

Weekly Information Sheet 06

THE NATURE OF CORPORATIONS

What is a "Corporation"

A corporation is a legal entity (an artificial person), separate and distinct from the legal personalities of those who own and manage the corporation.

A creature of law, its existence and attributes arise from state-enabling statutes, which give business participants significant freedom to choose their own customized relationships.

In New York, as elsewhere, corporate law is mostly statutory, and most of the statutory law relating to general business corporations (i.e., corporations for profit) is contained in the New York Business Corporation Law ("BCL").

The Rise of the Corporation:

Roman Law:

Founded in Rome: The modern corporation is actually of ancient origin, and like most things created from Rome, it arose as a practical solution to fill a need.

Based in Roman Law: The first corporation arose when Roman commerce and trade grew to a sophisticated level, and traders and merchants needed a business organization that could last beyond a person's natural lifetime, and have its own identity before the courts.

An Artificial, Separate, Person Under the Law: This Roman legal invention was treated as if it had a distinct personality apart from that of its owners or members, continued to exist beyond their lifetime, and was allowed to bring an action in law before Roman courts, as a distinct entity rather than under the name of any individual.

What's in A Name: This Roman legal invention was termed "corporation", meaning a business entity which is viewed as a separate and independent legal person under the law. It is a derivation of the Latin term "corpus" meaning "body".

English Law:

England Evolves Roman Law: These Roman principles were resurrected in England, a former Roman colony, as early as the 12th century.

Paralleled the Common Law: The corporation was first brought into the Anglo-American Legal System by Henry the Second. His innovations also developed much of what we know today as the English Common Law.

More than Just Business: King Henry adapted the concept of the Roman corporation to meet his needs of governmental organization and public infrastructure development. He used the sovereign authority to create fictitious legal persons through the granting of Royal charters.

Application to Business: Later rulers, then expanded this idea of the corporation by employing the corporate mechanism to establish trade guilds. These organizations would establish by-laws to govern all persons engaged in a specified field (such as weavers, tailors, goldsmiths, and haberdashers).

A British Staple of Law: By the time of the founding of Colonial America, the corporation attained a status in the social constitution of Great Britain and its colonies.

Expanded to Meet Economic Needs: As the needs of English society changed, the corporation was further developed. To meet these needs, British royal sovereigns began to grant charters for such purposes as constructing public works projects such as churches, hospitals, universities, waterways and canals.

A Means to Colonize: By the start of the 17th century, as England arose to the stature of a world superpower, Queen Elizabeth decided to deploy the corporation format to extend national influence into the area of colonization. Chartering such entities as the East India Trading Company, the Hudson's Bay Company, the Virginia Company and the Massachusetts Bay Company, England became the British Empire, using corporate powers to develop, settle and institute commercial operations all across the globe.

The Rise of the Corporation Continued:

English Law Continued:

Corporations as a Tool of Government and Business: These corporations were thus developed into a tool, granted by a king, to extend his rule and power, using the initiative of private individuals, to accomplish certain public purposes.

The Rise of Limited Liability: Most importantly, starting with the joint stock corporation, such charters could also provide, as aforementioned, for an extension of sovereign immunity, so as to limit the liability and financial exposure of corporate investors to only the amount of their investment.

A Powerful Mechanism: Accordingly, perhaps the most important factor, which has led to the dominance of the corporation as a business organization entity, is the development of this limited liability attribute. Moreover, at the time of its first inclusion in corporate charters, the concept of limiting one's liability to only the amount of their capital investment was not otherwise anywhere else recognized at common law.

Colonial America:

British Law Operated in the Colonies: By the time of the founding of Colonial America, the corporation was a well settled institution within the English Common Law. Under such, it had attained extensive acceptance and application in the domain of business. As a result, it is therefore not surprising that from a very early date, the corporation played a prominent role in American life.

Most Businesses Were Not Corporations: Despite the myriad of business organizations available under English Law, the business landscape of Colonial America contained only a handful of Corporation and was dominated by sole proprietorship businesses.

A Small But Growing Economy: As the American Colonies began to grow and prosper, they began to move toward independence from England. The pull of freedom was very strong. From farmers to merchants, single persons owned and worked their own businesses. Their sense of self reliance and independence was very strong. Although most people still were engaged in small businesses, with the growth of the economy, their new sense of an independent future, many began to envision a day when a growing number of businesses, would grow large enough to need a corporate charter.

Another Reason for Rebellion: In all of America, however, there were only 335 corporate charters granted by the British sovereign. This unwillingness to treat American businesses as equal their English Counterparts, only underscored America's desire for independence. They wanted freedom, including freedom to pursue their economic dreams in the manner they wished.

Competitive Advantage for Corporations: Those businesses, that did maintain the corporate form had a competitive advantage. They operated with the formidable strength and capital of limited liability, and the purpose and power of the state.

Another Unfair Power of the Crown: With the dawn of the American Revolution, all edicts of the Crown, including the corporation, became circumspect. As the denunciation of the king, and "his long train of abuses", became a rallying cry for American independence, this unfettered exercise of the state's authority by the British King, selectively granting corporate charters to British businesses, while denying them to Americans, was seen by the founders as another impediment against a truly free society.

British Parliament Began Granting Charters Too: Concurrently, at this same time the British Parliament also began to more frequently deploy its own legislative power to create corporations through the issuing of charters by statute. They were, however equally stingy in granting them to American concerns.

State Legislatures Began to Grant Corporate Charters: After the Revolution, corporate charters throughout America, began to be granted to individuals by special acts of their state legislature.

New York's General Incorporation Policy:

A New Law: In 1846 a modern method of forming business corporations was born in New York State:

"Corporations may be formed under general laws; but shall not be created by special act, except for municipal purposes, and in cases where, in the judgment of the legislature, the objects of the corporation cannot be attained under general laws. All general laws and special acts passed pursuant to this section may be altered from time to time or repealed." (Art X, Section1).

Through this provision, New York State established the policy of allowing businesses to incorporate by filing, pursuant to qualified rules established by statute. (known as the Business Corporation Law).

As a result, businesses no longer needed a special act of the state legislature to obtain corporate personhood through a charter granted by an individual dedicated law.

The Rise of the Corporation Continued:

New York's General Incorporation Policy Continued:

Effect of the Constitutional Amendment: This constitutional amendment, and the enabling statutes that followed, had the effect of transferring the monitoring of corporations from the legislature (through the crafting of a special laws awarding a charter) to the courts (through the administration of justice for statutory compliance).

Exponential Increase In Corporations: The amendment further resulted in an exponential increase in corporate organizations and provided the impetus to make New York State the commercial capital of the nation.

As Corporations Grow, Business Grows: As a consequence, by the time of the civil war, just fifteen years later, New York State developed a gross domestic product index over four times that of all the confederate states combined.

Corporate Personhood: In addition to the provisions outlined in Article 10, Section 1, the 1846 State Constitutional Convention also provided for a direct expression of corporate personhood. This section 4 of Article X reads as follows:

“The term corporations as used in this section and in sections 1 (the power to make general incorporation statutes), 2 (the power to hold incorporators liable for dues of the corporation) and 3 (limiting the legislature’s ability to make special charters just for banking purposes) of this article shall be construed to include all associations and joint-stock companies having any of the powers or privileges of corporations not possessed by individuals or partnerships. And all corporations shall have the right to sue and shall be subject to be sued in all courts in like cases as natural persons.”

Present Status of Corporations in New York: Almost immediately, upon the ratification of these amendments, enabling corporation statutes also began to evolve. From that time to the present we have thereupon seen the enactment of such controlling corporation laws as:

- **the Business Corporation Law,**
- **the Benevolent Orders Law;**
- **the Cooperative Corporations Law;**
- **the Limited Liability Companies Law;**
- **the Not for Profit Corporations Law;**
- **the Religious Corporations Law; and**
- **the Transportation Corporation Law.**

Definition of a "Corporation"

“A corporation is an artificial person or legal entity created by or under the authority of the laws of the state or nation, which has an existence distinct from that of its associated individuals, and has a duration that is either perpetual or for a limited term of years, and which acts as a unit in matters relating to the common purpose of the association and within the scope of the powers conferred upon it by law.”

Types of Corporations:

- **Private Corporations**
 - **Business Corporations**
 - **Foreign / Domestic**
 - **Close / Publically Traded**
 - **Professional Corporations**
 - **Subchapter S Corporations**
- **Public Corporations**
 - **Public Benefit Corporations**
 - **Public Authorities**
 - **Municipalities**
- **Not-for – Profit Corporations**

Types of Corporations Continued:

Private Corporations: A private corporation is a corporation organized under state law for purposes of finance, industry, and commerce. Often called “public” in business circles, when their stock is sold, due to the fact that such stock is offered for sale to the general public. They can be **foreign corporations** (meaning they are formed and chartered outside of the state), **domestic corporations** (meaning they are formed and chartered inside the state), **publically traded corporations** (meaning any person over the age of 21 may purchase their stock), or **close corporations** (meaning only their stock is not publically traded and that only select persons may purchase their shares, such as family members, employees or members of a certain class – including people with the same characteristics or locations or hobbies or vocations).

Business Corporations: are corporations organized under the New York State Business Corporation Law, to operate a business for profit.

Professional Corporations: are corporations where one or more individuals, duly authorized by law to render the same professional service within the state, may organize, or cause to be organized, a professional service corporation for pecuniary profit.

Public Benefit Corporations: are corporations (often called public authorities) that are chartered by an act of the State Legislature or Congress, to perform the work of the chartering entity for the benefit of the public.

Municipal Corporations: are Municipalities that have been formed by corporate charter. Some were chartered by the state government, but many were chartered before the formation of the United States, pursuant to a charter granted by a king. The City of Albany, and the City of New York, were both formed by Royal Charter in 1686.

Not-for-Profit Corporations: are a Corporation formed pursuant to the New York State Not-for-Profit Corporation Law, exclusively for an authorized purpose (such as civic, charitable, educational, scientific, religious, or other non-business purpose and not for pecuniary profit or financial gain).

Elements of Corporation

Principal Characteristics:

In general, corporations have the following principal characteristics:

Limited Liability: Because a corporation is a separate legal entity, its debts and obligations are treated as being distinctly its own; its shareholders and managers are ordinarily not liable for corporate indebtedness. One exception is the liability of the 10 largest shareholders of non-publicly traded corporations for the wages of corporate employees. [BCL §630]

Entity Powers: Since the time of their establishment under Roman Law, corporations have been held to be an Artificial Person under the Law. This Corporate “Personhood” means that the corporation is viewed as separate entity, a corporation can contract in its own name, sue or be sued, own or convey property, and be held criminally liable for crimes that it commits. (BCL §202)

Centralized Management: Control of a corporation is centralized in a board of directors elected by shareholders. In general, the shareholders have only extremely limited power to make management decisions (except insofar as they may elect and remove directors).

Continuity of Existence: Unless duration is specifically limited in the certificate of incorporation, a corporation's duration is “perpetual”; i.e., it continues until dissolved, merged, or consolidated in accordance with the BCL. The death, withdrawal, bankruptcy, or incapacity of any of its shareholders or managers has no effect on the corporation's existence. [BCL §202(a)(1)]

Free Transferability of Interests: The interest of the corporation's owners is divided into shares, and these shares may be freely transferred; that is, another person may be fully substituted in the place of the transferor as the holder of ownership interests (shares) in the corporation.

Statutory Sources of Authority: A corporation is a creature of statute; it and its managers and agents have only such authority to act as is conferred by or pursuant to statutes (principally the BCL), the case law (to a lesser extent), or legally permitted provisions of the certificate of incorporation or bylaws.

Constitutional Status: A corporation is an “artificial person” under the law. Accordingly, it is a “person” entitled to due process and equal protection of the law under the 5th and 14th Amendments. It has also been held to have similar civil rights afforded to people, such as protections under the 1st Amendment. But Courts have also held that corporations are not a “citizen” referred to by the Privileges and Immunities Clause of Article IV or the Fourteenth Amendment (meaning states can discriminate against out of state corporations), and that it holds no right against self incrimination under the 5th Amendment.

Comparison With Other Forms of Business

Comparison with Partnership:

A partnership is not a separate entity distinct from its owners, the partners. Each partner is jointly and severally liable for the debts of the partnership. (NYPL §26). Each partner has a voice in management unless the partners all agree to the contrary. The existence of the partnership cannot be perpetual, and the ownership interests are not freely transferable. Its statutory authority in New York is the Partnership Law.

Comparison with Limited Liability Company (LLC): A limited liability company in many ways is similar to a cross between a partnership and a corporation. Its owners, known as members, do enjoy limited liability, but it is not centrally managed as the members, like partners, provide the management of the company. Formed by means of an articles of organization, and managed in accordance with an operating agreement signed by all members, the LLC is a much less powerful, more streamlined, and more affordable to operate a small business with limited liability. Its statutory authority in New York is the Limited Liability Company Law.

Comparison with Sole Proprietorships: Sole proprietorships have no statutory requirements for formation, ownership or operation. There is no limited liability, and financial protections must be procured by means of the purchase of insurance. The owner is the sole manager, and all profits and all losses inure to their benefit or detriment.

Powers of a Corporation:

Transfer Property: This includes the power to transfer or mortgage all or any part of the corporation's assets. [BCL §202 (a)(5)];

Lend Money: A corporation has the power to lend money, invest its funds, and to take collateral therefor in connection with a business operation other than banking. Unless it is a banking corporation, it has no banking powers. [BCL §202 (a)(8)];

Buy and Sell Securities: A corporation has the power to acquire, hold, vote, and dispose of bonds, shares, and other securities of any other issuer (regardless of the issuer's business). [BCL §202 (a)(6)];

Contract and Borrow: A corporation has the power to make contracts, to borrow money, to issue notes, bonds and other obligations, and to give mortgages of its property as security. [BCL §202 (a)(7)];

Compensate Employees: A corporation has the power to fix compensation of employees, officers, and directors, and to pay pensions and establish retirement, incentive, and benefit plans and trusts for its employees, officers, and/or directors (including pension, profit sharing, share purchase, options, and bonus plans). [BCL §202 (a)(10) and (13)];

Participate in Other Ventures: A corporation also has the power to be a (i) promoter, (ii) partner, (iii) associate, or (iv) manager of other business enterprises or ventures. Also a New York corporation may also act as an incorporator of foreign corporations if permitted by the jurisdiction of incorporation. [BCL §202 (a) (15)];

Major Residuary Power: In addition to other specified powers, corporations may further exercise all powers that are necessary and convenient to effect any or all purposes for which the corporation is formed. [BCL §202(16)].

Contributions: The Business Corporation Law further authorizes corporations to make the following contributions:

Charitable Contributions: A corporation may make donations, irrespective of corporate benefit, for the public welfare or for charitable, educational, scientific, civic or similar purposes, subject to a certificate of incorporation. [BCL §202 (a)(12)];

Political Contributions: A corporation has the power to political contributions subject to campaign finance limits under federal and State Election Law. Federal law prohibits direct contributions to candidates from corporations and New York State Election Law (section 14-116) limits corporate contributions to a total of \$5000 for any calendar year;

Guarantees: The Business Corporation Law additionally authorizes corporations to give guarantees in furtherance of corporate purposes [BCL §202 (a)(7)], and also give a guarantee not in furtherance of corporate business when authorized by a vote of two-thirds of the shares entitled to vote [BCL §908];

Practice of Law: An ordinary business corporation may not engage in the practice of law.

Note: A professional corporation consisting of attorneys can engage in the practice of law [BCL – Article 15], as well as a court approved charitable organization helping indigents pursue civil remedies [N.Y. Jud. Law §495].

Indemnification of Directors and Officers: The Business Corporation Law also authorizes corporations to indemnify directors and officers, but the extent to which a corporation may (and must) indemnify its directors and officers for litigation related expenses is strictly controlled by law.

Acquisition of Its Own Shares: The Business Corporation Law further authorizes corporations to acquire, hold and dispose of (but not vote) its own shares, subject to certain limitations.