAWS OF CALIFORNIA**

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Notes on Formation and Organization of Business Corporations Under the Laws of California  
by James S. Bennett

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**JAMES S. BENNETT**

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OF THE LOS ANGELES BAR

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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."<sup>1</sup> A majority of the organizers must be residents of California,<sup>2</sup> 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,"<sup>3</sup> 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.<sup>4</sup> 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.<sup>5</sup> The Bureau of Building and Loan Supervision is given jurisdiction of savings and loan corporations and land and building corporations.<sup>6</sup> The Insurance Commis-

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.

6 Civil Code, Section 290a.

6 Statutes, 1911, page 6.

## Formation and Organization

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,<sup>7</sup> mining corporations,<sup>8</sup> cemetery corporations,<sup>9</sup> colleges and seminaries of learning,<sup>10</sup> co-operative business corporations,<sup>11</sup> industrial loan companies,<sup>12</sup> trust companies acting as trustees under deeds to secure the repayment of money,<sup>13</sup> 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.<sup>14</sup> 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.<sup>1</sup> Corporations organized under it were substantially joint stock companies of the English type.<sup>2</sup> 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,<sup>3</sup> 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<sup>4</sup> 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<sup>5</sup> and the election of officers<sup>6</sup> 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<sup>7</sup> and the stock is issued with no present intention of selling to the public<sup>8</sup> 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.<sup>9</sup> The corporation is regarded as the agency of the stockholders managing their property, to which it holds the legal title for purpose of convenience,<sup>10</sup> 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<sup>11</sup> without violating the fundamental concepts of capital stock. The Act of 1917 authorizing shares without nominal or par value<sup>12</sup> 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.<sup>13</sup> 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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<sup>9</sup> *Whitten v. Dabney*, 171 Cal. 621.

<sup>10</sup> *MacDermot v. Hayes*, 175 Cal. 95, 114;  
*Sargent v. Palace Cafe Co.*, 175 Cal. 737;  
*Garrettson v. Crude Oil Co.*, 146 Cal. 184.

<sup>11</sup> Civil Code, Section 309.

<sup>12</sup> Statutes 1917, page 1321.

<sup>13</sup> 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."<sup>14</sup>

PURPOSES AND POWERS.

A corporation is a creature of the law<sup>1</sup> having a life stated in its articles of incorporation not to exceed fifty years,<sup>2</sup> 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,<sup>3</sup> 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,<sup>4</sup> for any purpose for which individuals may lawfully associate themselves<sup>5</sup> and having powers and duties of natural persons,<sup>6</sup> to sue and be sued,<sup>7</sup> to make and use a common seal and alter the same at pleasure,<sup>8</sup> 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,<sup>9</sup> unless it is organized for the purpose of dealing in real estate,<sup>10</sup> and not then if a majority of its stock is owned by aliens who may not become citizens by naturalization,<sup>11</sup> and may not issue bills for circulation as money;<sup>12</sup> nor take property by last will and testament;<sup>13</sup> 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 3.  
10 Market St. Ry. Co. v. Hellman, 109 Cal. 590.  
11 Statutes 1913, page 206.  
12 Constitution, Article XII, Section 5;  
Civil Code, Section 354.