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A TREATISE OF THE LAW RELATING TO THE OVERRIDING OF THE CORPORATE FICTION

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LIMITATIONS

OF THE

CORPORATE ENTITY

A TREATISE OF THE LAW RELATING
TO THE OVERRIDING OF THE
CORPORATE FICTION

BY

WALTER H. ANDERSON, LL.B.

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DEDICATION

To the memory of the late Judge N. Green, and the late Dr. Andrew B. Martin, professors of law of Cumberland University—at whose feet the author, in his youth, was privileged to sit and hear the recondite principles of the law eruditely expounded— this book is dedicated as a slight token of affection and esteem.

PREFACE

THE legal profession throughout the years has fallen into the path of thought that the separateness of a corporation from its shareholders or members was so firmly established that it was formerly rather infrequently questioned. But in spite of such prevalent view, the corporate entity is a fiction of law, invented for convenience; that courts will now so regard is as well established as the rule of its recognition. Yet works on corporation law are written—unconsciously perhaps—on the theory that the corporate fiction may not, except in sporadic cases, be overridden. Therefore it is thought there is a void in the law on this subject. It is the purpose of this book to supply, in the field of corporation law, that which is lacking. We claim for this book that it covers a field of the law not occupied by any work on corporations, or any other treatise on any legal subject; that the rules of law in its pages parallel in importance the treatment of corporation law found in works dealing therewith. It is claimed for this book, further, that a cursory survey of it will disclose that, in many cases, it is indispensable that the corporation and its stockholders or members be treated as one in order to prevent injustice.

It has been our aim to treat, exhaustively, questions of rights and liabilities arising where an individual or partnership business is converted into a corporate form, but substance remaining the same; the law relating to one-man corporations; corporate contracts made in the name of a stockholder or officer; set off between stockholders and corporate creditors; conveyances made in the name of stockholders of property standing in the corporate name; insurable interest of stockholders in corporate property; effect of all stock becoming concentrated in the hands of one; estoppel of stockholders as operative against the corporation; defenses good against the stockholders as good against the corporation, including *res*

adjudicata; defense by insurer in suit by corporation that its stockholders burned property; the law relating to reincorporation; reorganization; consolidation; merger, and the like; rights and liabilities as to parent and subsidiary corporations, including the plea of *res adjudicata;* set off between the parent and debtor of the subsidiary. In short it has been our endeavor to deal with all questions where the corporate entity or separate corporate existence from stockholders could be an issue in actions at law or in equity.

This book has been written with the point of view of the practitioner kept constantly in mind. The author feels that his engagement constantly, for almost a quarter of a century, in the active practice of his profession has enabled him, to some degree at least, to appreciate the position of the practitioner. It is thought that too many textbooks are written in this day with theory only in view. While we do not wish to assume the role of critic, yet it is thought too many textbooks are offered to the profession, which are little short of a conspectus of the adjudicated cases on the subjects discussed. We have essayed in this book to analyze, and discriminately compare the cases upon the points decided, venturing to suggest those sustained by sound dialectics, and to criticize those thought to contain faulty ratiocination. As to how far we have succeeded in our efforts, we will be compelled to submit to the final but impartial judgment of our professional brethren. We bespeak for ourselves a charitable consideration at the hands of a noble profession.

A painstaking effort has been made to attain accuracy in statement of the law, and in citation of authorities, but it would be too much to hope that we have succeeded completely.

We would be lacking in gratitude, if we did not make public acknowledgment to W. H. Witty, Esq., of the Pocatello Bar, and the author's law partner, for reading the manuscript and making constructive criticisms and suggestions; to D. Worth Clark, Esq., of the Pocatello Bar for furnishing some citations and making suggestions; to my wife Emma B. Anderson for assisting in the verification of citations; to Mrs. Elizabeth Davis Hopkins, Mrs. Matelda M. Clemmens, Miss Erva

Sayer and Miss Marianne Hawkes, for performing the stenographic tasks attendant upon the preparation of the manuscript.

However, the author assumes the sole responsibility for any statements found in the book.

If the Bench and Bar shall find in this book, aid lessening their labors, the author will be sufficiently remunerated for his efforts.

WALTER H. ANDERSON.

Pocatello, Idaho, June 22, 1931.

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258. Where parties organize a corporation under such circumstances as to warrant findings that it was organized to evade contracts, corporators personally liable.
259. Corporation will be liable upon note given in the name of exclusive owner.
260. A corporation, the stock of which is owned by an individual, is the assignee of the contract of that individual and on rescission must restore full consideration.
261. Corporate entity disregarded to prevent defense of *ultra vires.*
262. So where all of the stockholders and all members of the board of directors of a corporation act together and enter into a contract in reality in the interest of the corporation, the corporate entity will be disregarded and their acts held binding on it.
263. Where two corporations have interlocking directors and are owned by the same stockholders, the corporate entities will be disregarded and defense of *ultra vires* denied.
264. Sole stockholder may pledge credit of debt-free corporation for stockholder's obligations.

265. Individual engaged in business organizes two corporations, one becomes bankrupt, both will be administered.
266. Where a merchant incorporates himself and sells stock to another and the corporation thereafter goes bankrupt, individual creditors of such merchant share in proceeds.
267. Corporate entity will be ignored to prevent the recovery upon a commission contract.
268. Where an individual owns two corporations organized under the laws of different states, identical in name, said corporations will both be held liable along with their owners for goods sold to either or being uncertain as to which of said corporations the goods were in fact sold.
269. Debtor and creditor may not organize corporation and put debtor's property in its name so as to be subjected to creditor's claim to the exclusion of other creditors.

CHAPTER XIII

DISREGARD OF CORPORATE ENTITY IN PROTECTION OF GOODWILL

270. A stockholder buying the stock of others in a corporation together with a stipulation for protection of goodwill may enforce such stipulation.
271. An individual selling his business may not thereafter organize a corporation to engage in that business and thus evade his contract of sale of goodwill.
272. Where individuals having valid contract restraining other parties from engaging in business, such individuals may enforce the contract, notwithstanding having transferred the business to a corporation they have formed.

CHAPTER XIV

A CORPORATION ORGANIZED OUT OF PARTNERSHIP, LIABILITY FOR DEBTS AT COMMON LAW

273. The rule at common law is that a partnership organized into a corporation, it is liable for the partnership debts.
274. Partnership organizing itself into a corporation, priority of payment by partnership creditors and corporate creditors.

275. Where a partnership is organized into a corporation, it is liable for the debts of the partnership whether expressly assumed or not.

276. Where a joint adventure is organized into a corporation, the corporation will be liable for the joint adventurer's debts.

277. Where an insolvent partnership or jointly owned business is formed into a corporation, the corporation will be presumed to have assumed the indebtedness.

278. An insolvent partnership organizing itself into a corporation, the corporation is liable for the obligations of its predecessor.

279. Presumption of liability, whether rebuttable or conclusive.

280. A partnership that has received a fraudulent conveyance and organizes itself into a corporation, the fraudulent conveyance may be set aside as against the corporation and the corporation held for the full value of the property received by such conveyance.

281. Where a corporation succeeds a partnership and is composed of the members thereof and takes negotiable securities payable to the partnership, it cannot be an innocent purchaser for value.

282. Three parties forming a partnership and agreeing to thereafter incorporate and hold the interest in the corporation in the same proportion as the partnership, will be subject to the same proportionate liabilities.

283. Corporation having taken over the assets of partnership and expressly assumed liabilities, substituting its note for that of the partnership, such note is supported by sufficient consideration.

284. Where a partnership is engaged in the loan business and has charged usury and is organized into a corporation, the corporation will be liable for such usurious conduct.

285. Where a partnership and another enter into an agreement providing for sharing of the fruits of the agreement 90% to partnership and 10% to the individual, and partnership is thereafter organized into a corporation it will be liable upon such agreement.

286. A corporation organized out of a partnership is subject to estoppel that is operative as against the partnership.

287. A partnership acting as agent for a mortgage concern which partnership is organized into a corporation, the corporation cannot recover for services which under the contract the partnership had rendered to the principal gratuitously.

288. Massachusetts Trust, Joint Stock Co., or Association converted into a corporation, the corporation is liable for the association's obligations.

289. Member of a partnership and a creditor thereof organizing the partnership into a corporation, it will be liable for the debts of the partnership.
290. Where a husband and wife are engaged in business and transform the business into a corporation, such corporation will be liable for the former obligations of the business.
291. Where practically the sole owner of a corporation makes a contract with another party that the other party shall receive a percentage of the profits arising from a corporate enterprise in excess of 6% on capital stock, such other party being an employee, this arrangement amounts to a partnership between the corporation or its principal stockholder and such employee.
292. A partnership owning substantially all of the stock in a corporation, the corporation and partnership will be treated as one.
293. In order to hold a corporation created out of a partnership, something more must appear than receiving a portion of the partnership assets.

CHAPTER XV

SIMILARITY BETWEEN CORPORATION AND PARTNERSHIP AND STOCKHOLDERS AS PARTNERS INTER SE

294. Corporation likened unto a partnership.
295. Corporation organized out of a solvent partnership which corporation thereafter became insolvent, holder of a corporate note for firm debt entitled to share in the distribution of the corporate assets.
296. A partnership composed of two members organizing a corporation holding company, the partners being the stockholders, as to each other and the corporate interest, the partners will be treated as such.
297. The modern rule is, and the one that is supported by the greater weight of authority, that corporators and stockholders *inter se* may be treated as partners.
298. In some states the courts will not override corporate entity and deal with the stockholders as partners even among themselves and in the absence of creditors.
299. California doctrine applied, stockholders treated as partners.
300. Where the stockholders of a corporation were largely the same family and it was a sort of a family affair, the stockholders will be treated as partners.

301. Two persons owning a corporation may agree among themselves as to salary.
302. Corporate entity disregarded, recovery allowed on contract of employment where a partnership owns three corporations.
303. Surviving partner may not execute lease and bills of sale to partnership property to a corporation that is his *alter ego*.
304. Corporation organized out of partnership, liable on a lumber contract entered into by partners, even though others interested in corporation.
305. Partners enter into a contract to pay royalties upon patented article thereafter incorporated, such corporation will be liable upon such contract and plea of statute of frauds will not avail.
306. It seems in New Jersey the courts are reluctant to discard the corporate entity theory and adopt the modern doctrine.
307. Corporation taking all the assets of a partnership liable for income tax owing by the partnership and property subject to lien.

CHAPTER XVI

SUFFICIENT GROUNDS FOR DISREGARD OF CORPORATE ENTITY

308. A corporation may not be organized for the purpose of conferring jurisdiction upon the courts of the United States.
309. Federal jurisdiction cannot be defeated by parties organizing themselves into a corporation.
310. It has been held that corporate entity not disregarded to authorize service on parent corporation by serving subsidiary.
311. When one corporation owns stock in another to dominate and control it, corporate entity will be ignored.
312. One corporation wholly under control of another, separate entity will not relieve latter from liability.
313. Mere ownership of stock alone is not enough to fix liability on stockholder for corporate acts, but stock ownership together with control, sufficient.
314. If corporations are practically identical, coupled with the control, warrants court in disregarding of entities.
315. Corporate entity not permitted to stand in the way of the enforcement of lien in admiralty court.
316. Where the difference between two corporations is reduced to a matter of bookkeeping, the corporate entities ignored.
317. Corporate entities ignored to allow offset between parent corporation and creditors of subsidiary.

318. Neither a corporation nor its receiver can avoid on behalf of corporation endorsement of negotiable paper by sole stockholder.
319. A corporation that is so controlled and conducted as to make it a mere agency or instrumentality of another, separate existences ignored.
320. If relations between two corporations are so interwoven and so intimate as to easily facilitate commission of fraud, entities disregarded.
321. Where the majority stockholder causes the assets to be transferred to a new corporation owned and controlled by him, such new corporation will be held liable to the minority stockholders of the old.
322. The rule that corporate entities will be disregarded in proper case is not affected by the fact whether one or more owns the stock of the corporation.
323. General rule is that if the stockholders of a corporation are estopped, the corporation will be estopped and *vice versa*.
323a. Defense good against stockholders, were they parties to the action available as against corporation.
323b. *Res adjudicata* and disregard of the corporate fiction.
324. Where a corporation is a dummy, the stockholders' acts are its acts.
325. Rule seems to be that where a corporation is a mere dummy behind which the stockholders are hidden, their liability would be measured by that of the dummy as if it were *bona fide*.
326. The ultimate determination of corporate affairs rests with stockholders.
327. All the stockholders entering into a contract manifestly for the benefit of the corporation, it will bind the corporation though not a party by name thereto.
328. Directors representing entire corporate stock may issue bonds even though they do not do it in accord with articles.
329. A corporation allowing its officers to exercise its functions, will be bound by their acts.
330. Directors owning all of the stock of a corporation, their separate action binds the corporation.
331. Manager of a corporation organizing a new corporation, and such new corporation accepting the profits of a contract with the old, the new corporation will be liable thereon.
332. One owning substantially all of the stock of a corporation, whose acts are acquiesced in by the directors, the corporation will be liable therefor.
333. Directors owning all of the stock of a corporation, are not within the rule prohibiting persons in fiduciary capacity from contracting for their benefit.

334. Directors acting in accordance with desires of stockholders, form of action immaterial in absence of creditors.
335. If by brushing aside corporate entities it appears that the substantial intent of the parties was to bind the corporation, the form of the transaction is immaterial.
336. Originally contracts could be made only in the name of the corporation, but it is now settled that a contract for corporate purposes in the name of its officers is a corporate contract.
337. Corporate entity will be disregarded to defeat the defense of *ultra vires* where stockholders knew of the act that such defenses urged against.
338. The corporate entity will not be allowed to stand in the way of showing that the corporation's property was burned by the stockholders and that such burning is a defense by insurer in an action on the policy.
339. Where the pledgee of the corporate stock burns the corporate property, the corporation may not recover the insurance thereon.
340. It seems that the mere pledging of substantially all of the assets of one corporation to another is not enough to invoke the rule of disregarding the corporate entity.
341. Corporation taking conveyance from its stockholders, who are its directors and promoters, takes such subject to equities against the grantors.
342. Corporate entity disregarded to prevent recovery on gambling transaction.
343. Where a corporation is formed in the contemplation of the carrying out of an agreement, the corporate entity will be ignored.

CHAPTER XVII

DISREGARD OF CORPORATE ENTITY BETWEEN PARENT AND SUBSIDIARY CORPORATION

344. Where one corporation is a mere instrumentality of another or an adjunct thereof, the corporate entities will be ignored.
345. General statement of liability of parent corporation.
346. Ownership of stock alone not enough to hold parent but stock ownership coupled with control sufficient.
347. Parent corporation may not file a claim in bankruptcy against its subsidiary.
348. Upon the bankruptcy of the parent, a subsidiary corporation will be required to turn over its assets to be administered with those of the parent.

349. The affairs of the parent and subsidiary corporation will be administered as one in receivership proceedings.
350. Where two corporations are practically indentical, one corporation may be held for property delivered to the other.
351. A parent corporation organized under the laws of one state and having a subsidiary organized under the laws of another, will be liable on lease to subsidiary.
352. A parent corporation will be liable for a libel committed by its subsidiary.
353. A railroad corporation operating its business through the means of subsidiary will be liable for personal injuries resulting from such operation.
354. Corporation owning and operating a railroad through intervention of a domestic corporation, is liable for personal injuries sustained on the subsidiary line, in violation of federal safety appliance act.
355. A railway company may not absorb a competing line by reason of an inhibition of constitutional provision, but control the lines through another corporation, the parent corporation is liable for personal injuries.
356. Where a parent corporation organizes subsidiary for the purpose of operating its property, the parent will be liable for personal injuries resulting from the negligence of the subsidiary.
357. Where one railroad actually controls another, operating both, dominant company liable for injury to freight occasioned by subsidiary.
358. Where a ship brokerage company organized and controlled a stevedoring company, it will be liable for personal injury to the subsidiary company's employees.
359. A national corporation may be the parent of state subsidiary corporation or the two may be regarded as one.
360. National bank and a state loan corporation may be considered as parent and subsidiary in dealing with violations of the national banking law.
361. Officers of national banking corporation cannot be held liable for misapplication of funds when such were used in the discharge of subsidiary's obligation, the two corporations being treated as one.
362. National Banking corporation is liable for acts perpetrated by a state corporation, its subsidiary.
363. Parent corporation is liable for fraud of its subsidiary.

CHAPTER XVIII

RIGHTS AND LIABILITIES OF PARENT AND SUBSIDIARY CORPORATION

364. A parent corporation will be held liable for nondelivery of goods purchased from its subsidiary.

365. A corporation engaged in the wholesale business will be held one and the same with its subsidiary corporation where the parent took over the business of another corporation and held it out as an agency.

366. A manufacturing corporation organizing a sales corporation, the two will be treated as one.

367. Two railroad companies substantially owning a terminal corporation, the separate entity of the terminal corporation will be disregarded.

368. Railroad corporation, seeking to avoid the effect of a decision, declaring its lease of another's property illegal, the railroad company organizes a third corporation to own the stock of the lessor corporation, is liable for the acts of the lessor corporation.

369. It is readily understood that the parent may be held for its transactions and acts through the subsidiary, but it seems the subsidiary is not liable for the acts of the parent.

370. Subsidiary corporation cannot recover for products sold to the parent, the stock of the subsidiary having passed into hands of other parties.

371. Parent corporation will be held liable for loans made to its subsidiary.

372. Where a parent corporation is organized in conjunction with two subsidiaries, and the parties interested treating all three as one, the parent will be liable upon obligations of the subsidiaries.

373. A corporation, controlling through stock ownership and conducting the business of another corporation by virtue of such ownership, is subjected to the strictest account.

374. The law disregards corporate forms and in so doing will hold that a foreign corporation is doing a business in the state through a subsidiary.

375. A corporation transacting business in a state through the instrumentality of a subsidiary is required to comply with the laws relating to foreign corporations doing business therein.

376. Corporation forms will be disregarded to compel a corporation owning a railroad to operate it.

377. Railroad company, owning a subsidiary telegraph company, will be held responsible upon the contracts of its subsidiary.
378. A parent holding corporation having under its control six or seven subsidiaries may be compelled to produce its books with those of the subsidiaries in an action against subsidiaries.
379. Stockholders are the equitable owners of the corporate property.
380. Corporation owned by two persons, there being no creditors, the stockholders may divide the property.
381. Where a corporation agrees to give a mortgage upon its property, but through an oversight or an error it was executed by the stockholders, the mortgage will be sustained.
382. Corporate entity ignored to allow surety on employee's bond to defend against false statements of officers of the corporation.
383. The corporate entity will be brushed aside in order to prevent a corporation from recovering money that has been used in the purchase of its stock by the consent of all of the stockholders.
384. Corporation may not evade liability by change of name.
385. Conversion of a corporation from *de facto* to *de jure* will not affect liability.
386. *De facto* corporation sufficient to prevent recovery against stockholders as partnership.
387. Transfer from one corporation to another, which amounts to a mere change of name, corporate entities disregarded and property held liable for obligations.
388. Courts will not disregard corporate existence if to do so will injuriously affect innocent stockholders.
389. The corporate existence may not be set aside in order to hold a nonparticipating stockholder for the fraudulent misconduct of another stockholder.

CHAPTER XIX

DISREGARD OF CORPORATE ENTITY IN PATENT INFRINGEMENT CASES

389a. The courts reject the view that corporate fiction can be made to serve as a shield against violation of patents.
390. A corporation may not be organized for the purpose of infringing a patent.
391. A corporation owning and controlling another will be responsible for a patent infringement through such subcorporation.

392. The doctrine of estoppel applicable as against the assignor of the patent, is operative against a corporation subsequently formed by him.

393. Corporate entity disregarded to hold responsible party for costs in infringement of patent case.

394. Corporation dominating another, together with owning its stock, *sufficient to hold stock-owning corporation responsible for patent infringement.*

395. One corporation owning and controlling another, including good will, and operating its plant, is responsible for patent infringement.

396. Where adjudication in a patent-infringing case is had against a subsidiary corporation, a plea of *res adjudicata* will be sustained in an action against the dominant corporation.

397. A corporation succeeding to the business and assets of another during pendency of patent litigation will be responsible for *judgment obtained.*

398. *Corporation succeeding a partnership* is bound by the contract of such in the sale of patent.

398a. A corporation having the same officers, largely the same directors, and infringing patent on property of another together with stock ownership makes both corporations liable therefor.

CHAPTER XX

RIGHTS AND LIABILITIES IN DEALING WITH TWO CORPORATIONS WHICH ARE THE SAME

399. *Government lands being obtained by fraud of which an individual* has knowledge, a corporation organized by him has the knowledge imputed to it.

400. Where two corporations are formed by the same stockholders and a mortgage is foreclosed on property executed by one of them, the other entity will not be permitted to enjoin foreclosure proceedings.

401. Two corporations sustaining such relationships as warranting the conclusion that they are one, they will be interchangeably liable upon contracts.

402. A corporation owned by a single individual is bound upon his contracts for attorneys and other employment contracts.

403. Where all stockholders enter into a contract of employment, the corporation will be liable thereon.

404. Two corporations organized under the laws of different states and owned by the same stockholders and with a single purpose in view, will be treated as one and upon insolvency of either the affairs of both will be administered.
405. An agreement made by persons in contemplation of incorporation, others not being affected, binds the corporation.
406. Where one corporation owns all of the stock in another and the property of the stock-owned corporation is sold on a judgment against the stock-owning corporation, the stock-owned corporation may not complain thereat.
407 Corporation may not, by juggling of entities, evade law against leasing of railroads.
408. Where a street railway company is the same with a construction company, the street railway company will be held liable for trespasses of the construction company.
409. Where two corporations are the same, a judgment by one against the other is void as far as creditors are concerned.
410. Where a number of corporations organize another, in the interest of their combined business, it will not be treated as an entity separate from its owners.
411 Set-off allowable between debtor of a corporation and its receiver where stockholder is indebted to the corporation's debtor.

CHAPTER XXI

DISREGARD OF CORPORATE ENTITY IN DEALING WITH TAX MATTERS

412. A corporation may not be used for the purpose of evading tax.
413. Corporate form will not serve to make property subject to income tax.
414. A holding corporation and a subsidiary will not be treated as one in order to allow the parent to escape taxes.
415. It has been held that the holder of stocks, exchanging them for stocks in a new corporation, taking over the business of the old is liable for a tax under a statute providing for taxation of gain in purchase or sale of property.
416. A tax on corporations doing business within a state may not be laid against a parent corporation whose only interest is stock within a subsidiary, within the state.

CHAPTER XXII

DISREGARD OF CORPORATE ENTITY IN CONNECTION WITH VIOLATION OF STATUTES

417. Corporate entity will not serve to shield its controlling head from prosecution for using mails to defraud.
418. Corporate entities will be abrogated to uncover violation of the Hepburn Act.
419. Corporate entities will be abrogated to discover violation of the Federal Anti-Trust Law.
420. Corporate entity will be sustained in such manner that an officer may not claim the constitutional privilege of it.
421. The corporate fiction will be abrogated to discover violation of the Clayton Law.
422. Corporations may not be manipulated so as to evade the provisions of the Alien Enemy Trading Act.
423. A corporation owned by citizens of belligerent antagonist will make the property of such corporation enemy property.
424. Corporate entity will be abrogated to allow recovery by government against stockholders of tax on distilled spirits.
425. The corporate entity will not serve as a cover for a monopoly.
426. Corporate entity may not be interposed to shield against prosecution for a criminal act.
427. A corporation organized for unlawful purposes, its stockholders will be personally liable on its obligations.

CHAPTER XXIII

DISREGARD OF CORPORATE ENTITY IN CONNECTION WITH FIRE INSURANCE ON CORPORATE PROPERTY

428. A stockholder has an insurable interest in the corporation's property in proportion to the amount of his stock.
429. The acquisition of all of the stock of a corporation is not such a change of interest as avoids an insurance policy.
430. It has been held that ownership of all of the stock in a corporation will not sustain a recovery on policy containing a provision that the interest of the assured must be absolute.
431. If corporation reorganizes so as to create new corporation, there is a change of possession as will defeat recovery on insurance policy.

CHAPTER XXIV

OVERRIDING CORPORATE ENTITY IN REGARD TO RIGHTS AND LIABILITIES OF STOCKHOLDERS OF CORPORATION

432. Corporate entity will be abrogated to defeat the plea of statute of limitations against government, it seeking to cancel fraudulent land patents.

433. Where two corporations own a third and all three are engaged in the same enterprise, the corporate entities will be disregarded and treated as public utilities.

434. Corporate entity will be overridden to hold its stockholders upon a guaranty of indebtedness.

435. A member of a partnership owning a corporation, which corporation was indebted to the firm upon the insolvency of the corporation, the firm will not be permitted to share in the assets until other creditors are paid in full.

436. Sometimes courts go to the extreme to sustain the corporate entity.

437. Corporate entity ignored to give real-estate broker commission.

438. Stockholders of a corporation using it as a mere instrumentality, are individually liable for labor bestowed upon the property in the name of the corporation.

439. A party purchasing goods from one corporation may counterclaim against it for an indebtedness due such purchaser from another corporation, the corporations being the same.

440. Corporate entities will not be treated as one where to do so would allow parties to take advantage of their own wrong.

441. Corporate entities disregarded to uncover usurious transactions.

442. A railroad corporation owning a majority of stock of another railroad corporation and the stockholders of the stock-owning company owning practically all of the balance of the stock, is sufficient to treat both corporations as one.

443. A railroad company agreeing with some individuals to charge them one-half the rate it charges other shippers and agreeing to pay over a certain portion of money it charges certain shippers to such individuals, a corporate entity will be ignored to uncover the transaction.

444. Corporate entities will be ignored to uncover rebating in freights.

445. Foreign corporation delivering gas at a state line and which is thereupon received by a domestic corporation and distributed, such foreign corporation owning the domestic corporation is a public utility within the state.

446. It is the modern rule, sustained by ample authority, that an individual cannot escape liability by incorporating himself and placing his property in the name of the corporation and such corporation will not serve as a shield when it is sought to hold its owner on a separate agreement between husband and wife.
447. The corporate entity will not be brushed aside to hold a corporation that owns all of the stock of another corporation but had disposed of its holdings in such other corporation prior to a breach of covenants.
448. A bank dealing with a corporation as a separate legal entity and recognizing it as such by extending credit to it may not thereafter seek satisfaction from its stockholders.
449. A corporation owned by three men and being a close corporation and two of such owners sign a contract for sale of stock and corporate assets, the contract will not be construed as one for sale of stock only.
450. A corporation owning a number of subsidiaries will be compelled to offset an account due to one of the subsidiaries with an account due from the parent corporation to its creditors.
451. Quasi entity of Massachusetts trust disregarded.
452. Organization of a corporation to succeed an existing business, either partnership or corporate, not within the statutes of fraud.

CHAPTER XXV

RIGHTS AND LIABILITIES UNDER CONSTITUTIONS AND STATUTES IMPOSING LIABILITIES ON SUCCEEDING CORPORATIONS

453. Legislation and constitutional provisions in a number of states fix liability upon succeeding corporation.
454. Ohio statute fixing liability upon successor of railroad company.
455. Kentucky statute.
456. Missouri statute.
457. Tennessee statute.
458. Alabama statute.
459. Georgia statute.
460. Kansas statute.
461. Michigan statute.
462. Wisconsin statue.
463. New York statute.
464. Pennsylvania statute.

465. California, Utah, Idaho, Washington, and Kentucky Constitutional provisions.
466. Massachusetts statute.
467. It is generally held that statutes imposing liability upon a buying corporation for the obligations of the old are but declarations of the common law.
468. Under statutes prescribing creditors may follow assets in the hands of succeeding corporation for liabilities of its predecessor; have a lien.
469. It seems that the lien given by statutes or constitutional provisions extends to torts as well as contracts.

CHAPTER XXVI

DISREGARD OF CORPORATE ENTITY TO HOLD STOCKHOLDERS OF FOREIGN CORPORATION AND IN CONSTRUCTION OF TREATIES AND CONTRACTS

470. A corporation organized in one state for the purpose of doing business in another only, are generally denominated "tramp" corporations.
471. "Tramp" corporation recognized by comity.
472. Limitations on comity.
473. Foreign corporation cannot do an act prejudicial to local interest or in contravention of local laws.
474. A corporation will not be permitted in a foreign jurisdiction to do acts in evasion of the laws of the state where it is created or of the laws where it is permitted to do business.
475. The fact that a corporation is organized under the laws of another state and permitted to do business in a state other than that of its creation, does not prevent courts from disregarding corporate entity.
476. Some courts hold that the organization of a corporation under the laws of one state expressly for the purpose of doing business in another is itself a fraud.
477. Corporation doing business in a state other than that of its creation without compliance with laws, stockholders liable as partners.
478. It seems that the liability attaching to stockholders of a foreign corporation doing business without compliance with law, is the same whether it is tort or contract.
479. Foreign corporation doing business in a state without compliance with law, no defense to criminal prosecution for embezzlement.

480. An individual engaged in business who thereafter organizes a foreign corporation and attempts to continue the business in the name thereof without compliance with local law, is liable.

481. Corporate entity will be ignored in the construction of treaty provisions.

482. Trustees of a will may not organize a corporation under the laws of a foreign jurisdiction and buy trust property in its name and avoid inheritance taxes.

483. Corporate entity disregarded to carry out intent of testator.

484. Corporation succeeding another may not sue for fraud perpetrated by one of its officers.

485. Corporation cannot sue directors for mismanagement, stockholders having changed.

486. Corporate entity set aside to allow sublessee right of renewal.

487. Owner of property making conveyance of all land owned by him, in a state, to a corporation, owned by him, will be ineffectual against creditors within the state.

488. Sale of property to corporation by stockholder there being no creditors, cannot be fraudulent.

489. Corporation cannot hold onto property and plead *ultra vires* against its purchase price.

490. Locaters of mining claims transferring same to corporation, relocating and transferring to a new corporation, former corporation may recover.

491. Property standing in the name of a corporation, and the corporation owned by a deceased person, the property of the corporation will be regarded as that of the decedent.

491a. Shares of stock as personalty; right of dower or curtesy in the corporate property or in the shares themselves.

492. Corporate entity disregarded in the interest of a conditional seller's rights, the contract not being recorded.

493. A merchant taking in a partner and thereafter incorporating and an involuntary petition of bankruptcy filed against the corporation, the prior debts against the merchant not considered.

494. Corporate entity will be disregarded to determine the true ownership and proper application of a fund paid into bankruptcy court.

495. Insolvent bank not permitted to pay obligations to a corporation owned by its officers.

496. Corporation cannot be organized or used after organization for the perpetration of fraud.

497. Under statutes providing that directors are statutory trustees on dissolution of corporations, the only stockholder who is a trustee may sue for corporate property.

498. Under statute making directors trustees on corporation going defunct, sole stockholder may convey property.

498a. A joint-stock company succeeding to the property rights of a corporation likewise will be held responsible for its obligations.

CHAPTER XXVII

PROCEDURE IN CONNECTION WITH THE DISREGARD OF CORPORATE ENTITY

499. Character of action to enforce liability of succeeding corporation.

500. Common counts will lie to hold a succeeding corporation on an obligation of its predecessor.

501. Assumpsit, action of, may be resorted to for recovery after disregard of corporate entity.

502. Necessary parties in action to hold a succeeding corporation.

503. Sufficiency of a plaintiff's pleading to hold two banks.

504. Insufficiency of plaintiff's pleading to hold one corporation for judgment against another.

505. Creditors' pleading alleging the formation of a corporation out of a partnership with fraudulent designs sufficient.

506. Sufficiency of plaintiff's pleading to hold successor corporation for personal injuries.

507. In an action for fraud of the substantial owner of a corporation to hold it thereby, plaintiff's pleading sufficient when.

507a. Sufficiency of plaintiff's pleading under a statute requiring *pro rata* distribution of assets of dissolved corporation, among creditors.

508. Property transferred from an existing corporation to a new in consideration of issuance of stock and assumption of mortgage indebtedness sufficiency of complaint to hold new corporation.

509. A complaint against stockholders and succeeding corporation which did not allege that they assumed the debts nor that any of the assets of the former corporation had come into their hands, insufficient in equity, but sufficient at law.

510. A complaint held insufficient for lack of allegations of fraud being alleged, that partnership put money arising from insurance, in corporation.

511. Complaint to disregard a corporate entity and hold it as one with its owner alleging unity of interest and adherence to the corporate fiction would sanction fraud.

512. Complaint held insufficient for failing to allege the assumption of indebtedness by succeeding corporation or fraud.
513. Sufficiency of complaint to set aside conveyances to a corporation organized out of a partnership.
513a. Sufficiency of complaint to hold practically the sole stockholder for goods sold and delivered to his corporation.
514. Sufficiency of complaint for dissolution of a copartnership accounting and receiver on theory that the corporation is a mere shell thrown around partnership operations.
515. To fix responsibility of one corporation for acts of another.
516. Plaintiff's pleading sufficient to hold stockholders as partners in a corporation doing business in a state without compliance with law.
517. In an action to set aside corporate entity, in the nature of a creditor's bill, the plaintiff acquires a lien upon the tangible property of the corporation.
518. A complaint in the nature of a bill of discovery in jurisdictions, where bills of discovery are permissible, will lie to uncover the organization of a corporation out of a partnership.
519. In an action by receiver of a corporation against a creditor thereof, a plea of set off against the only stockholder of the corporation will be allowed, if it sets forth that the corporation has otherwise sufficient assets to pay its creditors.
520. Under statutes making the directors statutory trustees at the time a corporation goes defunct, for the purpose of winding up its business, there being only two of such, one may sue the other for malfeasance.
521. Sufficiency of doing business through subsidiary as warranting service on foreign corporation.
522. Corporation organized under the laws of one state owning and controlling a corporation organized under the laws of another may not be held in a suit on its own obligation by serving the subsidiary.
523. A Kansas corporation authorized to do business in Nebraska, thereafter absorbed by a Missouri corporation, which in turn consolidated with a Utah corporation, neither of the latter being authorized to do business in Kansas, service may be had in Nebraska by serving Kansas corporation.
524. Corporate entity disregarded, notice given to parent corporation claiming lien on property in the name of subsidiary sufficient.
525. Where a corporation is equally owned by two stockholders and they are deadlocked, the court will appoint a receiver thereof as if they were partners, even though a corporation is solvent.

526. In an action against a corporation, having succeeded a partnership, attachment will lie against the corporation under Arizona statute.

527. Attachment will lie against succeeding corporation, under a statute providing that an attachment may issue in an action upon a contract express or implied for the direct payment of money.

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Limitations of the Corporate Entity

CHAPTER I

ORIGIN, DEVELOPMENT OF CORPORATIONS AND CORPORATE ENTITY

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§ 1. Origin of the Corporation

The corporate concept antedates according to some authorities, that of the individual, but how this could be it is indeed not easy to comprehend. However, it is asserted that "groups of men united by the reality or fiction of blood re-

lationship" into clans or families were recognized before the individual members of primitive civilization.[1] According to some authorities, the corporate idea is not the product of any one people, nor even of any one country, but has been developed more or less independently by the different systems of jurisprudence.[2] Some writers have traced the inception of the corporation to as early a period as the time of Solon of Greece, but to support this position more or less vague statements are cited from the Commentaries or Gauis on Roman Law, and assume that Solon permitted rather than created corporations of a private nature for certain purposes.[3] Blackstone is authority for the statement that corporations existed even at an earlier time than the day of Solon, and moves the time of their inception back as far as Numa Pompilius.[4] Blackstone further contends that corporations were afterwards mentioned considerably by the civil law, in which they were called universitates (universities), as forming one whole out of many individuals or collegia (colleges) being gathered together, and also that corporations were adopted by the Canon Law, for the maintenance of ecclesiastical discipline.[5] It also seems that the Romans took the corporate idea into Briton after its conquest, and that the English Law for various purposes adopted the idea, and there were created municipal, charitable, and purely private corporations, on principles fashioned after the Roman or civil law.[6] However, the modern Americana claims for the corporate idea a greater antiquity, and it is there stated that it existed in Greece 594 B. C., in Phoenicia 900 B. C., and possibly in Babylonia 2200 B. C. But this work concedes that the origin of corporations

[1] Maine Ancient Law (4th Ed.) 183.
[2] I History of English Law, Pollock & Maitland (2d Ed.) 486. It seems that in every system of law the necessity of creating corporate bodies was felt at an early day as a pressing requirement.
[3] Ayliffe on Civil Law 197.
[4] I Blackstone's Comm. 468-69; II Kent Comm. 268.
[5] I Blackstone's Comm. 469.
[6] Kent's Comm. 268 et seq.

is lost in antiquity.[7] It seems, however, that the Romans have the greatest claim to this masterpiece of juristic ingenuity.[8]

§ 2. Origin of the Corporation Continued

It is quite manifest from a very cursory examination of the authorities upon the subject that the corporate idea has its inception established at an early time but that the genesis of the corporate idea is shrouded in much darkness and is not clearly traceable. It has flown down through the ages. It is easy enough to take up the trail in modern times, and back track the course of its progress to the time of Edward IV, but when it is sought to follow it back a greater distance in time, we find that the traces of it become more and more dimmed until the trail has become completely lost in the sands of time and cannot be followed into the yearbooks to earlier times.[9]

§ 3. Corporations Cannot Be Created At Common Law

It seems strange enough that although the corporate concept can lay claim to birth at an earlier time than the advent of the common law into the systems of jurisprudence of the world, yet there is no common-law corporation as such, and the common law with all its ingenuity never attempted bringing into existence a corporate body. It seems that instead of being a creature of the common law, the corporation occupies more the position of a foundling, for the common law has to a great extent nurtured and developed it, and has taken the corporation unto itself by adoption.[10] The claim of parentage on the part of any system of jurisprudence to

[7] VIII The Americana, 3 et seq.
[8] VIII The Americana, 3 et seq.
[9] I History of English Law, Pollock & Maitland (2d Ed.) 492.
[10] Common-Law Conception of Corporations, 42 A. L. R., 529 et seq.; Genesis of the Corporation, 19 Harv. Law Rev., 350 et seq.

the corporation could certainly never be established with any degree of certainty.

§ 4. What Is a Corporation?

It seems that just what a corporation is, the legal authorities are not in accord, some taking the view that a corporation is almost a natural person, and regard it as acquiring an organic character which qualifies it to participate prominently in the life of the state and in law. This seems to be the German or associate theory, and has been followed to a certain extent by Sir Fredrick Pollock. On the other hand there are authorities and adjudications by the courts holding that a corporation is a *persona ficta.*[11]

§ 5. Similarity Between a Corporation and a Partnership

In dealing with many questions, the whole difficulty in connection with the corporation is probably the early idea that a corporation possesses peculiar attributes of longevity and sanctity, but as has been pointed out in modern times such a theory is certainly not gaining ground, and is very probably on the wane. It should always be borne in mind that the business corporation is brought into being solely for the purpose of more conveniently carrying on the joint undertaking of the part owners. The line of distinction between this form of association and certain partnerships is but a shadowy one, and it is hardly reasonable or natural to expect that when this shadowy boundary is passed great changes in relationship of the parties will result, and if this position is kept clearly in mind, many difficult problems arising from dealing with corporations generally will readily be solved.[12] There are authorities holding to the proposition under our law, a partnership or joint-stock company is a distinct and pal-

[11] Wormser on the Disregard of Corporate Fiction 3-4.

[12] Bowditch vs. Jackson Co., 76 N. H. 351; 1913A A. C. 366; 82 Atl. 1014; 1917A L. R. A. 1174; 239 U. S. 627; 36 S. Ct. 164; 60 L. Ed. 474.

pable entity in the idea of the law, as distinguished from the individuals composing it as is a corporation.[12a] But to follow this line of authority to its logical conclusion would be to dissipate all characteristic difference between a body politic and partnership, joint-stock companies, Massachusetts Trusts and the like.

§ 6. Untechnically Speaking Ownership of Stock Creates Partnership Relationship

Stock in a corporation is not merely property. It also creates a personal relationship between or among the stockholders analogous rather than technically to a partnership.[13] Accordingly it has been said that in modern times a favorite speculation is that philosophically a partnership and a corporation illustrate a single principle, and that the certificate of a share in one represents property in very nearly the same sense as does a share in the other. In either case the members can divide the assets after paying the debts. Yet from the letter of law, there remains still a very important difference, and so long as the corporate fiction is recognized or may be legally recognized, a corporation is always distinct from its owners and members, and its debts are not the debts of the members. Other distinctions might be enumerated.[14]

§ 7. Corporation Defined

Possibly the most laconic definition that has yet been advanced for a corporation is that of the great Chief Justice of

[12a] Eisner vs. Macomber, 252 U. S. 189; 40 S. Ct. 189; 64 L. Ed. 521; 9 A. L. R. 1570; 22 Harv. Law Rev. 393-396; 57 Cent. Law Jour. 343-348; 20 Harv. Law Rev. 589-592; Cincinnati Volksblatt Co. vs. Hoffmeister, 62 Ohio St. 189; 56 N. E. 1033; 48 L. R. A. 732; 78 A. S. R. 707.

[13] Barrett vs. King, 181 Mass. 476; 63 N. E. 934; Eisner vs. Macomber, 252 U. S. 189; 40 S. Ct. 189; 64 L. Ed. 521; 9 A. L. R. 1570.

[14] Merchants National Bank of Cincinnati vs. Thersa J. Wehrman, 202 U. S. 295; 50 L. Ed. 1036; 26 S. Ct. 613; 69 Ohio St. 160; 68 N. E. 1004; Bauernschmidt vs. Bauernschmidt, 101 Md. 148; 60 Atl. 437. See also sec. 294, infra.

the United States Supreme Court, John Marshall, and in the famous Dartmouth College case. A corporation was there defined as a being, indefinite, intangible, and existing only in contemplation of law.[15] In modern times the fact cannot be lost sight of that a corporation is an association of individuals, and in fact the Supreme Court of the United States has defined a corporation to be an association of individuals united for some common purpose, and permitted by law to use a common name and to change its membership without the dissolution of the association.[16] It is recognized that definitions are dangerous, and they are often too narrow, but more frequently too broad. Most of them include one or more attributes which are not now essential.[17] At an early day the great authority on corporations in England, Mr. Kyd, defined a corporation: "There are many things incident to a corporation, yet, to form the complete idea of a corporate aggregate, it is sufficient to suppose it vested with the three following capacities: (1) To have perpetual succession under a special denomination and under an artificial form; (2) to take and grant property, to contract obligations, and to sue and be sued by its corporate name and in the same manner as an individual; (3) to receive grants or privileges and immunities, and to enjoy them in common. These alone are sufficient to the essence of the corporation."[18] Judge Dillon took occasion to define a corporation: "A corporation is a legal institution devised to confer upon the individuals of which it is composed, powers, privileges and immunities which they would not otherwise possess, the most important of which are continuous legal liability and perpetual or indefinite succession under the corporate name, notwithstanding successive changes by

[15] Trustees Dartmouth College vs. Woodward, 4 Wheat. 518; 4 L. Ed. 629.

[16] Baltimore & Potomac R. R. Co. vs. Fifth Baptist Church, 108 U. S. 317; 27 L. Ed. 739; 2 S. Ct. 719; Ryan vs. Old Veteran Mining Co., 37 Idaho 625; 218 Pac. 381.

[17] Andrews Bros. Co. vs. Youngstown Coke Co., 86 Fed. 585; 30 C. C. A. 293.

[18] Ibid.

death or otherwise, in the corporators or members of the corporation. It conveys, perhaps, as intelligible an idea as can be given by a brief definition to say that a corporation is a legal person with a special name and composed of such members and endowed with such powers and such only as the law prescribes."[19] The brief definition suggested by Judge Dillon conveys somewhat of the same idea as the definition by Lord Coke, at an early date in the history of corporate law, who defined it to be invisible, immortal, and resting only in contemplation of law.[20] Still, we believe that the correct definition and one which conforms more to the modern view is that a corporation is more nearly a method than a thing. It is thought that the concrete import of the modern view of a corporation is that a corporation is more nearly a method than a thing, and that the law in dealing with a corporation has no need of defining it as a person or entity, or even as an embodiment of functions and rights and duties, but may treat it as a body or a collection of jural relations, each one of which must, in every instance, be ascertained, analyzed and assigned to its appropriate place according to the circumstances of the particular case, having due regard to the purposes to be achieved. A confirmation of the accuracy of this analysis of the "corporation form" is found in the fact that the word "corporation" has a variable and not a constant meaning.[21]

§ 8. Essential Attributes of a Corporation

It seems that in the last analysis the only absolutely essential attribute of a corporation is the capacity to exist and act within the powers granted as a legal entity, apart from the individual or individuals who constitute its membership.

[19] 1 Dillon Municipal Corporations (3d Ed.) sec. 18.

[20] Case of Suttons Hospital, 10 Co. Rpts. 1-32.

[21] Farmers Loan & Trust Co. vs. Pierson, 130 Misc. 110; 222 N. Y. Supp. 532; People vs. Knapp, 206 N. Y. 373; 99 N. E. 841; Drucklieb vs. Harris, 155 App. Div. 83; 140 N. Y. Supp. 60; 209 N. Y. 211; 102 N. E. 599.

It is clear that, when the essential attribute of a corporation alone is looked to, it is immaterial by what name it may be designated by the legislative body authorizing its creation, and it has accordingly been held that in cases where the legislature has designated a particular organization as a partnership association and the like, if they possess the one essential attribute of the corporation, the courts will declare such organizations to be corporations.[22]

§ 9. Corporations Created Only by Sovereign Authority

In keeping with the definition of Lord Coke, it is true in modern times that corporations rest only in intendment and contemplation of law.[23] And the corporations cannot be created nor exist, nor can corporate powers be assumed by an agreement of the parties. The only method by which a corporation may come into being and may exist is by virtue of the authority from the Sovereign power, express or implied.[24] In the United States corporations can be created and corporate powers granted only under legislative authority.[25] In English law the King's consent, either expressly given or by implication, has long been regarded as necessary to the creation of a corporation. The consent might be given by the King himself, in which case, of course, the charter was called a royal grant, or by an act of Parliament, to which the royal assent is a necessary element.[26] Therefore, it is seen that there must be some affirmative act

[22] Andrews Bros. Co. vs. Youngstown Coke Co., 86 Fed. 585; 30 C. C. A. 293.

[23] Case of Suttons Hospital, 10 Co. Rpt. 132.

[24] Boca Mill Co. vs. Curry, 154 Cal. 326; 97 Pac. 1117; Spotswood vs. Morris, 12 Idaho 360; 85 Pac. 1094; 6 L. R. A. N. S. 665; Greene vs. Dennis, 6 Conn. 293; 16 Am. Dec. 58; Franklin Bridge Co. vs. Wood, 14 Ga. 80; Meinhard Schaul Co. vs. Bedingfield Mercantile Co., 4 Ga. App. 176; 61 S. E. 34.

[25] American Ball Bearing Co. vs. Adams, 222 Fed. 967; see 231 Fed. 950; 146 C. C. A. 146; Kaiser Land, etc., Co. vs. Curry, 155 Cal. 638; 103 Pac. 341; Julian vs. Kansas City Star Co., 209 Mo. 35; 107 S. W. 496.

[26] I Blackstone's Comm. 472.

on the part of or under and by virtue of the authority given by the sovereignty before a corporation can come into existence. So it follows that therein lies a greater reason for designating corporations as jural persons, if persons they may be called at all.

§ 10. Prescriptive Corporations

If an association of individuals assume to act as a corporation and for a long time exercise corporate powers, it seems that a presumption arises that at some ancient time a charter was granted to that association, and that is what is meant when a corporation by prescription is referred to, or a prescriptive corporation.[27] The same principle has been applied where it was presumed that the City of London had at some remote time been granted a charter, it having existed as a corporation so long that the memory of man runneth not to the contrary.[28] But still it cannot be said that a corporation is created by prescription. What undoubtedly is meant is that when such a state of facts arises a conclusive presumption attaches that the sovereign power at some remote ancient time has created the corporation. The right to exist as a corporation does not mean there is a charter or grant issued to it in cases of prescriptive corporations. The situation is such that its right to exist cannot be disputed. Similarly, if a party has been in possession of real property for a long period of time asserting ownership thereto, he will be presumed to have a grant or conveyance thereto, but this presumption does not in fact create for such occupant of the land a physical grant or conveyance but he is merely in a position where he is presumed to have or to have had such grant or conveyance. So with a corporation by prescription, no physical charter is created for the corporation by pre-

[27] Greene vs. Dennis, 6 Conn. 293; 16 Am. Dec. 58; Stockbridge vs. West Stockbridge, 12 Mass. 400; Dillingham vs. Snow, 3 Mass. 276; New Boston vs. Dunbarton, 15 N. H. 201; Bow vs. Allenstown, 34 N. H. 351; 69 Am. Dec. 489; 4 Comyn's Digest 244.

[28] I Blackstone's Comm. 472-473.

scription but it is in such situation that its existence as a corporation cannot be disputed.

§ 11. A Corporation Has No Existence Beyond the Bounds of the Sovereignty Creating It

It is further substantiation of the statement that a corporation is to all intents and purposes, if a person at all, strictly a jural person, that it exists only in contemplation or by virtue of the law creating it, and where that law ceases to operate the corporation can have no existence. It must confine its domicile to the place of its creation. However, this principle does not prevent a corporation from exercising its corporate functions in another jurisdiction, but this may be done only with the consent of the governing authority of the place where the functions are so exercised.[29]

§ 12. The View That the Corporate Entity Stands Out Against All Attempts to Pierce It

The doctrine that the corporate entity stands out against any and all attempts to pierce it and visualize what lies behind is that all attempts to go behind the corporate veil are futile. A leading advocate of this position summed it up as his view that the fallacy of the contention is such that the entity created by statute is or can be treated as a mere form or technicality, by reason of the character of its shareholders and directors. A company formed and existing under the law has a real existence, with rights and liabilities as a separate legal entity. It is a different person altogether from the subscribers or shareholders. Once it is validly constituted as a corporation, it is an artificial creation of the law or statute and retains its existence for all purposes. It is a living thing with an existence which cannot be swept aside as a technicality. It is not a mask or a cloak or device

[29] Bank of Augusta vs. Earle, 13 Peters 519; 10 L. Ed. 274; 14 A. C. J. 1215; see sec. 470 et seq., infra.

to conceal the identity of persons; it is a legal body clothed with the form prescribed by the legislature.[30] That the corporate forms should be preserved for all legitimate purposes no one can dispute, and so long as the functions of the corporate entity are utilized for legitimate and proper ends, indeed it is true that the corporate entity is not a mere name or mask or cloak or device to conceal the identity of persons. But when the corporate entity is used for nothing more nor less than a mask, a cloak, or a device to conceal the identity of persons, it would seem proper that the corporate fiction should be pulled down from the high pedestal upon which the worshippers of forms have placed it.

That there are many instances in which the corporate entity theory is and ought to be disregarded, or as it is sometimes put, the corporate veil is lifted, and the court deals with the associates whom it finds behind the veil. And may it be said to the credit of the courts in this country, especially, that the decisions applying the most wholesome and equitable rule of lifting the corporate veil when the facts warrant it, are greatly and rapidly increasing.[31]

§ 13. Arrogance of Corporate Entity

It is easy to understand with such eminent champions as Lord Reading[32] that the corporate entity became arrogant and defied all attempts to enter its domains. In many cases, by reason of this barrier to pass beyond the corporate entity, solvent corporations were wrecked for purely illegal purposes; minority interests were frozen out and business immorality ran amuck, under the assumption that courts were

[30] Lord Reading, in Continental Tyre & Rubber Co. Ltd. vs. Daimler Co. Ltd. (1915), 1 K. B. 893 (1915); W. N. 441; 84 L. J., K. B., N. S. 927; 20 Com. Cas. 209; 59 Sol. Jo. 232; 5 B. R. C. 304; affirmed in House of Lords, 6 B. R. C. 269 (1916); 2 A. C. 307; 85 L. J., K. B., N. S. 1333; 114 L. T., N. S. 1049; 32 Times L. R. 624; 60 Sol. Jo. 602; 22 Com. Cas. 32; 1917C A. C. 170; Sneed vs. Santiam River Timber Co., 122 Ore. 652; 260 Pac. 237.

[31] Sneed vs. Santiam River Timber Co., supra.

[32] (See n. 30, supra.)

powerless, is too true, which assumption was verified and strengthened by judicial pronouncements that ascribed to the corporate fiction an idea that could have no place in courts of justice. But time has proven that that assumption was utterly wrong. Judicial hesitancy did not and does not mean judicial atrophy or judicial paralysis.[33]

§ 14. Presumption of Distinct Entity

If nothing appears to the contrary or to any way refute or disprove the presumption of legality attaching to a corporate organization under and by virtue of the authority in the jurisdiction where the court is sitting, the court will presume that the corporation is a separate and distinct legal entity, and will not in the absence of proof override, limit or disregard the legal effect of such an entity.[34] In brief, it would seem that the holding deduced from the case cited, is that the courts will not disregard, limit or override the corporate entity without proof of facts warranting it in so doing. This is but a natural position for the courts to take, for a great majority of the corporations are legally organized and in existence, and nothing appearing to the contrary, the courts will assume that all corporations are so organized and existing.

§ 15. For Legitimate Purposes Corporate Entity Preserved

It may be stated as a general rule, well established, and one of which both courts of law and equity take cognizance, that a corporation for legal and legitimate purposes, is a distinct legal entity—a distinct jural person—from its incorporators or members, and is to be considered as separate and apart from them, and cannot be held accountable for the personal rights or obligations of its stockholders. And this is a

[33] Boothe vs. Summit Coal Mining Co., 55 Wash. 167; 104 Pac. 207; 19 A. C. 1255.

[34] Fleming vs. Casady, 211 N. W. 488; 202 Iowa 1094.

faculty that is the most characteristic and distinctive attribute of the corporate organization. In other words a corporation is a distinct entity and an artificial person created by law, and within the intents and purposes of its organization may exercise all the rights and privileges of an individual.[35] But it must at all times be remembered that in a proper case the courts will just as readily brush aside the man, put forward in the corporate entity form, and see who the real parties are. This is true when the corporate entity is attempted to be invoked in support of an end subversive of the policy of the state. The corporate fiction is introduced for convenience and to subserve the ends of justice, and when it is seen that it is attempted to use it for some other purposes foreign to the legitimate ends of its creation, the law will disregard the corporate fiction.[36]

§ 16. For Legitimate Purposes the Entity of Corporations Recognized

For all legitimate purposes and within the proper sphere of the powers granted by the charter, a corporation has a separate entity or existence from its shareholders or members irrespective of the persons who own its stock, and this rule is not altered by the fact that the greater portion of the shares of such corporation are owned by a single individual. Moreover, it is held in some cases that the fact that the entire issue of stock happens to be concentrated in the hands of a single individual will not change this rule.[37] So it has been held that a loan made to one who was substantially

[35] 1 Fletcher Cyclopedia of Corporations 43, sec. 22.

[36] Southern Electric Securities Co. vs. State, 91 Miss. 195; 124 A. S. R. 638; 44 Southern 785.

[37] Monongahela Bridge Co. vs. Pittsburgh and B. Traction Co., 196 Pa. 25; 79 A. S. R. 685; 46 Atl. 99; Rhawn vs. Edge Hill Furnace Co., 201 Pa. 637; 51 Atl. 360. Kendall vs. Klapperthal Co., 202 Pa. 550; 52 Atl. 92; in re Goetz Estate, 236 Pa. 630; 85 Atl. 65; George Moran, Jr., vs. Scandinavia Belting Co., 264 Pa. 384; 107 Atl. 750; A. L. R. 1502; McMullin vs. Westinghouse Estate, 259 Pa. 281; 103 Atl. 57; Commonwealth vs. Muir, 170 Ky. 435; 186 S. W. 194.

the owner of all the stock of the corporation, and not to the corporation, under an usurious agreement, where there is no evidence that the corporation was a party to such agreement, the corporate entity and the owner of substantially all the stock will not be treated as identical but will be looked upon as separate and distinct.[38] Accordingly, the courts hold that the property of a corporation is owned by the corporate entity, and not by the owner or owners of its stock. This rule is generally applicable whether the stock is owned by several or only one, or whether it is owned by a natural person or by another corporation engaged in the same line of business.[39] True it is that where the stock of a Pennsylvania corporation was owned entirely by a Delaware corporation, the separate entity continues, but in a proper case where one corporation conducts its business through the instrumentality of another and in its name, the capital invested therein by the former corporation cannot and will not be treated as a loan to the latter as against the rights of third parties. For equity looks to the substance of the transaction and ignores mere matters of form, and a court of conscience will not permit a loss to be shifted to innocent parties when the loss can be avoided.[40] And in such case where the stock-owning company put its money into the operating company for operating purposes, it put its money into its own enterprise, and not into another's business by way of a loan, for the law pays little heed to the label parties put upon the transaction.[41] Under such circumstances the controlling company cannot share as a creditor in the assets

[38] Salvin vs. Myles Realty Co., 227 N. Y. 51; 124 N. E. 94; 6 A. L. R. 581; 177 App. Div. 886; 163 N. Y. Supp. 1131; see sec. 441, infra.

[39] Atchison T. & S. F. R. R. Co. vs. Weeks, 248 Fed. 970; 254 Fed. 513; 166 C. C. A. 71; 249 U. S. 602; 39 S. Ct. 259; 63 L. Ed. 797; Kardo Co. vs. Adams, 231 Fed. 950; 146 C. C. A. 146; American Ball Bearing Co. vs. Adams, 222 Fed. 967.

[40] S. G. V. Co. of Delaware vs. S. G. V. Co. of Pa., 264 Pa. 265; 107 Atl. 721.

[41] Brunswick & Balke Co. vs. Hoover, 95 Pa. St. 508; 40 Am. Rpts. 674; 37 A. R. 664.

of its insolvent subsidiary company. Any other rule would defeat justice, and would open the door to and invite fraud to enter therein.[42] Even a holding company which owns the stock of another company will be treated as a separate entity, and their respective corporate existence recognized in a proper case. But where it is attempted to invoke such separate corporate existence for an illegal purpose or to accomplish anything that is not within the legitimate purview of the corporate purposes of the corporations, or is even used as an instrumentality for the concealing of truth, or is a mere instrument in the hands of the holding corporation, then the rule of recognition of separate entity does not apply.[43] Accordingly, where all of a railroad company's capital stock was in the name of a steel company, with the exception of a few shares held by directors, and otherwise appearing to be a proper case, the two corporations will be treated as one, for when there is fraud or some other good ground for its action courts in the furtherance of justice have ample power to go behind the legal entity and treat a corporation and the owners of its capital stock and assets as identical.[44] While it is true that a corporation may have sufficient number of owners of stock to comply with the law and will therefore be recognized as a valid corporation such as the case where one person took the entire capital stock, but allotted sufficient shares to his employees, the corporation was held valid because the requirements of general incorporation law under which it was formed were fairly and substantially complied with. But when there is fraud or some other good ground for its action in furtherance of the ends of justice, it is true that both at law and in equity the courts will disregard the fiction of a corporate entity apart from its members not-

[42] S. G. V. Co. of Delaware vs. S. G. V. Co. of Pa., supra.

[43] Pittsburg & Buffalo Co. vs. Duncan, 232 Fed. 584; 146 C. C. A. 542; in re Watertown Paper Co., 169 Fed. 252; 94 C. C. A. 528; Martin vs. Development Co. of America, 240 Fed. 42; 153 C. C. A. 78.

[44] Bethlehem Steel Co. vs. Raymond Concrete Pile Co., 118 Atl. 279; 141 Md. 67.

withstanding that the general corporation laws have been fairly and substantially complied with.[45]

§ 17. Corporate Entity Continues Though Stock Owned by One Person

Possibly the outstanding case which it seems goes to the extreme to uphold the corporate entity, and it might be said place it high on a pedestal and worship it as an idol, is an early case from Wisconsin, and has been referred to as a leading case.[46] In that case the sole owner of the shares of stock in the corporation brought an action in a court to recover in replevin certain personal property which it was alleged to have been taken unlawfully from the corporation, and it appeared throughout the case that the plaintiff owned all the stock and his position was that he was therefore the owner of the property that was in the corporation's name. In other words, he was the corporation. But this contention the Supreme Court of Wisconsin denied, and adhered to the ancient and antiquated rule that the corporate entity must be recognized, and that as the title of the property was in the corporation and not in the plaintiff, the plaintiff must fail; that his only position was that of a stockholder, and nothing more.[47] So accordingly in some modern cases the rule of recognition of the corporate entity separate and distinct from the owners of the stock, is strictly adhered to, and it has been accordingly held that property acquired by a corporation belongs to the corporation and not to the stockholders, even though all the stock be concentrated in one person.[48] For the rule of law has been declared, that a corporation continues to exist as a separate legal entity until

[45] (See n. 44, supra.) See sec. 84, infra; Potts vs. Schmucker, 84 Md. 535; 36 Atl. 592; 35 L. R. A. 392; 57 A. S. R. 415; Folsom & Co. vs. Detrick Fertilizer & Chemical Co., 85 Md. 52; 36 Atl. 446.

[46] Wormser on Disregard of Corporate Fiction 17.

[47] Button vs. Hoffman, 61 Wis. 20; 20 N. W. 667, 50 Am. R. 131.

[48] Eichelberger vs. Arlington Building, 280 Fed. 997; 52 App. D. C. 23; Parker vs. Bethel Hotel Co., 96 Tenn. 252; 34 S. W. 209; 31 L. R. A. 706.

legally dissolved, and the corporation and its shareholders are not one and the same, even though the number of stockholders be reduced to one.[49] This rule has found application in a case wherein the sole owner of a drug corporation was held to be not responsible, and allowed to retain his permit to dispense intoxicating liquors, notwithstanding the violations of regulations by employees of the corporation.[50] However, we shall see in a later place in this book that this rule is by no means unanimous.[51]

[49] Mioton vs. Del. Corral, 132 La. 730; 61 Southern 771; State vs. Morgans L. & T. R. & S. S. Co., 106 La. 513; 31 Southern 115; in re Belton, 47 La. Ann. 1614; 18 Southern 642; 30 L. R. A. 648; Buckeye Cotton Oil Co. vs. Amrhein, 168 La. 139; 121 Southern 602; Shreveport Drug Co. vs. Jackson, 2 Fed. (2d) 65.

[50] (See n. 49, supra, Shreveport Drug Co. vs. Jackson.)

[51] See secs. 20, 85, 237, 439, infra.

CHAPTER II

ORIGIN, DEVELOPMENT OF GENERAL RULES OF DISREGARD OF THE CORPORATE ENTITY

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§ 18. Corporate Entity Disregarded If Used For Unfair Advantage

At an early day it was very forcibly declared that deeds, obligations, contracts, judgments, and even corporate bodies might be instruments through which parties could obtain unrighteous advantages. All such devices have been resorted to, to cover up fraud, but whenever the law is invoked all such instruments are declared nullities, and they are all disregarded. The law looks upon them as if they had never

been executed, and this rule was very forcibly applied to the corporate existence in a court of law and in a case involving a tort.[1] Lord Mansfield declared that it is a certain rule of law that a fiction of law shall never be contradicted so as to defeat the end for which it was invented, but for every other purpose it may be contradicted.[2] Corporations were invented for the advancement of justice and for convenience in the transaction of business, and the corporate fiction will be applied for no other purpose. It is in this sense that their existence has been consistently understood and applied, and when it is sought to make use of it for a purpose beyond the proper purview of their legal operation, the courts will call a halt.[3]

§ 19. Mere Ownership of Stock Not Enough to Disregard Corporate Entity

It is rather difficult to formulate general rules by which every case may be tested in the development of the principle under consideration. The conditions have not always been uniform in applying the rule to the same state of facts, but it probably can be said with a degree of safety that the mere ownership of stock in one corporation by another or by an individual, entirely disassociated from any other reasons for so doing, the courts will not disregard the corporate entity and declare the two corporations the same or fix liability upon a stockholder in such case.[4] Accordingly it has been held in Wm. Wrigley Jr. Co. vs. L. P. Larsen Jr. Co., a case where a decree was rendered in favor of one corporation against another requiring an accounting for unfair competition, that the decree could not be made to operate in

[1] Booth vs. Bunce, 33 N. Y. 139; 88 A. D. 372.

[2] Johnson vs. Smith, 2 Burr. 962.

Rossman vs. McFarland, 9 Ohio St. 369; Miller vs. Donaldson, 17 Ohio St. 265; State vs. Standard Oil Co., 49 Ohio St. 137; 15 L. R. A. 145, 30 N. E. 279; 34 A. S. R. 541.

[4] Wood Estate Co. vs. Chanslar, 286 Pac. (Cal.) 1001; Wm. Wrigley Jr. Co. vs. L. P. Larson Jr. Co., 5 Fed. (2d) 731.

such a manner as to require an accounting from a separate and distinct legal entity under the control of the same stockholders, and apparently was engaged in the enterprise that involved the unfair competition.[5] The soundness of this decision may be questioned, for it would seem to appear from equitable principles that where the stockholders were identical no good reason could be advanced why the other corporation controlled by them should not account for its share in the illegal transaction, and this would seem especially true in the case cited in the footnote, for in the case where the corporation was required to account, it was a corporation organized under the laws of one of the states, while the other corporation that was not required to account, but yet was owned by identically the same stockholders, was a Canadian corporation. It would seem to be a hardship to require the litigant to journey into another country, and seek redress which ultimately must come from the identical parties that had already litigated the question with him, or because the court felt the necessity of subscribing to the sanctity of a mere corporate form. So the rule has been applied that the mere ownership of stock will not suffice to move the court to treat two corporations as one, and accordingly an offset was denied, even though the stockholders of both corporations were identical.[6] Accordingly, the courts denied the application of the rule that the corporate fiction in a proper case would be ignored where a majority of the stock was held by the same persons in two corporations.[7] It seems that considerable influence upon the court was had by reason of the fact that separate organizations were kept up, and in such case the court declined to override

[5] Wm. Wrigley Jr. Co. vs. L. P. Larson Jr. Co., 5 Fed. (2d) 731.

[6] Pittsburg & Buffalo Co. vs. Duncan, 232 Fed. 584; 146 C. C. A. 542; Waycross Airline Ry. Co. vs. Offerman & W. Ry. Co., 109 Ga. 827; 35 S. E. 275.

[7] Ex parte Fisher, 20 S. C. 179; Lange vs. Burke, 69 Ark. 85; 61 S. W. 165; New York Airbrake Co. vs. International Pump Co., 64 Misc. Rpts. 347; 120 N. Y. Supp. 683; 136 App. Div. 931; 120 N. Y. S. 1137; Birmingham Realty Co. vs. Crossett, 98 Southern 895; 210 Ala. 650.

the corporate fiction, no other facts appearing to call for the application of such rule except the mere ownership of stock.[8]

§ 20. Set-Off Allowed Between Stockholders and Third Parties

It is thought that the modern trend of authority is very strongly in favor of the rule that under certain circumstances the legal entity of a corporation will be entirely disregarded, and that the courts have found frequent occasion to analyze the circumstances calling for an application of this rule. And the firm grasp that this rule has, even in this day, is rapidly gaining upon the system of jurisprudence, prevailing throughout the United States. It has been declared that it would be a mere travesty on justice if courts should refuse to look further than the form of a transaction and wholly disregard the real parties in interest. And accordingly it is now well recognized that the separate entity of a corporation may be disregarded where it is organized and controlled, and its affairs are so conducted as to make it a mere instrumentality of another corporation. The courts will no longer hesitate to look through forms to substance. The rights of third parties will be protected. In application of this principle, the court held that where a corporation was seeking to recover upon an account and promissory note, which corporation was organized by an individual for the transaction of his personal business, and the dealings and transactions involved were between that individual and the third party, the court would hold such individual as the real party in interest, and allow a set-off between the corporation and such third party.[9] However, some courts cling to the antiquated position that the corporate entity—without regard to justice, without regard to substance—

[8] In re Watertown Paper Co., 169 Fed. 252; 94 C. C. A. 528; White vs. Pecos Land Co., 18 Tex. Civ. App. 634; 45 S. W. 207.

[9] Western Securities Co. vs. Spiro, 62 Utah 623; 221 Pac. 856; see sec. 411, infra.

must be recognized, though a mere form it be, and being actuated by a greater regard for form and substance it has been held that a set-off would not be allowed that was probably due from the president, though he was the corporation.[10] But the rule allowing set-off between stockholders and third parties must be sound since it harmonizes with the doctrine that in the absence of creditors corporate securities may be used by stockholders to pay their debts, where they agree among themselves so to do, or where the corporation has but one stockholder.[11]

§ 21. Corporate Entity Cannot Be Recognized If to Do So Requires Inequitable Results

While it is true, as some courts hold, that the mere ownership of stock is not enough to cause the courts to override the corporate fiction and regard the owners of the stock and the corporation as one, yet it is well settled that both at law and in equity when necessary to circumvent fraud, protect the rights of third parties, and accomplish justice, the corporate existence may be disregarded, and it seems sufficient to call upon the courts to do this if it is necessary to work out the ends of justice, and give operation to equitable principles.[12] It has also been held that it is well settled law that, while in general a corporation is a separate legal entity, nevertheless, when one corporation so dominates and controls another as to make that other a simple instrumentality of or an adjunct to it, then courts will readily look beyond the legal fiction of distinct corporate existence as the interests of justice require, and so accordingly, where a stock ownership is resorted to, not for the purpose of legitimately

[10] Sellers vs. Morehouse, 133 Atl. (N. J.) 174.

[11] See sec. 83, infra.

[12] Erkenbrecher vs. Grant, 187 Cal. 7; 200 Pac. 641; Colonial Trust Co. vs. Montello Brick Works, 172 Fed. 310; 97 C. C. A. 144; Richmond & I. Construction Co. vs. Richmond N. I. & B. R. Co., 68 Fed. 105; 15 C. C. A. 289; 34 L. R. A. 625; 163 U. S. 679; 16 S. Ct. 1199; 41 L. Ed. 310.

participating in the affairs of the corporation in the customary and usual manner, but for the purpose of controlling the subsidiary company so that it may be used as a mere agency or instrumentality of the owning company, the court will not permit itself to be blinded by mere corporate form but will, in a proper case, disregard the corporate entity and treat the two corporations as one.[13]

§ 22. Ownership of Stock Coupled With Control, Actuates Court to Disregard Corporate Entity

It is unquestionably true that as a general proposition, mere ownership of stock does not of itself, and standing alone, make the stockholder responsible for the obligations and contracts of the corporation, but it is equally and unquestionably true that where stock ownership is resorted to, not for the purpose of participating in the legitimate, usual, and customary manner in the affairs of a corporation, but for the purpose of so dominating, controlling, and directing a subsidiary company that it becomes a mere agency of the stock-owning company, such stock-owning company may not escape liability for the acts of the subsidiary.[14]

§ 23. Ownership of Stock, Coupled With Control, Enough to Disregard Corporate Entity, Whether Stockholder Is a Legal or Natural Person

The modern rule is clearly established by the authorities beyond all question, that when a corporation is owned and controlled by a single individual, either a natural person or

[13] Platt vs. Bradner Co., 131 Wash. 573; 230 Pac. 633; Mitchell vs. Lea Lumber Co., 43 Wash. 195; 86 Pac. 405; 9 L. R. A. N. S. 900; 10 A. C. 231; Roberts vs. Hilton Land Co., 45 Wash. 464; 88 Pac. 946.

[14] Chicago-Milwaukee & St. Paul Ry. Co. vs. Minn. Civic & Commerce Ass'n, 247 U. S. 490; 38 S. Ct. 553; 62 L. Ed. 1229; 134 Minn. 169; 158 N. W. 817; U. S. vs. Lehigh Valley Ry. Co., 220 U. S. 257; 31 S. Ct. 387; 55 L. Ed. 458; Gulf C. & S. F. Ry. Co. vs. Cities Service Co., 281 Fed. 214; 270 Fed. 994; 273 Fed. 946; Platt vs. Bradner Co., 131 Wash. 573; 230 Pac. 633.

a jural creation, the rule that the corporation and the shareholders have a separate entity and existence can never be made use of for the purpose of evading responsibility, or as a means of distorting, or hiding the truth, or covering up transactions. In such cases, the presumption that knowledge of the facts and circumstances affecting the interest of the stockholders of a corporation cannot be imputed to the corporation itself, has no application unless the interests of the stockholder and the corporation are adverse; but on the contrary, the presumption is otherwise where such interests are not adverse. The courts in all such cases look beyond a formal corporate difference into the real and substantial rights, rather than mere matters of organization.[15] However, this position is not entirely without dissent and accordingly it has been held that claims against a corporation for money advanced to it by its sole stockholder, for which notes were given, some of which were secured by collateral, were provable against it in a suit to wind up its affairs on the basis of equality with the general creditors. The court seemed to be of the opinion that the corporate entity would not be ignored except in cases in equity, or in cases which proceed on the theory of an estoppel, or where a corporation is merely an agency of another and in which case it is sought to enforce debts of the latter against property ostensibly owned by the corporation, or debts of the corporation against its owner.[16] However, the statement of the rule in Peckett vs. Wood is entirely too restricted and in the light of modern authority, and in view of numerous thoroughly considered and well reasoned adjudications from many jurisdictions, this could not possibly be sustained as a correct statement of the rule. This statement of the rule entirely overlooks the principle

[15] Searchlight Horn Co. vs. Am. Graphophone Co., 240 Fed. 745. It is interesting to note that in this case the court held that a corporation which, although not a party to the record, assumes full control and conduct of litigation on behalf of the defendant, is as fully bound by the decree therein as though made a defendant to the action. National Conduit Mfg. Co. vs. Conn. Pipe Mfg. Co., 73 Fed. 491.

[16] Peckett vs. Wood, 234 Fed. 833; 148 C. C. A. 431.

that ownership of stock, together with control, is a sufficient actuating cause to move the court to brush aside the corporate fiction and deal with substance and not bow down in worship to a form. This pronouncement, in Peckett vs. Wood, of the rule ignores the cases that go up on the more just principle that the corporate veil will be pierced when it is necessary to defeat injustice.[17]

§ 24. Agreement as to Division of Corporate Profits Not Sufficient to Destroy Entity

The corporate entity clings to the juristic corpus with a tenacity, and accordingly it has been held that, while in a proper case the legal fiction that a corporation is a separate entity will be disregarded, such rule does not apply to a corporation organized and existing and functioning as a distinct entity prior to the making of an agreement between its stockholders that the profits or dividends will be distributed twenty per cent to such stockholders as dividends proper and eighty per cent of the earnings of the corporation to one of its stockholders until certain advances made by him have been liquidated.[18]

§ 25. More Than Identity of Names is Required to Brush Aside Entity

In further substantiation of the statement made in the preceding section that the corporate entity clings to the juristic

[17] Erkenbrecker vs. Grant, 187 Cal. 7; 200 Pac. 641; Platt vs. Bradner, 131 Wash. 573; 230 Pac. 633; Gulf C. & S. F. Ry. Co. vs. Cities Service Co., supra; Spokane Merchants Ass'n vs. Clere Clothing Co., 84 Wash. 616; 147 Pac. 414; Clere Clothing Company vs. Union Trust & Savings Bank, 224 Fed. 363; 140 C. C. A. 49; Advance Rumley Thresher Co. vs. Geyer, 40 N. D. 18; 168 N. W. 731; in re Eilers Music House, 270 Fed. 915; 274 Fed. 330; 257 U. S. 646; 42 S. Ct. 55, 60 L. Ed. 414; Luckenbach S. S. Co. vs. S. R. Grace & Co., 267 Fed. 676; 254 U. S. 644; 41 S. Ct. 14; 65 L. Ed. 454; Hunter vs. Baker Motor Vehicle Co., 225 Fed. 1006; 238 Fed. 894; 152 C. C. A. 28.

[18] Cuppy vs. Ward, 187 App. Div. 625; 176 N. Y. Supp. 233; 227 N. Y. 603; 125 N. E. 915.

creation with a tenacity, it has been accordingly held that similarity, or even identity of names of two corporations formed, however, under different sovereignties, and composed of identically the same stockholders, will not sustain a holding that the corporations are identical.[19] This holding, however, is of very uncertain soundness. It is a very short distance removed from the position maintained by the courts that they would forever bow to the archaic fiction of corporate form, and that when, in the course of investigation, they were confronted with the corporate entity, further inquiry would not be made as to the component parties, or individuals parading behind that entity.

§ 26. Same Officers Not Enough to Cause a Disregard of Entity

It is, of course, hornbook law that the separate entity of corporations will not be ignored because they have common officers, or in some transactions, acted one for the other where they were separately organized and maintained, and kept up separate entities, and this is especially true where it was a custom acted upon or known to the corporations with a common president acting for both.[20] And it has never been doubted that having largely the same stockholders is not sufficient to call for an overriding of the separate corporate entities.[21] However, this statement should not be confused with the rule that a new corporation is subject to the implication of fraud or unfair dealing where it appears that its officers and stockholders had such an interest in an old company that it had succeeded, that a creditor would be justified in asserting their identity, the fact appearing that the

[19] Knott vs. Fisher Vehicle Woodstock & Lumber Co. of Erin, 190 S. W. (Mo.) 378; Wm. Wrigley, Jr. Co. vs. L. P. Larson, Jr. Co., 5 Fed. (2d) 731.

[20] Planters Oil Co. vs. Gresham, 202 S. W. (Tex. Civ. App.) 145; see sec. 56, n. 24.

[21] Smith vs. Henry Knight & Sons, 211 Ky. 111; 277 S. W. 290; see also sec. 56, n. 24.

property was partly the stockholders' under one name and otherwise to be the property of the stockholders under another name, the facts seeming to justify the position that in truth the transaction amounted merely to a change of name.[22]

§ 27. Government Ownership of Majority or All of Stock in Corporation Does Not Make Corporation Government Department or Destroy Entity

The ownership of a majority of the stock of a corporation by the United States government, or by a territorial government, does not make such corporation a department of the United States government, nor an agent of a department within the terms and purview of revised statutes of the United States, Section 5266 (Compiled Statutes, Section 10075).[23] By application of analogous principles, it would seem that a state-controlled corporation, the state owning the majority of the stock, would not make the corporation a department of the state. Of course, however, if a question of fraud, or other ground sufficient to move the courts to ignore the corporate entity, could arise, in such case no doubt the entity would be disregarded as has been done in at least two cases[24] before the United States Supreme Court when it be-

[22] Art Society of Pittsburgh vs. Leader Publishing Co., 60 Pa. Super. Ct. 548.

[23] Commercial Pacific Cable Co. vs. Philippine National Bank, 263 Fed. 218; 269 Fed. 1022. In this case the Philippine National Bank was a corporation organized under a charter granted by the Philippine legislature and the charter provided that 51% of the stock of the bank was to be owned by the Philippine government and to be voted by the governor general and the presiding officers of the two branches of the legislature. The remainder of the stock was subject to general ownership and the question arose by reason of the insistence on the part of the bank that it was entitled to priority of service and government rates on cablegrams from the Commercial Pacific Cable Company, and this contention was denied and the entity maintained. See however sec. 125, infra.

[24] U. S. Grain Corp. vs. Phillips, 261 U. S. 106; 67 L. Ed. 552; 43 S. Ct. 283; U. S. vs. Walter, 263 U. S. 15; 68 L. Ed. 137; 44 S. Ct. 10; 291 Fed. 662.

came necessary in the characteristic language of Justice Holmes:

> "To guard against the corporate fiction becoming a nonconductor in the wrong place."[25]

So, accordingly, it has been held that where even the government of the United States owns all of the stock of a corporation created by it, it does not serve to bring the corporation within the rule that in proper cases the court will disregard the corporate entity. The courts refuse, in such cases, to hold that the agents of such corporation are agents of the government.[26] Likewise the rule has been invoked but its application denied, that a corporation created under congressional authority, and the whole stock of which is owned by the United States government, could not lay claim to immunity from suit by reason of such governmental ownership. In other words, the immunity from suit that shields and protects the United States government at the instance of individuals cannot be extended to, or shared by corporations created and owned by the government and such corporations may be sued in the courts of the country with the same freedom as other juristic creations.[27]

§ 28. Corporate Concept Product of Progress of Civilization

It is manifest, without a careful study of the authorities, that the corporation concept is the product of civilization and its existence is indispensable in the modern world of gigantic business, but the ingenuity of mankind was not content with the functioning of the corporation in its proper sphere and frequent essays were made to make it perform duties without the pale of the proper field of its operation; to compel it to cover situations that were entirely beyond

[25] Wormser on the Disregard of Corporate Fiction 9.
[26] U. S. vs. Strang, 254 U. S. 491; 65 L. Ed. 368; 41 S. Ct. 165.
[27] Sloan-Shipyards Corporation vs. U. S. Shipping Board Emergency Fleet Corporation, 258 U. S. 549; 66 L. Ed. 762; 42 S. Ct. 386; 268 Fed. 624; 272 Fed. 132; 42 S. Ct. 588.

the proper concept of the corporate theory and, therefore, it became abused and came to be used by designing men as a shield to protect fraud, to hide and cover up improper transactions, and as a complete panoply against inquiry and investigation, but the courts refused to be trammeled by the purest form of a fiction and arose equal to the occasion and brushed aside in proper cases, the corporate entity, investigated, and dealt with the live-acting individuals that were back of the corporate "smoke screen." Innovations in law are slow to be adopted, but yet when cases are presented, calling for action, the courts of common-law jurisdiction in conjunction with equity, have always arisen equal to the occasion.

From the earliest times, it has been hard for the courts to not apply anthropomorphistic reasoning to corporations and to treat them as an association of individuals. As early as Edward IV's day, the mayor and commonalty of Newcastle gave a bond to the person who happened to be mayor, naming him by his personal name. It was held void, for a man cannot be bound unto himself.[28] This is possibly the earliest case that discloses the ignorance of the corporate fiction by a court of law, and the principle thus established in that early dawn of the common law, was indeed ephemeral, or rather remained for centuries in desuetude.

In another case, earlier still, in the year 1429, an action of trespass was brought against the mayor, bailiff, and commonalty of Ipswich and one J. Jabe, the defendants pleading that Jabe was one of the commonalty and was, therefore, named twice over, and they urged that if the defendants were found guilty, Jabe would be charged twice over, and they argued that it was within the realm of possibility that he might be found not guilty and the commonalty guilty, and the illative result would be that he might be found guilty and at the same time not guilty. Notwithstanding that this position was twice urged on the court, the record of the case

[28] 1 Pollock & Maitland History of English Law 492; 3 Y. B. 21; Edward IV F. f. 15 f. 68.

fails to disclose the ultimate decision reached thereon, but it serves to show that the rule disregarding the corporate entity had not sufficiently taken root at that early time in the English system of jurisprudence to be applied by the courts.[29]

In the year 1701, possibly the modern renaissance of the rule that was recognized to exist—even if not applied—in the 15th century, took place. In that year the City of London brought a suit against one Wood by and through city's corporate name in the Mayor's court. Objection was taken that the court had no jurisdiction by reason of the fact that the court was held before the mayor and aldermen and the action was brought in the name of the mayor and commonalty—that being the legal corporate name of the City of London—and that it is against all law that the same person should be party and judge in the same case. The objection rested therefore upon the character of the individuals who were members of the corporation. The judges were unanimous in holding they could look beyond the name and notice the character of the individuals.[30]

It was in comparatively modern times in the United States that the principle urged at such an early time was called forth from its slumbers and was aroused into action. The principle in that case had been so far lost sight of that eminent counsel in one of the recent cases, where the question of overriding the corporate entity was involved, characterized the rule as:

"A modern heresy largely invented during the late crusades against the principle of an association in business, that a corporation is not 'legal entity,' but simply an asso-

[29] I Pollock & Maitland History of English Law 493.

[30] City of London vs. Wood, 12 Mod. 669. Dissenting opinion of Buckley L. J. in Continental Tyre & Rubber Co. vs. Daimler Co. (1915), 1 K. B. 893 (1915); W. N. 441; 84 L. J., K. B., N. S. 927; 20 Com. Cas. 209; 59 Sol. Jo. 232; 5 B. R. C. 304. The majority opinion, however, was affirmed in the House of Lords, 6 B. R. C. 304 (1916); 2 A. C. 307; 85 L. J., K. B., N. S. 1333; 114 L. T., N. S. 1049; 32 Times L. R. 624; 60 Sol. Jo. 602; 22 Com. Cas. 32; 1917C A. C. 170.

ciation of stockholders endowed with certain legal faculties."

And the same counsel in the same case further contended this idea, that:

"The disregard of the corporate entity is so opposed to authority and effects such radical changes in corporate law and is fraught with such dangerous results, that it behooves the court to seriously consider the question in all its bearings before enunciating such a principle."[31]

The great hue and cry raised by counsel in that case was promptly silenced by the court by announcement of the principle that no reason could be perceived why the principle applicable to fictions in general, should not apply to the fiction that a corporation is a personal entity, separate from the natural persons who compose it and for whose benefit it has been invented.[32] So that palingenesis of the rule was established in modern times.

The alarm of the worshippers of the corporate fetish must have been extreme when an eminent author on corporate law would make bold to assert that the corporate fiction is a stumbling block in the advance of corporation law toward the discrimination of the real rights of men and women and should be abandoned.[33]

§ 29. Development of Rule That in Proper Case Corporate Fiction Will Be Ignored, Is Not Encouraged in England

The principle that a corporation is a fiction, and like all fictions, will, when justice demands, be ignored, has not found favor in the comparatively modern jurisprudence of England and it seems there that the courts are content to continue to bow and worship at the shrine of the corporate fetish. The theory that the courts will not look behind the corporate

[31] Argument of Counsel, State vs. Standard Oil Company, 49 Ohio State 137; 15 L. R. A. 145; 30 N. E. 279; 34 A. S. R. 541.

[32] Ibid.

[33] Taylor on Corporation sec. 51; State vs. Standard Oil Company, supra.

entity, has such a grasp upon the system of jurisprudence in that country, that it has been held that if the proprietor of a solvent business turns it into a limited liability company, of which he is practically the owner, and takes in payment, shares and debentures of the company, on the insolvency of the company, the debentures will be superior to ordinary debts of the company.[34]

It would seem that such a pronouncement is glad tidings to all those who would desire to evade the payment of their just debts and obligations. It is difficult to see how a court could reach such an unconscionable conclusion that a man, while yet forsooth is solvent, although that solvency may be a paper solvency, could incorporate himself into a company, take a mortgage back on the assets of the company, together with its stock, and then, on declared insolvency, retrieve the very assets that he put into the incorporated company and leave his creditors denied of justice. In other words, Dr. Jekyll is not responsible for the doings of Mr. Hyde.

[34] Salamon vs. Salamon & Company (1897), A. C. (Eng.) 22; 65 L. J., Ch., N. S. 35; 75 L. T. N. S. 426; 45 Week Rpts. 193; 4 Manson 89; Continental Tyre & Rubber Co. vs. Daimler Co. Ltd. (Court of Apps.) (1915), 1 K. B. 893 (1915); W. N. 441; 84 L. J., K. B., N. S. 927; 20 Com. Cas. 209; 59 Sol. Jo. 232; 5 B. R. C. 304. Affirmed in House of Lords, 6 B. R. C. 269 (1916); 2 A. C. 307; 85 L. J., K. B., N. S. 1333; 114 L. T. N. S., 1049; 32 Times L. R. 624; 60 Sol. Jo. 602; 22 Com. Cas. 32; 1917C A. C. 170. When the case was before the Court of Appeal, Buckley L. J. delivered an unanswerable dissent, that showed an understanding of the principle that a corporation apart from its members was a fiction, that the other judges did not seem to grasp. This dissent cited and approved Bank of U. S. vs. Deveaux, 3d L. Ed. 38; 5 Crouch 61.

CHAPTER III

ABSTRACT IDEA OF A CORPORATION AND THE CORPORATE FICTION

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§ 30. Abstract Idea of a Corporation

The abstract idea of a corporation, the legal entity, the impalpable and intagible creation of human law, is itself a fiction and has been appropriately described as a figure of speech. It serves well to designate in our minds the collective action and agency of many individuals as permitted by law and the substantial inquiry always is, what in a given case has been the collective action and agency as between a corporation and those with whom it deals? The manner of its exercise usually is immaterial.

The state gives the franchise—the charter—not to the impalpable, the intangible, and always nebulous fiction of our thought, but to the corporators, the individuals, the acting and living men, to be used by them to redound to them and their benefit, to strengthen their hands and to add energy to

their capital. If it is taken away, it is taken from them as individuals and corporators, and the legal fiction disappears.

The benefit of the charter, the franchise, and the privilege of collectively functioning belongs to the corporators—the stockholders. If that privilege is abused, the merited punishment in the last analysis is visited upon the corporators and both benefits and punishments must ultimately flow to the corporators and must attend and depend upon the conduct of the corporators and not the impalpable, intangible, juristic creation of human thought and, so accordingly, when all the corporators act collectively as an aggregate body, without the least exception, and so acting, large results will accompany purposes clearly corporate in their design and character and affecting the vitality, the independence, the utility of the corporation itself, and there should be no hesitation to conclude that there has been corporate conduct for which responsibility will follow and which cannot be defeated by the assumed innocence of a convenient fiction. Such is necessarily the abstract idea of a corporation.[1]

§ 30a. The Existence of a Corporation Independent From Its Shareholders, Is a Fiction

In consonance with the modern trend of judicial decisions, the rule is well established that the existence of a corporation, independent of its shareholders, is a fiction. Its rights and duties are in reality nothing more nor less than the rights and duties of the persons who compose it, and not of an imaginary being.[2] How there ever could have been a time when courts of law could blindly and stubbornly refuse to look to the human component parts of every corporation is most difficult to understand. If the courts stubbornly and blindly refuse to consider that there are living and acting

[1] People vs. North River Sugar Refining Co., 121 N. Y. 582; 24 N. E. 834; 18 A. S. R. 843; 9 L. R. A. 33; 5 L. R. A. 386; 54 Hun. 354.
[2] San Diego Gas Co. vs. Frame, 137 Cal. 441; 70 Pac. 295.

human beings that really control the corporation, think for it, decide for it, act for it, and enjoy the privileges of having the right to function as a corporation conferred upon them, it is indeed hard to see how there ever could have been an action to abate a nuisance, where the property affected was that of a corporation. This point is well illustrated in a case where a church is disturbed by smoke fumes and gas emitted from railway engines in close proximity to the church—the title to the property being in the corporation. If the courts did not consider the indispensable human element that is in every corporation, there certainly could not be an abatement of the nuisance, for it must be the members of the corporation that were affected by the nuisance, and not the corporation itself. The Supreme Court of the United States had before it a case of this sort, and the court there readily held that it would not blindly refuse to look further than the corporation itself, and accordingly abated the nuisance.[3]

§ 31. A Fiction Is Never Allowed to Work an Injustice

The principle underlying the numerous judicial pronouncements reaching the conclusion that the courts will look through and behind the corporate fiction when a proper case is presented, has long been well expressed in a Latin maxim: *In fictione juris semper subsist aequitas existit.*[4] Since the time of Blackstone, the law undoubtedly has been that no fiction is erected to work an injustice—its proper operation being to prevent a mischief or remedy an inconvenience that might result from a general rule of law.[5] How it could ever have been assumed that a corporation was not subject to this rule of law, it is indeed difficult to comprehend.

[3] Baltimore etc. Ry. Co. vs. Fifth Baptist Church, 108 U. S. 317; 27 L. Ed. 739; 2 S. Ct. 719.

[4] Union Refrigerator Transit Co. vs. Kentucky, 199 U. S. 194; 26 S. Ct. 36; 50 L. Ed. 150; Lehl vs. Strong Mercantile Co., 259 Pac. 512; 82 Colo. 343; State vs. Standard Oil Co., 49 Ohio State 137; 15 L. R. A. 145; 34 A. S. R. 541; 30 N. E. 279.

[5] III Blackstone's Comm. 43.

§ 32. A White Corporation Composed Entirely of Colored Members

In a single jurisdiction in application of the rule that a court would not look behind the corporate fiction to see who compose it, it was held that where a conveyance is made to a corporation, composed entirely of colored persons, that the conveyance did not violate a condition inserted in a prior conveyance that "the title to this land never to vest in a person or persons of African descent," the court humbly bowing to the fetish and felt bound to hold that it would not look behind the artificial, invisible, intangible, juristic persons, which existed only in contemplation of law.[6] Manifestly, the original purpose of the concept of the corporate theory never contemplated the application of the fiction to such a situation. That courts ignore the corporate fiction is not indeed hard to comprehend in a proper case, but it would seem that the difficulty is to understand how courts ever brought themselves to be so blinded as to adhere to it under any and all circumstances.

§ 33. The Corporation, Its Life and Death, Are Fictions

For the clearest reasons and upon the soundest principles, the corporate being—a mere juristic creation—existing only in contemplation of law, and for and during such term as the law may direct, the corporation itself is a fiction, and so is its life, and likewise its death. These are all mere figures of speech.[7] In application of the principle that the corporation itself, its life and death are all fictions, the court in a case where an action was brought in the name of a cor-

[6] Peoples Pleasure Park Co. vs. Rohleder, 109 Va. 439; 61 S. E. 794; 63 S. E. 981. The court might well have placed its decision upon other grounds than that it would not look behind a pure legal fiction to ascertain the identity of the persons composing that fiction, and according to a line of decisions, might well have held the restriction void; Porter vs. Barrett, 233 Mich. 373; 206 N. W. 532; 42 A. L. R. 1267; Los Angeles Investment Co. vs. Gary, 181 Cal. 680; 186 Pac. 596; 9 A. L. R. 115; Title Guarantee & Trust Co. vs. Garrott, 42 Cal. App. 152, 183 Pac. 470.

[7] Bonfils vs. Hayes, 70 Colo. 336; 201 Pac. 677.

poration and the corporate capacity was accordingly alleged, and the defendant answered, denying the corporate capacity, and pleading affirmatively that the corporation's charter had expired by lapse of time, the court upon application permitted an amendment to substitute the name of the statutory trusteeship in place of the corporation, and this was accordingly allowed, and in which decision the Supreme Court of the state assumed and asserted the rule of law to be that a fiction is never allowed to work an injustice.[8] The general proposition that a corporation is to be regarded as a legal entity existing separate and apart from the natural persons composing it is not to be disputed. But this rule has its limitations which must not be lost sight of. So accordingly, the statement that it is a mere fiction, existing only in idea, is well understood, and now amply established in this country, and is not controverted by anyone who pretends to accurate knowledge on the subject. The corporate idea has been introduced from the earliest times for the convenience of the company in making contracts, in acquiring property for corporate purposes, in suing and being sued, and to preserve the nonliability of the stockholders by distinguishing between the corporation's debts and property of the company, and of the stockholders in their capacity as individuals. All fictions of law have been introduced for the purpose of convenience, and to subserve the ends of justice. But when they are urged to an intent and purpose not within the reason and policy of the fiction, they have always been disregarded by the courts, with the possible exception in favor of corporations until comparatively modern times. Even in Lord Mansfield's time, it was declared that "it is a certain rule that a fiction of law shall never be contradicted so as to defeat the end for which it was invented, but for every other purpose it may be contradicted." Fictions were invented for the advancement of justice, and should never be applied for any other purpose.[9] Certain it is that no reason or argument could be advanced why the principles applicable to fictions in general should not apply

[8] Lehl vs. Strong Mercantile Co., 259 Pac. 512; 82 Colo. 343.
[9] State vs. Standard Oil Co., 49 Ohio State 137; 15 L. R. A. 145;

to the fiction that a corporation is a separate entity, separate from the natural persons who compose it, and for whose benefit it has been invented.[10] One author has at least made bold to assert that the corporate fiction is a stumbling block in the advancement of corporate law towards the discrimination of the real rights of actual man and woman, and should be abandoned.[11] So it is in modern times, that courts no longer hesitate to look through forms to substance, and ignore a mere colorable corporate entity to the end that the rights of third parties shall be protected. And this seems to be a principle based upon the soundest of reasons, and sustained by irrestible argument, grounded in logic and sustained in right and justice.[12]

§ 34. A Corporation Is a Fiction and Will Be Disregarded As Other Fictions, in Proper Cases

No reason is, or can be perceived, why the principle applicable to fictions in general should not apply to the corporate fiction that considers it separate from the natural persons who compose it, and for whose benefit it has been created.[13] The idea that the corporation is an entity, distinct from the corporators who compose it, has been aptly characterized as a nebulous fiction of thought.

Much learning has been indulged in, and much space occupied by text writers and courts in an effort to differentiate the essential character of a corporation from that of its stockholders, and great ingenuity has been displayed in the argument, but it has been, in the main, a fruitless metaphysical discussion for the purpose of description, and in defining cor-

34 A. S. R. 541; 30 N. E. 279; Johnson vs. Smith, 2 Burr 962; Wood vs. Furgeson, 7 Ohio State 291; Hood vs. Brown, 2 Ohio 269; Rossman vs. MacFarland, 9 Ohio State 269; Miller vs. Donaldson, 17 Ohio 266.

[10] See secs. 34, 327, 328, infra.

[11] State vs. Standard Oil Co., 49 Ohio State 137, 15 L. R. A. 145, 34 A. S. R. 541, 30 N. E. 279.

[12] Spokane Merchants Ass'n vs. Clere Clothing Co., 84 Wash. 616; 147 Pac. 414.

[13] State vs. Standard Oil Company, 49 Ohio State 137; 30 N. E. 279; 15 L. R. A. 145; 34 A. S. R. 541.

porate rights and obligations and characterizing corporate action. The fact that a corporation is an artificial person, or entity, apart from its members, may be convenient and generally useful, but on the other hand, it may be urged with no little force that the argument favoring the essential separate entity of a corporation under some conditions fails, and it is doubtless true that the effort has resulted in misleading conceptions and in much confusion of thought on the subject.

It necessarily follows that a corporation is not in reality a person, or thing, distinct from its constituent parts, and that the constituent parts, the stockholders, as much so in essence and in reality as the several partners, are the constituent parts of the partnership. Stripped of misleading verbiage, the corporation is a device created by law, whereby an aggregate of persons who may avail themselves of its privileges by organization, are permitted to use their property in a way different from that which is permitted to others who do not so organize.[14]

The fiction by which an ideal legal entity is attributed to a duly formed incorporated company, existing separate and apart from the individuals composing it, is of such general utility and application as to induce the belief that it must be universal, and be in all cases adhered to, although the greatest frauds may thereby be perpetrated under the fiction as a shield and, like other fictions of law that seek to assert themselves beyond their proper bounds, it will be disregarded.[15]

That a corporation is a legal entity, apart from the natural persons who compose it, is a mere fiction introduced for convenience in the transaction of its business, and of those who do business with it, but like every other fiction of law, when urged to an intent and purpose not within its reason and purpose, it will be disregarded.[16]

[14] Cincinnati Volksblatt Co. vs. Hoffmeister, 62 Ohio State 189; 56 N. E. 1033; 48 L. R. A. 732; 78 A. S. R. 707.

[15] First National Bank of Chicago vs. Trebein, 59 Ohio State 316; 52 N. E. 834.

[16] Parkside Cemetery vs. Cleveland Bedford & Geauga Lake Traction Co., 93 Ohio State 161; 112 N. E. 596; 1918C A. C. 1051.

§ 35. Ownership of Stock Alone Is Not Sufficient to Hold Parent Corporation For Torts of Subsidiary

The rule seems to be the same where it is sought to hold the parent corporation for a tort of a subsidiary, as it is when it is sought to hold the parent corporation for contractual obligations of the subsidiary.[17] And so it is held, that stock ownership alone is insufficient to charge the dominant corporation with liability arising from the commission of torts by the subsidiary company. In some of the cases holding this rule, the court attached considerable importance to the proposition that the separate entities were maintained and that the finances of the two corporations were at all times kept separate. Also, the point was stressed that the dominant corporation did not organize the subsidiary, but acquired the stock after it was organized by other parties.[18] It seems that *these holdings are not by any means in accord with the great* weight of modern authority. It is not easy to comprehend what difference it could make as to whether the dominant corporation organized the subsidiary or acquired it after its creation by others. The rule as to when the corporate entity will be ignored does not rest upon such unsubstantial basis.

§ 36. Theory Now Prevails That Corporation Is Merely an Association of Persons

Although, for all legitimate purposes, and to serve all proper ends, a corporation is a legal entity, and a juristic creation distinct from the members who compose it, and with

[17] Auglaize Box Board Co. vs. Hinton, 126 N. E. 881; 100 Ohio State 505; 254 U. S. 610; 41 S. Ct. 60; 65 L. Ed. 437.

[18] Berkey vs. Third Ave. Ry. Co., 244 N. Y. 84; 155 N. E. 58. It must be conceded, however, that this is indeed a close case and it requires that the fundamental distinctions by which entities are held separate must be kept constantly and clearly in mind. It seemed, however, that there was no control or domination of the subsidiary by the stock-owning parent corporation. In line with the rule in the last cited case are also: Elenkrieg vs. Siebrecht, 238 N. Y. 254; 144 N. E. 519; 34 A. L. R. 592; 206 App. Div. 736; 200 N. Y. Supp. 307; Stone vs. Cleveland, C. & St. L. Ry. Co., 202 N. Y. 352; 95 N. E. 816; 35 L. R. A. N. S. 770 (N. S.); 136 App. Div. 907; 120 N. Y. S. 1147; see, however, sec. 244, infra, where Berkey vs. Third Ave. Ry. Co. is analyzed.

this principle kept in view, it will be recognized and given effect both at law and in equity. But, nevertheless, it is clear that a corporation is, in fact, a collection of individuals who, in case of the modern corporation of a private nature, in reality own its property, and it is the stockholders who carry on the corporate business, but this is done, of course, through the proper instrumentality of officers, directors, and agents, for the benefit and the profit of the stockholders and in view of the modern authorities upon the question, it is utterly impossible to ignore the idea that a corporation is a mere fiction of law, introduced into the system of jurisprudence in this country for convenience in conducting business in this privileged way, and it is well settled that when this fiction is urged to an intent not within its legitimate reasons and purposes, it will be disregarded and the corporation considered and dealt with as an aggregate of persons and this is true whether the question arises in a court of law or in equity.[19]

[19] Nashville vs. Ward, 16 Lea (Tenn.) 27; People vs. North River Sugar Refining Co., 3 N. Y. S. 401; 16 N. Y. Civil Procedure I; 2 L. R. A. 33; 54 Hun. 354; 7 N. Y. S. 406; 5 L. R. A. 386; 121 N. Y. 582; 24 N. E. 834; 18 A. S. R. 843; 9 L. R. A. 33; 27 N. Y. State Rep. 282; U. S. vs. Trinidad Coal, etc., Co., 137 U. S. 160; 11 S. Ct. 57; 34 L. Ed. 640; 37 Fed. 180; Baltimore etc. Ry. Co. vs. Fifth Baptist Church, 108 U. S. 317; 2 S. Ct. 719; 27 L. Ed. 739; Exploration Mere Co. vs. Pac. Hdwe. Co., 177 Fed. 825; 101 C. C. A. 39; Ryan vs. Old Veteran Mining Co., 37 Idaho 625; 218 Pac. 381; Olympia Mining etc. Co. vs. Kerns, 24 Idaho 481; 236 U. S. 211; 35 S. Ct. 415; 59 L. Ed. 542; 135 Pac. 255; J. J. McCaskill Co. vs. U. S., 216 U. S. 504; 30 S. Ct. 386; 54 L. Ed. 590; Hale vs. Henkel, 201 U. S. 43; 26 S. Ct. 370; 50 L. Ed. 652; U. S. vs. United Shoe Machinery Co., 234 Fed. 127; Hunter vs. Baker Motor Vehicle Co., 225 Fed. 1006; 238 Fed. 894; 152 C. C. A. 28; Clere Clothing Co. vs. Union Trust etc. Bank, 224 Fed. 363; 140 C. C. A. 49; Joseph Foard Co. vs. Maryland, 219 Fed. 827; 135 C. C. A. 497; Smith vs. Moore, 199 Fed. 689; 118 C. C. A. 127; 182 Fed. 540; Ford vs. Chicago Milk Shippers Ass'n, 155 Ill. 166; 39 N. E. 651; 27 L. R. A. 298; Linn & Lane Timber Co. vs. U. S., 196 Fed. 593; 203 Fed. 394; 116 C. C. A. 267; 121 C. C. A. 498; 236 U. S. 574; 35 S. Ct. 440; 59 L. Ed. 725; Gay vs. Hudson River Elec. Power Co., 187 Fed. 12; 109 C. C. A. 66; York Mfg. Co. vs. Brewster, 174 Fed. 566; 98 C. C. A. 348; Wise Realty Co. vs. Stewart, 169 Cal. 176; 146 Pac. 534; San Diego Gas Co. vs. Frame, 137 Cal. 441; 70 Pac. 295; Martin vs. D. B. Martin Co., 88 Atl. 612; 10 Del. Ch. 211; Jones vs. Williams, 139 Mo. 1; 39 S. W. 486; 40 S. W. 353; 61 A. S. R. 436; 37 L. R. A. 682; Home Fire Ins. Co. vs. Barber, 67 Neb. 644; 93 N. W. 1024; 108 A. S. R. 716; 60 L. R. A. 927. See sec. 379, infra.

CHAPTER IV

EARLY INTIMATION OF THE RULE OF DISREGARD OF THE CORPORATE ENTITY

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§ 37. Some Early Intimations of the Rule

The Supreme Court of Georgia, at an early date, strongly hinted at the possible existence of such a rule as in a proper

case it would ignore the corporate fiction and deal with the corporation and its property and the persons composing it in their true life and based its intimation upon the ground that it would be sustained and sanctioned by enlightened administration of equity jurisprudence.[1] And earlier still, the Supreme Court of Maryland seems to have been strongly persuaded that, when all of the stock of the corporation became concentrated in the hands of a single individual, the body politic would be thereby virtually dissolved.[2] It is singular enough that the Supreme Court of Georgia would be one of the first courts to intimate the existence of such a rule and yet at this late date, it refuses to adopt the rule in all of its ramifications, as we shall presently see.[2a]

It is now declared very generally, that where an individual, or partnership, organizes himself or themselves into a corporation, the corporation is liable for the debts of the individual, or partnership, that has so formed the corporation.[3] And it seems clear enough that this is but one of the many aspects of the modern rule that the corporate entity will not be allowed to occupy the position of a "smoke screen" and thus hide the assets of the debtor from his creditors, but the operation of the rule in this regard has been repeatedly denied in the state of Georgia,[4] but the federal courts in the state decline to follow this antiquated rule on the part of the state courts, and have even gone so far as to declare that Georgia courts in this respect were not governed by the common law and the Federal Courts insisted that it should follow the juster and sounder doctrine that so generally prevails at this time.[5]

[1] Hightower vs. Thornton, 8 Georgia 486; 52 Am. Dec. 412.
[2] Bellona Co.'s Case, 3d Bland Ch. 442.
[2a] See secs. 140, 141, infra.
[3] Secs. 130, 273, infra.
[4] Bludwine vs. Crown etc. Co., 14 Ga. App. 285; 80 S. E. 853; Georgia Co. vs. Castleberry, 43 Georgia 187; Greenberg Miller Co. vs. Everett Shoe Co., 138 Georgia 729; 75 S. E. 1120; Culberson vs. Alabama Construction Co., 127 Georgia 599, 9 L. R. A. N. S. 411; 56 S. E. 765; 9 A. C. 507; Taylor Lumber Co. vs. Clark Lumber Co., 127 S. E. 905; 33 Ga. App. 815.
[5] In re W. J. Marshall Co., 3 Fed. (2d) 192.

§ 38. The Supreme Court of the United States Said to Be the First to Disregard the Corporate Fiction

It has been asserted by at least one of the federal courts that the Supreme Court of the United States was the first to break away from the notion that a corporation may not at all times be regarded as a legal entity, even though to so regard it would work an injustice. It is assumed that the courts had reference to the case of Bank of the United States vs. Deveaux,[6] but it is seen upon going into the question at greater length, that the courts in some of the earliest times had this question urged before them and, in fact, in a sort of primitive legal fashion, passed thereon. About the most that could be claimed for the Bank of the United States vs. Deveaux is that it passed upon a jurisdictional question. Indeed Bank of U. S. vs. Deveaux followed the English case of City of London vs. Wood, decided in 1701.[6a]

§ 39. Rule of Bank of U. S. vs. Deveaux Applied With Respect to Jurisdiction Only

As stated in the preceding section, the greatest length that the court went in the case of Bank of the United States vs. Deveaux, was that the courts would disregard the corporate entity in dealing with jurisdictional questions, and it is thought that the modern kaleidoscopic application of the rule has been possibly fostered more by the trust-fund doctrine than any other principle running through the American system of jurisprudence. There are many applications of the doctrine that courts will override the corporate entity in proper cases that serve well as analogues to the trust-fund doctrine, and if this similarity of the two doctrines is kept in mind, expansion of the doctrine of disregarding the corporate entity, and its application to other phases of corporations, operating with greater scope and in a wider field than the

[6] 3 L. Ed. 38; 5 Cranch 61.
[6a] See. 28, supra, 12 Mod. 669.

trust-fund doctrine was ever applied, and when this is kept in mind, many questions arising are more readily solvable.

However, the principle announced in Bank of the U. S. vs. Deveaux has always been, in so far as we have been able to ascertain, confined to purely questions of a jurisdictional nature, for at an early day the Supreme Court of Connecticut made the observation that there are cases, however, in which courts have drawn aside the veil and looked at the character of the individual corporators, particularly when the question arises as to the jurisdiction of the court; this has been done by the Supreme Court of the United States the better to carry into effect the spirit of the constitution giving the courts of the United States jurisdiction in suits between inhabitants of different states, but this is confined to the question of jurisdiction and has never been extended further.[7]

The principle of Bank of the United States vs. Deveaux has been followed at an early day in Missouri and it was by operation of this principle that an Illinois banking corporation was allowed to sue in the courts of the state of Missouri.[8]

§ 40. Jurisdictional Doctrine of Bank of the United States vs. Deveaux Discarded

The doctrine announced by the Supreme Court of the United States that the jurisdiction of the federal courts depended rather upon the citizenship of the corporators, than upon the jurisdiction to which the corporation owed its existence, has long since been discarded, and it is now the universal rule that a corporation is treated as if it were a citizen of the state by or under the laws of which it was chartered, or, as it has sometimes been put, the corporation is conclusively presumed to be composed of the citizens of the state under whose laws it exists. This same presumption comes into op-

[7] Fairfield County Turnpike Co. vs. Thorpe, 13 Conn. 173; Bank of Augusta vs. Earle, 13 Peters 586; 10 L Ed. 306; O'Neal vs. Jones, 34 S. W. (2d) 689. In this case it was held the corporate entity would be disregarded to determine the proper venue of an action.

[8] Bank of Edwardsville vs. Simpson, I Mo. 184.

eration as regards corporations organized under the laws of foreign countries.[9]

So it is thought that the principle announced in the case of the United States vs. Deveaux could have contributed little to the influence and development of the rule that courts will, in proper cases, disregard the corporate entity. The fact that the great tribunal—the Supreme Court of the United States—had, even at an early day, applied the doctrine for jurisdictional purposes, may have perhaps lent strength to the courts to assume the stand that the corporate entity is not vested with any sanctity.

§ 41. Trust-Fund Doctrine

The trust-fund doctrine, or, as it is sometimes denominated, the American doctrine, is that the capital stock of a corporation, or the assets of an insolvent corporation representing its capital, is a trust fund for the benefit of the creditors of the corporation.[10] Mr. Justice Story seems to have originated the trust-fund doctrine at an early day.[11] The doctrine, at its inception, was announced to be:

"It appears to me very clear upon general principles, as well as the legislative intention, that the capital stock of banks is to be deemed a pledge or trust fund for the payment of the debts contracted by the bank. The public, as well as the legislature, have always supposed this to be a fund appropriated for such purpose. The individual stockholders are not liable for the debts of the bank in their private capacities. The charter relieves them from personal responsibility and substitutes the capital stock in its stead. Credit is universally

[9] Sec. 47 Foster's Federal Practice.

[10] Camden vs. Stuart, 144 U. S. 104; 36 L. Ed. 363; 12 S. Ct. 585; Hatch vs. Dana, 101 U. S. 205; 25 L. Ed. 885; Wilson vs. Baker Clothing Co., 25 Idaho 378; 50 L. R. A. N. S. 239; 137 Pac. 896; Hightower vs. Thornton, 8 Georgia 486; 52 Am. Dec. 412; Jennings Neff & Co. vs. Crystal Ice Company, 128 Tenn. 231; 47 L. R. A. N. S. 1058; 159 S. W. 1088; Simpson vs. Western Hdwe. & Metal Co., 97 Wash. 626; 167 Pac. 113.

[11] Wood vs. Dummer, 3 Mason 308; Fed. Case No. 17, 944.

given to this fund by the public, as the only means of repayment. During the existence of the corporation it is the sole property of the corporation, and can be applied only according to its charter, that is, as a fund for the payment of its debts, upon the security of which it may discount and circulate notes. Why, otherwise, is any capital stock required by our charters? If the stock may, the next day after it is paid in, be withdrawn by the stockholders without payment of the debts of the corporation, why is its amount so studiously provided for, and its payment by the stockholders so diligently required? To me this point appears so plain upon principles of law, as well as common sense, that I cannot be brought into any doubt, that the charters of our banks make the capital stock a trust fund for the payment of all the debts of the corporation. The billholders and other creditors have the first claims upon it, and the stockholders have no rights, until all the other creditors are satisfied. They have the full benefit of all the profits made by the establishment, and cannot take any portion of the fund, until all the other claims on it are extinguished. Their rights are not to the capital stock, but to the residuum after all demands on it are paid. * * * If I am right in this position, the principal difficulty in the cause is overcome. If the capital stock is a trust fund, then it may be followed by the creditors into the hands of any persons, having notice of the trust attaching to it. As to the stockholders themselves, there can be no pretense to say, that, both in law and fact, they are not affected with the most ample notice. The doctrine of following trust funds into the hands of any persons, who are not innocent purchasers, or do not otherwise possess superior equities, has been long established." [11a]

It is thought that this is the seed from which the doctrine, that courts will, in a proper case, disregard the corporate entity, germinated and has now flourished and grown to an extent that it is indeed gratifying as a rule that subserves the ends of justice.

[11a] Wood vs. Dummer, supra.

§ 42. The Position That the Doctrine of Disregarding the Corporate Entity Sprang From Trust-Fund Doctrine, Strengthened

The position that the doctrine that the courts will, in proper cases, override the corporate entity and treat the corporators and the entity as one sprang from the trust-fund doctrine, is further strengthened by reason of the fact that the trust-fund doctrine is a product of American jurisprudence and so is the rule that in proper cases, the courts will brush aside the corporate veil and treat parties as they are, for this rule has not found favor at the hands of the English courts.[12]

The influence of the trust-fund doctrine as a contributing element to the fostering of the rule that the courts will, in a proper case, disregard the corporate entity, is seen in some of the adjudicated cases. In a case from North Carolina it is apparent throughout the opinion that the court was confused between a proper application of the principle that the corporate entity will be disregarded in proper cases, and a strict application of the trust-fund doctrine, and by this confusion the court doubtlessly wandered afield in a position, to say the least of it, is very difficult to maintain. It was there held that where a surviving partner of a firm who was personally liable as an endorser of a note executed in the firm name, who, without authority, organized a corporation and transferred the assets of the firm to such corporation in payment of his subscription to the corporation stock, and by reason of the lack of fraud on the part of such surviving partner, the court felt constrained to hold that the corporation was not liable on the note. This holding undoubtedly would not meet with favor in view of the modern drift of authority. It is also thought that had the court a clear understanding of the trust-fund doctrine, as well as the rule under consideration, that such a pronouncement would never have been made.[13]

[12] Salamon vs. Salamon & Co. (1897), A. C. (Eng.) 22; 65 L. J., Ch. 35; 75 L. T., N. S. 426; 45 Week Rep. 193; 4 Manson 89.

[13] National Union Bank of Maryland vs. Hollingsworth, 135 N. C. 556; 47 S. E. 618.

It was doubtless upon the theory that the court did not feel itself at liberty to wander so far afield from the trust-fund doctrine theory when it delivered a dictum to the effect that, where a corporation organized itself into a new corporation and took over the assets of the old, it was liable for the debts of the old, but the court observed that a distinction with respect to transactions of this character exists between a corporation and a natural person.[14]

The case of National Union Bank of Maryland vs. Hollingsworth[15] falls into the error of making the same distinction as between a corporation that organizes itself into a new corporation and an individual who organizes himself into a corporation and holding, that in the former case the creditors of the old company could hold the new liable, whereas the creditors of an individual would be without a remedy against his corporation. The trust-fund doctrine would come to the aid of the creditors of the old corporation that had been reorganized into a new and the rule that in a proper case the corporate fiction will be disregarded would afford relief to the creditors of the individual organizing himself into a corporation, and would also afford a remedy to creditors in case of reorganization of a corporation. It is thus seen that the rule under discussion is of more general utility, broader in scope, and has a wider application than the trust-fund doctrine. However, the Supreme Court of Oklahoma adverted to this position that a difference existed between a corporation reorganizing itself into a new corporation and an individual creating a corporation and transferring his property to it, but declined to commit itself even by way of dictum, as in accord with, or contrary to such distinction, but it is clear from a further analysis of the opinion that were the court pressed, it would not follow the doctrine suggested in Hibernia Insurance Company vs. St. Louis & New Orleans

[14] Hibernia Ins. Co. vs. St. L. & N. O. Transportation Co., 13 Fed. 516; 4 McCrary 432.

[15] 135 N. C. 556; 47 S. E. 618.

Transportation Company and followed in the National Union Bank of Maryland vs. Hollingsworth.[16]

It is quite manifest from an examination and analysis of an opinion from the Supreme Court of Kansas, that in a decision of the case, the court was not quite clear whether it was being governed by the trust-fund doctrine, or by an application of the principle that the courts will brush aside the corporate entity in a proper case. In some parts of the opinion, the court is discussing the trust-fund doctrine and in other parts it is dealing with the rule that courts will, under certain circumstances, disregard corporate entities and ultimately holding that the judgment of the lower court could be sustained upon either the theory of the trust-fund doctrine, or by an application of the principle that the courts will, in a proper case, pierce the corporate veil.[17]

It seems, however, that where the trust-fund doctrine prevails, that when the assets of one corporation are transferred to another, either upon express assumption of the debts of the old corporation, or under such circumstances and facts as an assumption of such debts will be raised by implication, then the assets in the hands of the transferee are impressed with a lien in favor of the creditors of the old corporation.[18]

§ 43. Corporate Entity Not Sacred

The fiction of a legal corporate entity cannot be so manipulated and applied by partners, or others, as to work a fraud on their creditors, or hinder and delay them in the collection of their claims. The doctrine of corporate entity is not so sacred that a court looking through form to substance of

[16] Collinsville National Bank vs. Esau, 176 Pac. 514; 74 Okla. 45.

[17] Spadra-Clarksville Coal Co. vs. Nicholson, 93 Kan. 638; 145 Pac. 571; 1916D A. C. 652; Exp. Savings Bank of Rockhill, 73 S. C. 393; 5 L. R. A. N. S. 520; 53 S. E. 614; Cole vs. Millerton Iron Co., 133 N. Y. 164; 28 A. S. R. 615; 30 N. E. 847; 59 Hun. 217; 13 N. Y. S. 851; 38 N. Y. St. R. 34; Hurd vs. N. Y. & Commercial Steam Laundry Co., 167 N. Y. 89; 60 N. E. 327; Reversing 52 App. Div. 467; 65 N. Y. S. 125.

[18] In re Rieger, Kapner & Altmark, 157 Fed. 609; Exp. Savings Bank

things may not, in a proper case, ignore it to preserve the rights of innocent parties or to circumvent fraud.

There is a general doctrine of good faith in every business transaction and this doctrine is just as applicable to juristic creations as natural persons and while it is recognized that, of course, a corporation is an entity separate and distinct from its officers and directors, but in cases where a corporation is organized as part of a fraudulent scheme, courts should not hesitate to go behind the corporate screen and find the real parties, ignoring the corporate existence, if necessary, to circumvent fraud. A corporate entity is not so sacred as to be permitted to become an instrumentality of, or a cloak for, fraud and where a corporation is organized for such purposes, courts are justified in regarding the corporation as a mere association of persons and holding the incorporators individually responsible.[19]

§ 44. The Courts Will Not Be Trammeled by Logic of Corporate Entity

Of late, the courts have refused to be always and utterly trammeled by the logic derived from corporate existence and this is especially true where the corporate existence serves only to distort, conceal, or hide the truth, or where it is injected into a case in the form of a purely technical defense and when such is the case, the courts will not hesitate to refuse to permit the truth to be obscured by corporate forms.[20] And when a proper case is present, the courts will readily permit a disregard of the logic derived from corporate existence.[21]

The abstraction of the corporate entity will not be permit-

of Rockhill, 73 S. C. 393; 53 S. E. 614; 5 L. R. A. N. S. 520.

[19] Pain vs. Kiel, 288 Fed. 527; Dickenson vs. Schee, 4 Fed. (2d) 483; Remington & Son Pulp & Paper Co. vs. Caswell, 126 App. Div. 142; 110 N. Y. Supp. 556.

[20] Anthony vs. American Glucose Co., 146 N. Y. 407; 41 N. E. 23; 66 Hun. 634; 21 N. Y. S. 667; 49 N. Y. St. R. 857.

[21] Cook on Corporations (8th Ed.) secs. 6, 663, 664; Ross vs. Jacobwitz, 216 App. Div. 184; 214 N. Y. Supp. 514; Seymour vs. Spring Forest Cemetery Ass'n, 144 N. Y. 333; 39 N. E. 365; 26 L. R. A. 859; 19 N. Y. S. 94; 45 N. Y. St. R. 520; 64 Hun. 632.

ted to bar out and pervert the real and obvious truth.[22] It is competent for the courts to look back of the mere artificial and formal corpus of the corporate existence and treat the juristic creation and individuals owning all of its stock and assets as identical.[23]

§ 45. Corporate Entity Endures Only For Lawful Purpose

The fiction by which an ideal legal entity is attributed to the duly formed corporation, existing separate and apart from the individuals composing it, is of such general utility and application as frequently to induce the belief that it must be universal, and be in all cases adhered to, although the greatest frauds may thereby be perpetrated under the fiction as a shield. But modern cases sustained by the best text-writers confine the fiction to the purpose for which it was adopted—convenience in the transaction of business, and in suing and being sued in its corporate name and the continuance of its rights and liabilities unaffected by changes in its corporate membership—and, therefore, repudiated in all cases where it has been insisted upon for purposes beyond the lawful purview of its creation, as in cases for the protection of fraud, or any other illegal transaction.[24] So where a corporation was formed for the purpose of effecting an illegal agreement between the corporation and a railroad company for a discrimination in freight rates between the corporation and other shippers, the courts refused to allow the corporate fiction to subserve such an end, and accordingly, granted a recovery to one of the parties who had been discriminated against in a like manner as if the corporation had no existence.[25]

[22] Seymour vs. Spring Forest Cemetery Ass'n, supra; Bauernschmidt vs. Bauernschmidt, 101 Md. 148; 60 Atl. 437; Pott vs. Schmucker, 84 Md. 535; 36 Atl. 592; 35 L. R. A. 392; 57 A. S. R. 415.

[23] Pott vs. Schmucker, supra; Bauernschmidt vs. Bauernschmidt, supra.

[24] First National Bank vs. Trebein Company, 59 Ohio State 316; 52 N. E. 834; Brundred vs. Rice, 49 Ohio St. 640; 32 N. E. 169; 34 A. S. R. 589; Thompson vs. Walker, 234 N. W. (Mich.) 144.

[25] Brundred vs. Rice, supra; First National Bank vs. Trebein Co., supra.

A corporation from one point of view may be considered as an entity without regard to its shareholders, and this view is sustained only so long as the corporation endures for lawful purposes, and beyond that point the fact becomes self-evident that it is not in reality a person, or thing, distinct from its constituent parts. Even the word "corporation" is but a collective name for the members who compose it.

It is doubtful if any general rule can be laid down in the present state of authority, but if a general rule could be formulated, it is perhaps safe to say that a corporation will be looked upon as a legal entity until sufficient reason appears to the contrary; but when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons. It is assumed that this much may be granted and yet not approve the theory advanced that the legal entity is a fiction, or a mere legal creation, or that the idea of invisibility, or intangibility is sophism; and the position that a corporation cannot be used, or endure for any purpose beyond those in lawful contemplation when it was created, does not run counter to the idea that a corporation, as expressive of legal rights and powers, is no more fictitious or intangible than a man's rights to his own home or his own liberty. So the corporate form will not be so far dissipated as to require majority stockholder to account to corporate creditors for the proceeds, arising from the sale of his stock in such corporation, even though the corporation is insolvent.[26]

§ 46. Corporate Entity Disregarded When It Is a Business Conduit of Alter Ego of Stockholders

We have already seen that as early as 1905[27] that the court very diffidently suggested that if any general rule could be

[26] U. S. vs. Milwaukee Refrigerator Transit Co., 142 Fed. 247; Home Fire Insurance Co. vs. Barber, 67 Neb. 644; 93 N. W. 1024; 60 L. R. A. 927; 108 A. S. R. 716; Donaldson vs. Andersen, 150 Atl. (Pa.) 616; Nashville vs. Ward, 16 Lea (Tenn.) 27; 84 Tenn. 27; Ford vs. Chicago

laid down in the state of authority at that time, it was that a corporation could be looked upon as a legal entity as a general rule and until such sufficient reason to the contrary appeared, but when the notion of a legal entity was used to defeat public convenience, to justify wrong, to protect fraud, or defend crime, the law would even at that time regard the corporation as an association of persons, and it was ventured then that that much could be expressed without approving the theory that the legal entity is a fiction, or a mere mental creation, or that the idea of invisibility or intangibility was a sophism and at the same time adhered to the position that a corporation, as expressive of legal rights and powers, was no more a fiction, or intangible than a man's rights to his own home or his liberty.

But since that time the diffidently suggested general rule has received much treatment, and has greatly expanded until today it occupies a fixed position in our system of jurisprudence, and it is possible that general rules could be better formulated in the light of the research, learning, logic, and ability that have been expended upon the development, discussion, and analysis of the rule under consideration, so it now may be stated, with a reasonable degree of assurance of correctness, that when it appears one man, or two men, own the stock and control the policies, and there is such a unity of interest and ownership that the individuality of such corporation, and of such person, or persons, has ceased, and it further appears that the observance of the fiction of separate existence would, under the circumstances, sanction fraud, or promote injustice, then separate corporate existence will be denied.[26] This general rule is equally ap-

Milk Shippers Ass'n, 155 Ill. 166; 39 N. E. 651; 27 L. R. A. 298; Buffalo Loan, etc., Co. vs. Madina Gas, etc., Co., 12 App. Div. 199; 162 N. Y. 67; 56 N. E. 505; 42 N. Y. Supp. 781; Smith vs. Moore, 199 Fed. 689; 182 Fed. 540; 118 C. C. A. 127.

[27] Sec. 45, supra, Smith vs. Moore, supra; U. S. vs. Milwaukee Refrigerator Transit Co., supra.

[28] Wood Estate Co. vs. Chanslor, 286 Pac. 1001; 209 Cal. 241; Ellet vs. Los Altos Country Club Properties, 88 Cal. App. 740; 264 Pac. 270; Minifie vs. Rowley, 187 Cal. 481; 202 Pac. 673; Erkenbrecher vs. Grant,

plicable whether the stockholder is a natural person, or is a jural personality.[29]

§ 47. A Corporate Entity Will Be Ignored in Interest of the Public Good, or For the Benefit of Creditors

The relation of a stockholder to the corporation and to the public who deal with the corporation, might properly be denominated a quasi fiduciary capacity in so far as the stockholder is concerned, and is such to require the utmost good faith and fair dealing in every transaction between the stockholder on the one part and the corporation on the other, which may injuriously affect the rights of creditors, or be detrimental to the general public good, and a most rigid scrutiny will be made into all such transactions in the interest of the public good and on behalf of the rights of creditors.[30]

§ 48. Corporate Entity Regarded Only When For a Lawful Purpose

While it is a theory of law, conceived at an early day in the jurisprudence of the world, and advocated by leading jurisconsults, and sanctioned by judicial authority, that in theory a corporation has a separate and distinct existence from its constituent parts, this is but a fiction and will be disregarded where its recognition would permit the perpetration of fraud, or give sanction to the accomplishment of any unlawful object.[31]

And so it is true that for certain purposes the law will recognize the corporate body as an entity, distinct from the

187 Cal. 7; 200 Pac. 641; Dixie Mining & Mfg. Co. vs. Williams, 128 Southern (Ala.) 799; French Market Ice Mfg. Co. vs. Dalton, 130 Southern (La.) 122.

[29] Sec. 23, supra.

[30] Sawyer vs. Hoag, 17 Wall. 610, 21 L. Ed. 731; Morawetz on Private Corporations (2d Ed.) Secs. 1, 227, 229, 231, 818; in re McCarthy Portable Elev. Co., 196 Fed. 247; 201 Fed. 923; 120 C. C. A. 261.

[31] Lowenstein vs. British-American Mfg. Co., 300 Fed. 853; 7 Fed. (2d) 51.

individual stockholders, but the fact remains that the corporation is a fiction and is resorted to solely for the purpose of working out the lawful object for which the corporation was given existence, and it will never be allowed to be resorted to when to so do it would work an injury to anyone, or allow a fraud to be perpetrated against anybody under the shield of a separate corporate entity.[32]

So, accordingly, the modern view is that the distinction between a corporation as being an impalpable entity, and a corporation as being the living person of whom it consists, is for many purposes a substantial distinction necessarily involved in the creation and the use of corporations, but when it is attempted to use the corporate entity for any purpose beyond the operation of its proper sphere, it is not only a fiction, but under many circumstances, it is a useless and unreasonable fiction.

It is a well settled principle of law in modern times that in certain cases where the corporate fiction can serve no purpose but to accomplish an injustice, and to screen the corporation and its constituent parts from the just consequences of its and their acts, the court will not permit this legal fiction to prevail against real substance. Sometimes the rights, relationships, and liabilities between the corporation and the individuals composing it, are so interlarded that it becomes difficult to follow the line of demarcation between the rights, distinctions, relationships, and liabilities of the corporation and its members. It is often impossible to separate the interests, rights, relationships, distinctions, and liabilities of the individual members in a corporation from the rights, interests, relationships, distinctions and liabilities of the corporation itself.[33]

[32] Chicago & N. W. Railway Co. vs. Whitton, 13 Wall. 270; 20 L. Ed. 571; U. S. vs. Milwaukee Refrigerator Transit Co., 142 Fed. 247; Lowenstein vs. British-American Mfg. Co., supra.

[33] Edwards vs. Stonington Cemetery Ass'n, 20 Conn. 466; Starr Burying Ground Ass'n vs. North Lane Cemetery Ass'n, 77 Conn. 83; 58 Atl. 467.

§ 49. The Rule That Courts Will in a Proper Case, Override the Corporate Existence, Should Not Be Confused With Cases Holding Corporators Liable on Account of Defective Organization

The rule that courts will, in a proper case, brush aside the corporate existence and look to the real parties in interest—deal with substance and refuse to be hampered by form—ought not to be confused with the separate and distinct rule of law that persons assuming to act as a corporation, but not entitled to the use of the corporate form, either *de facto* or *de jure*, and are for that reason liable as partners upon the contracts, obligations, and liabilities of the supposed corporation. The cases are numerous holding that parties who have attempted to incorporate and have fallen short of the consummation, or, who, without attempting to incorporate, assumed to act as such, are liable as partners.[84] The rule under consideration that the courts will, in a proper case, go behind the corporate entity and there deal with the living human beings found, presupposes a valid corporate existence, for in the absence of a valid corporate existence there is little need or justification for invocation of the powers of a court in a proper case to disregard the corporate entity. Neither should the rule be confused with cases fixing liability upon stockholders who continue to exercise corporate functions after the right

[84] Empire Mills vs. Alston Grocery Co., 15 S. W. 200-505; 12 L. R. A. 366; 4 Wilson Tex. Civ. App. 221; Fuller vs. Rowe, 57 N. Y. 23; Cinn. Cooperage Co. vs. Bate, 16 Ky. L. R. 626; 96 Ky. 356; 49 A. S. R. 300; 26 S. W. 538; Simmons vs. Ingram, 78 Mo. App. 603; Seeberger vs. McCormick, 178 Ill. 404; 53 N. E. 340; 73 Ill. App. 87; 175 U. S. 274; 44 L. Ed. 161; 20 S. Ct. 128; Bigelow vs. Gregory, 73 Ill. 197; Meinhard Schaul & Co. vs. Bedingfield Merc. Co., 4 Ga. App. 176; 61 S. E. 34; Brooke vs. Day, 129 Ga. 694; 59 S. E. 769; Lynch vs. Perryman, 29 Okla. 615; 1913A A. C. 1065; 119 Pac. 229; Perrine vs. Levin, 68 Misc. 327; 123 N. Y. Supp. 1007; Campbell vs. J. I. Campbell Co., 117 La. 402; 117 La. 418; 41 Southern 696; 41 Southern 702; Montgomery vs. Forbes, 148 Mass. 249; 19 N. E. 342. So it would seem when a foreign corporation is found doing business in a state in violation of its laws that there is no application of the rule of disregarding corporate entity, but that the entity does not enter into the matter at all. See secs. 477, 478, infra.

thereto has ceased to exist under the law, either by a dissolution of the corporation, or by reason of the expiration of the corporate charter.[35]

§ 50. Corporate Charter Granted For Useful Purpose. Disregarded When Used For Any Other Purpose

A corporation is a distinct entity, and property acquired by it belongs to it and not to its stockholders and has been held true even when all of the stock is owned by one person.[36] This is what is known as the entity rule, but there is an exception to the entity rule where its recognition would result in promoting illegality, fraud, or injustice. In other words, since the franchise is granted by the state for a useful and valid purpose, it may not be employed to further wrong, or its operation will not be allowed in any field that is without the useful and valid purposes for which it was granted, and where it is so employed, the courts will, in the administration of law, disregard the entity rule and go behind the fiction and treat the stockholders as if the corporation did not exist.[37]

§ 51. If the Purpose and Intent of the Corporation Are Bad, the Entity Will Not Be Recognized

Corporations cannot be used as a cover under which wrongs may be committed and fraud perpetrated. In such a case

[35] Central City Savings Bank vs. Walker, 66 N. Y. 424; Ewald Iron Co. vs. Com., 140 Ky. 692; 131 S. W. 774; 142 Ky. 465; 134 S. W. 481.

[36] Hollins vs. Brierfield Coal & Iron Co., 150 U. S. 371; 14 S. Ct. 127; 37 L. Ed. 1113; Donnell vs. Herring-Hall-Marvin Safe Co., 208 U. S. 267; 28 S. Ct. 288; 52 L. Ed. 481; McCaskill Co. vs. U. S., 216 U. S. 504; 30 S. Ct. 386; 54 L. Ed. 590; Atchison T. & S. F. Ry. Co. vs. Weeks, 248 Fed. 970; 254 Fed. 513; 166 C. C. A. 71; 249 U. S. 602; 39 S. Ct. 259; 63 L. Ed. 797. See, however, secs. 84, 85, infra; Peckett vs. Wood, 234 Fed. 833; 148 C. C. A. 431.

[37] McCaskill Co. vs. U. S., supra; U. S. vs. United Shoe Machinery Company, 234 Fed. 127; Linn & Lane Timber Co. vs. U. S., 236 U. S. 574; 35 S. Ct. 440; 59 L. Ed. 725; 196 Fed. 593; 116 C. C. A. 267; 203 Fed. 394; 121 C. C. A. 498; Eichelberger vs. Arlington Building, 280 Fed. 997; 52 App. D. C. 23.

the court will look through the form of the corporation to ascertain its actual purpose and intent, and if the purpose and intent of the corporation are bad, its corporate entity cannot be used to subserve such a purpose and intent.[88]

[88] MacFadden vs. Jenkins, 40 N. D. 422; 169 N. W. 151; Clark vs. Millsap, 242 Pac. 918; 197 Cal. 765; Lowenstein vs. British-American Mfg. Co., 300 Fed. 853; 7 Fed. (2d) 51.

CHAPTER V

CASES CALLING FOR DISREGARD OF CORPORATE ENTITY AS SUI GENERIS

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Section

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76. When corporations organized to conduct the owners' business, its acts are the owners'.
77. Entity not disregarded where a corporation is formed by an agent at the instance of his principal.
78. Where one owns all, or even practically all of the stock of a corporation, is regarded as the corporation's double.
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80. A group of persons of the same family may choose to form one or more corporations for conduct of business and the entities will be held separate.
81. Where corporations attempt to consolidate in the absence of statutory authority the corporation having the assets is liable for obligations of both.
82. Equity will not hesitate to look through one-man corporations.
83. Sole owner of a corporation may pay his debts with corporate securities.
84. Effect of all stock being owned by one person.
85. Where one person is sole owner of the corporate stock, he may mortgage or convey corporate property; all stockholders may bind corporation by contract.
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87. Corporation is obligated for acts of its owners as if it did not exist.
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96. Corporate entity disregarded to relieve a legatee or devisee of an indebtedness of a corporation where such legatee is sole owner thereof.
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98. One corporation organizing another to sell its stock, responsible for the acts of the stock-selling company and notes and mortgages given it will be cancelled in the hands of the parent corporation.
99. Corporate entity disregarded to hold practical owner of its stock on oral guaranty of payment of mortgage.

§ 52. Each Case Involving the Question of Whether or Not the Court Will Disregard the Corporate Entity Regarded As Sui Generis

The fiction of corporate entity may be disregarded where one corporation is so organized and controlled, and its affairs are so conducted that it is in fact a mere instrumentality or adjunct of another.[1] But it is true that no all-embracing rule upon this subject has been laid down by which it may be determined when the rule will be applied, and when relief or the application of the rule will be denied; but it follows that applying the general principle enunciated and epitomized in

[1] Matter of Watertown Paper Co., 169 Fed. 252; 94 C. C. A. 528; in re Muncie Pulp Co., 139 Fed. 546; 71 C. C. A. 530; 202 U. S. 621; 26 S. Ct. 766; 50 L. Ed. 1175; Gay vs. Hudson River Elec. Power Co., 187 Fed. 12; 109 C. C. A. 66; Pittsburgh & Buffalo Co. vs. Duncan, 232 Fed. 584; 146 C. C. A. 542; New York Trust Company vs. Carpenter, 250 Fed. 668; 163 C. C. A. 14; Majestic Co. vs. Orpheum Circuit, 21 Fed. (2d) 720.

the cases cited in the footnotes to this section, that each case should be regarded as a *sui generis* and unless a competent authority is at hand, the decision being sufficiently analogous, should be given controlling effect.[2]

So, accordingly, it has been so difficult to enunciate general principles that would serve as guides in the decisions of the different cases arising, that it seems very useful that there should be a collection of the different cases involving the matter under consideration. This is occasioned by reason of the fact that courts, in making application of the rule under consideration, have reached different conclusions upon similar state of facts of the cases; so it has been stated that whether a particular state of facts call for a disregard of the corporate entity, depends upon the circumstances of each particular case.[3] However, Lord Mansfield declared contrary to this position that: "The law does not consist of particular cases, but of general principles which are illustrated and explained by these cases."[4]

§ 53. The Modern Tendency of Courts Is to Disregard Corporate Fiction

The number of decisions disregarding the corporate entity is rapidly increasing and considerable effort has heretofore been made to classify the cases under some well defined rules of corporation law.[5] Moreover, it may now be said that there is a consistent determination by the courts of this country to look through corporate form, and this disposition is shown with increasing firmness as the interests of justice require.[6] The principle that the courts will disregard the corporate entity, and deal with substance, and ignore mere fiction and

[2] Industrial Research Corp. vs. General Motors Corp., 29 Fed. (2d) 623.
[3] Collinsville National Bank vs. Esau, 176 Pac. 514; 74 Okla. 45; Batchelder vs. Batchelder, 220 Mass. 42; 107 N. E. 455; Gardiner vs. Burrill, 225 Mass. 355; 114 N. E. 617.
[4] Dec. 1930 U. S. Law Rev. 635.
[5] Sneed vs. Santiam River Timber Co., 122 Ore. 652; 260 Pac. 237.
[6] Auglaize Box Board Co. vs. Hinton, 100 Ohio St. 505; 254 U. S. 610; 41 S. Ct. 60; 126 N. E. 881; 65 L. Ed. 437.

form, has become so deeply engrafted upon the system of jurisprudence prevailing in this country, that it may now well be stated that the modern tendency of courts—and it is thought a tendency in the interest of justice—is to disregard the corporate fiction when the same is invoked for any illegal purpose, or to subserve any end that is improper.[7]

§ 54. The Rule That the Court Will, in a Proper Case, Override Corporate Entity Is Becoming Applicable More and More

It is true that where the corporate form is used by individuals for the purpose of evading the law, or for the perpetration of fraud, the court will not permit the legal entity to be interposed so as to defeat justice. The necessity for this rule is becoming more apparent each day and is becoming more and more applicable to transactions finding their way into courts and this is true not only in the maintenance of private rights, but for the preservation of public rights in the regulation and necessary control of large corporations.[8]

We have already seen that perhaps no all-comprehensive general rule could be laid down as a guide in the cases where a court should, or should not override the corporate entity,[9] still it has been undertaken to formulate four general factors, and it has been accordingly stated that there are four principal considerations as factors in entering into each case and that the underlyng essentials of these factors concisely stated are:

First, ownership of stock of one corporation by another, or, the identity of stockholders.

Second, identity of directors and officers.

[7] Goodwin vs. Albilene St. Bank, 294 S. W. (Tex.) 883, 287 S. W. 1111; 20 S. W. (2d) 1090.

[8] State vs. Creamery Package Mfg. Co., 126 N. W. 126; 110 Minn. 415; 136 A. S. R. 514; Erickson vs. Revere Elev. Co., 110 Minn. 443; 126 N. W. 130.

[9] Sec. 53, supra.

Third, the manner of keeping the books and records; and

Fourth, the method of conducting the business.[10]

This is by no means an adequate statement of the situations to which the rule is applicable. The four propositions outlined above omit many cases that come clearly within the rule; such, for instance, as the case where an individual organizes himself into a corporation and transfers his property to it; such, for instance, where the stockholders reorganize the old corporation into a new, transfer the assets to the new, and take stock of the new for such transfer.[11] As to relationship between parent and subsidiary, and as to overriding entities, it has been suggested the following pertinent characteristics:

Other writers have suggested that, (1) Ownership of all the stock of a subsidiary; (2) ownership of a majority of stock of a subsidiary or a controlling interest therein; (3) ownership by the same persons of the stock of both corporations; (4) sufficiency or insufficiency of the capital of the subsidiary as measured by that employed in normal competitive units; (5) degree to which subsidiary is financed by the parent; (6) method of financing; (7) the extent to which there is a common directorate; (8) the extent to which there are common officers and employees; (9) the extent to which separate meetings of stockholders and directors are held; (10) the extent to which both had common departments of business; (11) degree to which interests between the two corporations were favorable to one rather than the other; (12) the extent to which separate books and accounts are kept; (13) the extent to which an officer or director of one was permitted to determine the policies of the other; (14) the extent to which an employee, officer, or director of the parent was casually connected with the tort or contract on which suit is brought; (15) the type of business of each; (16) the extent

[10] 4 Minn. Law Rev. 221.
[11] Sec. 130, infra.

to which the trade or public generally regarded the two business units as one unit; (17) whom the contract claimant regarded as the promisor; (18) the extent to which there are conveyances by the subsidiary to the parent in fraud of creditors of the former.[12] Even in dealing with disregard of entities between parent and subsidiary it cannot be said these characteristics are a mechanical open sesame.[13]

The Supreme Court of California essayed to state a general rule, and which is perhaps correct, if the facts of the particular case come within the rule as stated, but not sufficiently broad to comprehend all cases, and the rule there laid down is, that before the acts and obligations of a corporation can be legally recognized as those of a particular person, and *vice versa*, the following combination of circumstances must be made to appear:

First, that the corporation is not only influenced and governed by that person, but that it is such a unity of interest and ownership, that the individuality and separateness of said persons and corporation has ceased.

Second, that the facts are such that an adherence to the fiction of a separate existence of the corporation would, under the particular circumstances, sanction a fraud, or promote injustice.[14]

It is perhaps true that a very limited number of cases arising, calling for an application of the rule, could be said to come within the first proposition laid down by the court. That proposition, however, clearly fails to comprehend those cases where an individual organizes himself into a corporation, or where there is a reorganization of a corporation and the property of the old corporation is placed in the name of the

[12] Douglas & Shanks Insulation From Liability Through Subsidiary, 39 Yale L. J. 193; see also 29 Yale L. J. 659; XXXV Com. L. J. No. 11, 684.

[13] XXXV Com. L. J., supra.

[14] Minifie vs. Rowley, 202 Pac. 673; 187 Cal. 481; Continental Securities & Investment Co. vs. Rawson, 280 Pac. 954; 208 Cal. 228; Erkenbrecker vs. Grant, 200 Pac. 641; 187 Cal. 7; Llewellyn Iron Works vs. Abbot Kinney Co., 172 Cal. 210; 155 Pac. 986; Schmitt vs. Northern Counties Land & Cattle Co., 292 Pac. (Cal.) 173.

new, and the stock of the new is issued to the stockholders of the old and no provision is made for the payment of the old corporate debts, and possibly other situations could be suggested where it is wholly inapplicable. But as to the second proposition, as laid down by the court, it is thought that it is broad enough to comprehend any case that might arise, calling for application of the doctrine under consideration, as we shall presently have occasion to see by a statement of general rules laid down by different courts.[15]

§ 55. No Statutory Authority Required to Confer Upon Courts the Right to Apply Rule

The facts of a given case, if they are sufficient to require a court of equity to disregard the corporate entity, it will be done and no statutory authority is necessary for the court to exercise the jurisdiction, as courts of equity have always had inherent power in such cases to treat the corporation and the individuals owning its stock as identical, and so the corporate entity, existing as such, and entirely distinct from its members, may be ignored in order to circumvent the fraudulent purpose of the stockholders in its organization. Likewise, this may be done in order to redress wrongs committed including fraud, and to protect rights of third parties or to prevent a palpable injustice, and when this situation arises, equity will interfere and cast aside the legal fiction of corporate existence and deal with the corporation and its stockholders as identical entities, and with identical duties and obligations.[16] And so it has come to pass that not only courts of equity will, in a proper case, disregard the corporate fiction, but courts of law as well, will exercise this jurisdiction, contrary to the axiomatic expression that equity follows law—law follows equity.[17] This is undoubtedly an application of common-law principles.

[15] Sec. 56, infra.

[16] Ayer & Lord Tie Co. vs. Com., 208 Ky. 606; 271 S. W. 693; Clark vs. Millsap, 242 Pac. 918; 196 Cal. 765.

[17] Llewellyn Iron Works vs. Abbot Kinney Co., supra; Com. Security

§ 56. General Statements of the Rule of Disregarding Corporate Fiction by Different Courts

The distinction between the conduct of the corporation and of its stockholders is of importance and of controlling influence when the question involved arises between the corporation and its stockholders, or between the corporation or its stockholders and third persons, but this distinction rests upon a mere fiction that the corporate existence and corporate fiction are distinct from that of the stockholders. This fiction is introduced for convenience and to subserve the ends of justice, but when it is invoked in support of an end subversive of its policy, it should be and will be disregarded by the courts.[18] It is clear that a body corporate cannot maintain a suit for equitable relief except as representatives of the stockholders. It necessarily must follow that if the shareholders are without equity, that they cannot, through the corporate organization, or in its name, obtain relief, either for themselves or for the corporation. In equity, the conception of a corporate entity is used merely as a formula for working out the rights and equities of the real parties in interest.[19] The courts will disregard corporate form when justice requires it, to look to the substance and not to the shadow.[20]

A long line of decisions will be found where it is held that where a person, firm, or corporation shall have reorganized and continued its or their business under the form of a cor-

Co. vs. Modesto Drug Co., 184 Pac. 964; 43 Cal. App. 162; Erkenbrecker vs. Grant, 187 Cal. 7; 200 Pac. 641; Midwest Air Filter Pacific Co. vs. Finn, 258 Pac. 382; 201 Cal. 587; Home Fire Insurance Co. vs. Barber, 67 Neb. 644; 93 N. W. 1024; 60 L. R. A. 927; 108 A. S. R. 716; State Trust & Savings Bank vs. Hermosa Land & Cattle Co., 240 Pac. 469; 30 N. M. 566; Bryan vs. Banks, 277 Pac. (Cal.) 1075; 98 Cal. App. 7[illegible]8. Not only will courts override corporate forms, but boards and commissions having taxing power will do likewise. Palmolive Co. vs. Conway, 43 Fed. (2d) 226.

[18] Southern Elec. Sec. Co. vs. State, 91 Miss. 195; 44 Southern 785; 124 A. S. R. 638.

[19] Home Fire Ins. Co. vs. Barber, 67 Neb. 644; 60 L. R. A. 927; 108 A. S. R. 716; 93 N. W. 1024.

[20] Phoenix Safety Inv. Co. vs. James, 28 Ariz. 514; 237 Pac. 958; Mosher vs. Lee, 261 Pac. 35; 32 Ariz. 560.

poration, under such circumstances as to show such corporation to be nothing more nor less than a continuation of the former business, either because there is absolutely no change in the personnel of the ownership, nor in the kind of business carried on, or if there is any change in the personnel, it appears that the additional parties were such in name only, really deriving their interest from the prior concern, then the new corporation is but a successor of the former concern and liable, as such, for its debts. It will be found, however, in this class of cases, that assets of the corporation were practically identical with those of the former concern.[21]

Practically all of the authorities agree that in certain cases, and at certain times, a corporation is to be regarded as a legal entity and personalty. There is also a substantial agreement that at certain times the fiction of corporate entity is inapplicable. Sometimes a corporation is looked upon as a unit, at other times as a collection of persons.

The doctrine of separate existence may be carried too far and is properly disregarded in cases of fraud, circumvention of contract, of statute, public wrong, monopoly, and like instances. If any general rule can be laid down in the present state of authority, it is that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears, but when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons only.[22]

A corporation will be regarded as a legal entity, separate and distinct from its stockholders, unless such consideration is offered to defeat public convenience, justify wrong, protect fraud, or defend crime, in which case the corporation will be regarded as an association of persons only.[23]

[21] Byrne & Hammer Dry Goods Co. vs. Willis Dun & Co., 23 S. D. 221; 29 L. R. A. N. S. 589; 121 N. W. 620.

[22] State Trust & Savings Bank vs. Hermosa Land & Cattle Co., 30 N. M. 566; 240 Pac. 469; U. S. vs. Milwaukee Refrigerator Co., 142 Fed. 247; 1 Fletcher Cyc. Corp. 56.

[23] Smith vs. Moore, 199 Fed. 689; 118 C. C. A. 127; 182 Fed. 540.

Although there is a commingling of officers and directors of two corporations, still this fact standing alone does not prevent both corporations from maintaining separate and distinct entities with the concomitant right to contract with each other in their respective corporate capacities. Moreover, the corporations may not only contract with each other in their corporate capacities, but likewise they may sue and be sued by each other in regard to such contracts, or other accruing causes of action, but at all times it must be remembered that in such transactions and relationships, the privileges thus accorded by law must not be abused. It seems to follow as an illative result of these legal principles that the fact that the stockholders of two separately chartered corporations are identical; that one owns shares in the other; and that they have mutual dealings, nothing else appearing, will not as a general rule operate to merge them into a single corporate entity.[24]

So where two corporations are engaged in the same line of business, but operate separately, and both corporations have the same president, and the holders of the majority of the stock in both are the same, and the majority of the board of directors are the same, such facts will not of themselves make the two corporations one and the same, where they continued to maintain two distinct organizations and maintained their separate legal entities.[25] It is true that a corporation is a legal entity, which is entirely distinct from the individuals who compose it, and some courts maintain this distinction even when all of the stock of the corporation is owned by one individual,[26] but the modern rule is such as will not permit this doctrine to become a shield for the contrivers of fraudulent schemes. So it is held that in an appropriate case, and

[24] Jones Lumber Co. vs. Wisarkana Lumber Co., 125 Ark. 65; 187 S. W. 1068; Leavenworth vs. C. R. I. & P. Railway Co., 134 U. S. 688; 10 S. Ct. 708, 33 L. Ed. 1064; see secs. 26, supra, 69, infra.

[25] Baker vs. Bowie Lumber Co., 151 La. 598; 92 Southern 129; Lombard vs. Bowie Lumber Co., 151 La. 606, 92 Southern 132.

[26] For the effect of all stock becoming concentrated in a single stockholder, see sec. 84.

in the furtherance of the ends of justice, a debtor corporation and the individual owning all of its stock and assets, will be treated as identical, even independent of any question of fraud.[27]

§ 57. Legal Entity Not Regarded If to Do So Gives Litigant Advantage Over Another

It has been held that in general, the legal entity may be even disregarded if it is invoked for the purpose of giving one litigant an advantageous position over another, and a position that such litigant would not otherwise have and to which such litigant is not justly entitled.[28]

§ 58. Entity May Not Be Carried to the Extent of Its Recognition Impairing Constitutional or Statutory Property Rights of Stockholders

The corporate entity will not be adhered to, nor its recognition carried to the extreme where to do so it would result in an impairment of the constitutional property rights of its innocent stockholders.[29] Of course if the corporate entity runs counter to the constitution, it must give way to the organic law. It would surely be true too, that the recognition of entity of corporations could not be carried to extreme of conflicting with statutory provisions.

§ 59. Operation of Rule That Courts Will Disregard Corporate Entity Not Confined to Cases Involving Rights of Creditors

While many cases in which the courts have applied the rule that in proper cases the corporate entity will be disre-

[27] Pott vs. Schmucker, 84 Md. 535; 36 Atl. 592; 35 L. R. A. 392; 57 A. S. R. 415; Roberts vs. W. H. Hughes Co., 86 Vt. 76, 83 Atl. 807; Birmingham Realty Co. vs. Crossett, 98 Southern 895; 210 Ala. 650.

[28] In re Home Mutual Aid Ass'n, 3 Ohio N. P. 145; 4 Ohio S. & C. P. Decisions 272.

[29] Wheeling Bridge & Terminal Railway Co. vs. Gilmore, 8 Ohio C. C. 658; 4 Ohio C. D. 366.

garded and the parties as living, acting individuals will be dealt with, were in cases dealing with the rights of creditors, manifestly no reason is perceived why the principle does not apply equally in other cases where the ends of justice require it. So, it would seem to follow, the rule calling for disregard of corporate fiction is by no means to be employed exclusively by creditors seeking to reach debtor's property.[30]

§ 60. Courts Are Not Powerless to Grant Relief to Minority Stockholders by Reason of Corporate Entity

In a case where there was a consolidation of two corporations over the objection of minority stockholders, which consolidation was attacked on the basis of fraud on the part of the stockholders consolidating, and where counsel for such stockholders argued with such ingenuity and persuasive force that the court felt commanded admiration, counsel's position being, that conceding the wrong, there were many reasons why a court of equity could not apply a remedy. Counsel contended that the existence of the consolidated corporation could not be collaterally assailed and annulled by private parties and that it was vulnerable to attack at the instance of the state only, and cited a long line of cases in support of that contention. However, in disposing of that position, the court replied that the perpetrator of fraud, or the abuser of a trust, or their privies, could not shield themselves behind the inactivity of the state, quiet the conscience, and escape the grasp of a court of chancery more successfully by appropriating the property of a *cestui que* trust by means of a consolidation of corporations, than could be done by a decree of foreclosure and sale,[31] by a transfer of all the property of a corporation on its dissolution,[32] by a lease,[33] or by any other legal device that may happen to be adopted.

[30] Phoenix Safe Inv. Co. vs. James, 237 Pac. 958; 28 Ariz. 514.
[31] Jackson vs. Ludeling, 21 Wall. 616; 22 L. Ed. 492.
[32] Ervin vs. Ore. Railway & Navigation Co., 20 Fed. 577.
[33] Meeker vs. Winthrop Iron Co., 17 Fed. 48; but see 122 U. S. 635; 30 L. Ed. 1243.

Moreover, such position that the state only can complain, of a fraudulent consolidation of corporations, overlooks the true nature and purpose of such actions. The gravamen of the pleadings in such actions, when properly framed, is to recover their just share of the property that has gone into the consolidation, and not to destroy the existence of the consolidated corporation. In other words, the end sought to be accomplished in such case is not the ouster of that corporation, as would be if the state exhibited its complaint to a court of equity, but the restoration to the holders of the minority stock of one of the consolidating companies of their share of the property of that company, or its value. So it is that the rule that the existence of a corporation may not be collaterally assailed by a private individual, constitutes no bar in such case by minority stockholders to avoid fraud, breach of trust, or a contract and act of consolidation, and to restore the property of the corporation injured to its former owners.[84]

§ 61. The Rule That Courts Will Go Behind the Corporate Entity Not Applied Unless There Is Showing That Stockholders Were the Same or Had Common Directorate

It seems essential and indispensable that in order to move a court to apply the rule and brush aside the corporate entity, where the question involves two corporations, there must be some showing that the stockholders in the two corporations, where it is sought to hold one as an instrumentality or adjunct of another, were the same in each corporation in whole or in part, or possibly that the two companies had a common directorate, mere ownership of stock not being sufficient to call for a disregard of the corporate entity,[85] it must be shown —in addition to stock ownership—that the separate existence of the corporation, is a mere sham, or has been used as an

[84] Jones vs. Mo. Edison Elec. Co., 144 Fed. 765; 75 C. C. A. 631; reversing 135 Fed. 153.

[85] Sec. 19, supra.

instrument for concealing the truth, or that the organization and control of one of the corporations is shown to be such that it is but an instrumentality or adjunct of the other corporation.[36]

§ 62. Theory That Courts Will Disregard Entity Only on the Ground of Agency or Estoppel

There are some courts that feel the binding effect of the corporate entity, and they decline to disregard it except upon the grounds of agency or estoppel, and the position of such courts is summarized that if the corporation is an agent of another, owning its stock, or not, as the case may be, through which the other as principal, disclosed or undisclosed, carries on business, the liability of the principal will be ascertained through principles of law well known and long established.[37]

And accordingly, this line of cases subscribes to the doctrine that no corporation, acting within its powers, could be held liable for the debts of another corporation legally organized because it controls such corporation by reason of ownership of stock, or otherwise, except by reason of contract, or on grounds of agency, or of estoppel, or because the controlled corporation has been used in such a way that the maintenance of its character as a separate and distinct entity would work an injury.[38] Of course, if the court means to say that the entity should be disregarded in all cases where to recognize it would work an injustice, then there is no complaint or stricture to be placed upon the statement of the rule, but if by the language used, the court intends to restrict the operation of the principle, the court will, in a proper case, go behind the corporate entity, then the holding is indeed too

[36] Martin vs. Development Co. of America, 240 Fed. 42; 153 C. C. A. 78; Pittsburgh & Buffalo Co. vs. Duncan, 232 Fed. 584; 146 C. C. A. 542; Comm. vs. Muir, 170 Ky. 435; 186 S. W. 194; U. S. Smelting R. & M. E. Co. vs. Wallapai M. & W. Co., 27 Ariz 126; 230 Pac. 1109.

[37] New York Trust Co. vs. Carpenter, 250 Fed. 668; 163 C. C. A. 14.

[38] New York Trust Co. vs. Carpenter, 250 Fed. 668; 163 C. C. A. 14.

narrow and is not in accord with the modern trend of authority.

The better position seems to be expressed that to disregard the fiction of a separate corporate entity, it is unnecessary even to show actual fraud. It is sufficient if a refusal to recognize the identity of a corporation with that of an individual would bring about inequitable results. So, upon a showing that a corporation is an instrumentality merely through which business is done for convenience, or otherwise, the courts will look to substance, and this is true whether the proceeding is in equity or at law, and will hold the responsbile parties obligated for the acts of such corporation.[39]

§ 63. Entity Disregarded to Protect Real Parties in Interest

That under certain circumstances, the legal entity of a corporation must be entirely disregarded, is pointed out by the courts and the courts have had frequent occasion to consider facts and circumstances and to apply the law to such facts and circumstances. It would indeed be a mere travesty of justice if courts could or should refuse to look behind the mere form of a transaction in order to ascertain the real truth and to reach and hold responsible and protect the real parties in interest.

So it is that courts no longer hestitate to look through form to substance and ignore a mere colorable corporate entity to the end that the rights of third parties shall be protected.[40] It is indeed hard, however, to reconcile even some recent opinions from courts of high repute, such for instance as Briggs & Company vs. Harper Clay Products Company,[41] from the Supreme Court of Washington, wherein the court seems to have taken the position that there must be such a commingling of affairs of a dominant person with that of a corporation as to work a fraud on rights of third persons

[39] Wenban Est. vs. Howlett, 227 Pac. 723; 193 Cal. 675.
[40] Western Sec. Co. vs. Spiro, 62 Utah 623; 221 Pac. 856.
[41] 272 Pac. 962; 150 Wash. 235.

before the court can find itself justified in piercing the veil of the corporate entity and in holding the corporation and private person as one in law. It is indeed hard to conceive how courts can take such a position in the light of modern authority, and it is thought that such cases merely represent lapses of judicial consideration.[42]

§ 64. In Some States Corporate Entity Not Favored by Courts

The inroads made on the territory occupied by the position that a corporate fiction must be sustained against all attacks, have been made to such an extent, and have progressed so far that it is now true that in some states at least, the corporate entity is even brought under disfavor when it comes before the courts and the courts broadly take the position that the fiction that the corporation is a being, independent of and separate from those who are associated as its stockholders, is not favored.[43]

§ 65. The Ease of Organizing a Corporation, and the Facility of Manipulation Ought to Dispose Courts to Disregard Corporate Entity

In the modern method of doing business, and especially in view of the ease with which a corporate charter may be secur-

[42] However such cases are becoming fewer and fewer and indeed sporadic, yet the extreme to which some courts go in blinding themselves, by the adherence to the corporate entity, is well illustrated by a decision from Massachusetts where a manufacturing company engaged in one line of business began the manufacturing of automobiles, and operated this venture as a separate department of its business and under a trade name different to the corporate name. Later this department was incorporated under such trade name. Both corporations had the same officers and largely the same stockholders. At the time of incorporating such department under such trade name, an automobile was registered in the name of the first corporation, but was transferred to the new corporation, which registration was not changed. The law required motor vehicles to be registered in the name of the owner. An accident occurred at a railway crossing, involving such automobile. It was held no recovery could be had because of such lack of registration. Manifestly both corporations were the same. It ought to be said, however,

ed and the facility with which a corporate entity may be manipulated by its creators, and made a shield for their protection, and how easily the corporate entity may be so manipulated as to hide and cover up fraud, misdeeds, and questionable transactions, all should be taken into consideration and should dispose the courts to look through any such intended veil of corporate fiction into the face of the individual or individuals hiding behind it.[41] It suggests itself that possibly strength was given to the corporate entity and a high regard was held for it because in ancient times it took the solemn act of a royal grant to bring it into existence and so much solemnity was attached to its creation, that it rather deterred the courts to make bold to assert that they would venture upon the semisacred territory that was thus granted by the royal act, and in later times corporations were largely brought into existence by special legislative enactments in this country and that served to create a hesitancy on the part of courts to question an act of the legislative department, but since corporations are created under a grant of authority from the legislative branch of the state, it seems that the courts are not imbued with a high regard for the sanctity of the corporate creation.

§ 66. The Modern Tendency Supports the Philosophy Gained by Ignoring the Corporate Entity

Undoubtedly, philosophy has gained by the successful attempts in recent years to look through the fiction of a corporation to the fact, and such a philosophy is so thoroughly established that it now may be well said that the courts, both state and federal, follow a tendency to disregard the theory of a corporation as an entity, separate from its corporators,

that the court was not pressed to dissipate the corporate fictions. Chase vs. New York Central R. Co., 208 Mass. 137; 94 N. E. 377; see criticism of this case Feb. 1931 U. S. Law Rev. 23.

[42] Dow vs. Northern Railroad Co., 67 N. H. I; 36 Atl. 510; Bowditch vs. Jackson, 76 N. H. 351; 1913A A. C. 366; 82 Atl. 1014; 1917A L. R. A. 1174; 239 U. S. 627; 36 S. Ct. 164; 60 L. Ed. 474.

[43] T. Towles & Co. vs. Miles, 131 Tenn. 79; 173 S. W. 439.

where justice between the real parties will require it, and that a view that holds otherwise must be deemed as archaic and as based upon a slavish adherence to the fetish that a corporation is an entirely separate entity from its corporators and is followed by losing sight of the substantial facts and the lawful rights of the real parties in interest.[45]

§ 67. Distinction Between Corporation and Stockholders Disregarded When Against Public Policy

The distinction between a corporation and its stockholders is of importance and under many circumstances of controlling influence when it involves questions in some instances arising between the corporation and its stockholders, or between the corporation or its stockholders, and third persons, but even then it is only recognizable when within the operation of its proper sphere. However, in all cases this distinction rests upon a mere fiction that the corporate existence and the corporate functions are distinct from that of the stockholders The introduction of this fiction has been permitted and sanctioned for convenience and in the ends of justice and not contrary thereto, and when the corporate entity is invoked in opposition to, or subversive of the policy of the state, it should be, and is disregarded by the courts for in the creation of the corporation in the interest of public weal there never could be ascribed to the state a purpose in granting a charter to a corporation to be utilized by such juristic creation in contravention of the public policy of the granting authority.[46]

So it is true that equity will not be abashed by forms or fictions nor bound by technical rules but will penetrate to the very substance of the matter and a corporation, being a legal fiction which has its appropriate purpose and use, but it can

[45] Spadra-Clarksville Coal Co. vs. Kan. Zinc Co., 93 Kan. 638; 145 Pac. 571; 1916D A. C. 652; Berry vs. K. C. Ft. S. & M. Railway Co., 52 Kan. 759; 34 Pac. 805; 39 A. S. R. 371; Altoona vs. Richardson, 81 Kan. 717; 106 Pac. 1025; 26 L. R. A. N. S. 651; Donnell vs. Herring Hall Marvin Safe Co., 208 U. S. 267; 28 S. Ct. 288; 52 L. Ed. 481.

[46] Southern Elec. Sec. Co. vs. State, 91 Miss. 195; 44 Southern 785; 124 A. S. R. 638; U. S. vs. Milwaukee Ref. Transit Co., 142 Fed. 247.

never be urged to an intent and purpose not within the reason and the policy of its organization.[47]

§ 68. The Rule That the Courts Will Override Corporate Entity Applies to Municipal Corporations

The principle that the corporate entity in a proper case will be disregarded by courts, and substance and not form will be looked to and dealt with, is by no means hampered in its application, or confined in its operation to private corporations but will apply with equal force and vigor in proper cases to municipal corporations. Indeed the renaissance of the rule in comparatively modern times took place in a case involving the disregard of a municipal corporate entity—the City of London. In an action it was sought to assert rights of the municipality in the mayor's court. The corporate fiction of London was ignored and it was denied the right to redress its wrongs before its mayor and alderman, who presided over its court.[48] So a change in the charter of municipal corporations in whole or in part by amendment or even by substitution of a new charter in the place of the old, so long as it embraces substantially the same corporators and territory, in the absence of a declaration by the legislative authority to the contrary, will not be deemed a new corporation, or relieve it of any prior existing obligations.[49] So where two municipal corporations are consolidated and the new corporation receives assets of value, or in a case where one municipal corporation is absorbed by another and receives its properties, the new consolidated or absorbing corporation will be liable for the liabilities of the old municipal corporation, although this liability may be confined to the assets and properties received by such consolidated, or absorbing corporation.[50]

[47] Keokuk Elec. Railway & Power Co. vs. Wiesman, 146 Iowa 679; 126 N. W. 60.

[48] Broughton vs. Pensacola, 93 U. S. 266; 23 L. Ed. 896; City of London vs. Wood, 12 Mod. 669; see also sec. 28, supra; Thompson vs. Abbot, 61 Mo. 176; Walker vs. Rome, 6 Ga. App. 59; 64 S. E. 310; University of Ala. vs. Moody, 62 Ala. 389.

[49] Broughton vs. Pensacola, supra.

[50] Walker vs. Rome, supra; Thompson vs. Abbot, supra; Univ. of Ala. vs. Moody, supra.

§ 69. Not Enough to Disregard Corporate Entity Because Corporations Have Same Stockholders

It is not enough to move the court to brush aside the corporate entity and treat two corporations as one because they have the same stockholders where the entities are otherwise kept up and there is not such a commingling of affairs and records as to destroy the demarcation between the respective entities. So, accordingly, a maritime lien may be asserted when the lien claimant has largely the same stockholders as the corporation against which the lien is sought to be established.[51]

§ 70. Ownership of All the Stock by an Individual Makes Corporation and Such Individual As One

The modern rule, supported by well considered cases, fortified by reason, and sustained by logic, is that where an individual owns all, or even practically all of the stock of a corporation and controls its policies and operation, the corporation and such individual are, in proper cases, and sufficient reason appearing therefor, regarded by the courts as one and the same.[52]

So it is that where all of the stock is owned by one man and the corporation is, what is sometimes termed, "a one-man corporation," that in such case the sole owner of the stock *may* do what he pleases with the assets and credits of the corporation and in the absence of creditors no one may complain.[53] Where one man owns all of the stock of a corporation, the cor-

[51] The Gloucester, 285 Fed. 579.

[52] Smith vs. Moore, 199 Fed. 689; 118 C. C. A. 127; 182 Fed. 540; Linn & Lane Timber Co. vs. U. S., 196 Fed. 593; 116 C. C. A. 267; 236 U. S. 574; 121 C. C. A. 498; 59 L. Ed. 725; 203 Fed. 394; 35 S. Ct. 440; Groh vs. Groh, 80 App. Div. 85; 80 N. Y. S. 438; but see 177 N. Y. 8; 68 N. E. 992; in re Wilson's Estate, 85 Ore. 604; 167 Pac. 580; Mason vs. Carrothers, 105 Maine 392; 74 Atl. 1030; Davis vs. Fanny Briggs Carr, Inc., 288 Pac. 710 (Cal.).

[53] First National Bank vs. Winchester, 119 Ala. 168; 24 Southern 351; 72 A. S. R. 904; Schilling & Schneider Brewing Co. vs. Schneider, 110 Mo. 83; 19 S. W. 67; Scales vs. Holje, 183 Pac. 308; 41 Cal. App. 733; see secs. 117, 264, infra.

poration may execute a note and be bound thereon for purely the personal indebtedness of its sole stockholder and in the absence of intervening rights of creditors, no one may complain of the transaction.[54]

The rule announced by the text in this section, and supported by the cases cited in the footnotes, marks the progress made in comparatively recent times in dealing with the question of when the courts will, or will not look behind the corporate fiction. It certainly seems that the modern rule is more in consonance with sound logic, reason and justice. In Button vs. Hoffman,[55] it was held that the sole owner of the corporate stock of a corporation could not maintain an action of replevin for the property upon the sole ground, and for the reason that the pure legal title to the property was in the corporation. This is undoubtedly a holding that would fail to find favor in the light of modern authority in courts of justice today. So in Barnes vs. Smith,[56] even as late as 1913, while perhaps not going to the full extent that Button vs. Hoffman went, yet even in that case it was held that the owner of all the stock by one individual did not serve to give such stockholder the legal title to the property that was in the name of the corporation. Also, in accordance with such position, it was held in Baldwin vs. Canfield,[57] that the stockholders did not have any interest in the corporate property. But the court in the case of Barnes vs. Smith,[58] was forced to admit the advent of the rule that the corporate form would not be sustained and adhered to under all conditions. So where one corporation owns all of the stock of another and becomes equitably the owner of the property of such stock-owned corporation, and such property may be levied upon in proceedings against the stock-owning corporation.[59]

[54] Sargent vs. Palace Cafe Co., 175 Cal. 737; 167 Pac. 146; see secs. 84, 85, 117, infra.

[55] 61 Wis. 20; 20 N. W. 667; 50 A. R. 131.

[56] 137 Pac. 541; 48 Mont. 309; if corporate function is suspended when all stock is owned by one, where is legal title to property? See sec. 84, infra.

[57] 1 N. W. 261; 26 Minn. 43.

[58] Supra.

[59] Ft. Worth Publishing Co. vs. Hitson, 14 S. W. 843, 80 Tex. 216.

§ 71. In a One-Man Corporation It Is Bound by the Acts of Its Owner

In the case of a one-man corporation, such corporation being merely an *alter ego* of its owner, it is bound by his acts and he is bound when he acts through it, it being the modern rule that the doctrine of corporate entity is not so sacred that a court of equity will not look through form to the substance of a thing, there being a growing tendency exhibited on the part of the courts to look beyond corporate form to its purpose. The courts have ceased to sanction a mere form of fiction of law introduced for the sake of justice and convenience should be permitted to work a wrong contrary to the real truth and substance of the thing. So where a corporation is merely the outward manifestation of its sole stockholder, and owned and controlled by him, such corporation will not be permitted to stand in the way of an examination and investigation into the real substance of the situation. An individual who owns all the stock of a corporation, and of which he is the inspiration and the soul, the court may very properly render a judgment against him on the supposed corporate liability.[60] So where the president of a corporation was the sole owner of the business whose corporate form constituted a difference in name only of an enterprise justifies rendition of judgment against the corporation on the obligation of such owner. Moreover this is true even if the contractual obligation—the basis of such judgment—antedates the formation of the corporation.[61]

§ 72. Corporate Entity Disregarded and Its Owner Held Liable Where It Is His Alter Ego

Where a corporation is owned by a single individual and is so manipulated in such fashion that the conclusion is

[60] Gamer Paper Co. vs. Tuscany, 264 S. W. 132; Witmann vs. Whittingham, 259 Pac. 63; 85 Cal. App. 140.

[61] Davis vs. Fanny Briggs Carr, Inc., 288 Pac. (Cal.) 710.

readily forced upon the court that such corporation is merely an *alter ego* of its owner, then in such case the court will readily hold that such owner is bound for the acts of the corporation and the corporation is likewise bound for the acts of such owner and will enforce contracts against such owner made in the name of such corporation.[62]

§ 73. Where the President of a Corporation Controlled It, He Is Liable on Breach of Contract of the Corporation

Where the evidence shows that the corporation is an instrument in the hands of the president, or such individuals, and another, then such president, or such individuals as are manipulating the corporation so as to make it a mere instrumentality in their hands, are liable for its acts. In such case it is immaterial that the president of the corporation executed the contract by signing the corporate name by himself. It nevertheless remains as his contract and while on the face of things, a breach of such contract nominally appears to be that of the corporation, it is in deed and in truth, and in fact, the breach of the individual manipulating the shell of the corporation. Efforts on the part of such individual to entrench himself behind the corporation will be futile and especially this is true where the transaction savors of fraud.[63]

§ 74. President of a Corporation Owning One-Half of Stock May Convey His Interest in Corporate Realty

The old rule was that the owners of shares in a corporation are not the owners of the corporate property, the corporation being a separate entity and, accordingly, its property could only be transferred or mortgaged by the corporation itself, acting through its officers and subject to the conditions prescribed by law, but the modern and better rule is that if the ultimate determination of the corporate affairs

[62] Witmann vs. Whittingham, 259 Pac. 63; 85 Cal. App. 140.
[63] Fowler vs. Small, 244 S. W. 1096; Norma Min. Co. vs. Mackay, 241 Fed. 641.

rests with the stockholders, it would be quite absurd to say that their acts are not to be deemed valid unless assented to by their agents, the directors. So, accordingly, it is held that where the directors own all of the shares they may agree among themselvs, not in their character of directors, but rather in their characters of stockholder, to authorize a sale of the corporate property. In application of the trend of modern decisions, it has been held that where, after the organization of a corporation, no meetings were held and no corporate functions were performed, and the president, being the controlling head of the corporation, and owning one-half of the stock, conveyed the land that stood in the corporate name, without consultation of the board of directors as a body, that the president of such corporation was estopped to deny the execution of a conveyance, and that the grantee would at least take the portion of the land as the president's stock bore to the total issued capital stock of the corporation."[64] The holding in the decision cited in the case note would hardly be safe as a rule applicable in all cases allowing a stockholder to convey his proportion of the corporate property, there being more than one stockholder, but the last cited case went off on the doctrine of estoppel.

§ 75. The Only Creditor of a Corporation May Sue the Only Stockholder of the Corporation For a Corporate Debt in a Proper Case

In accordance with the tendency to disregard corporate entity in proper cases, it has been held that where there is only one creditor of a corporation and only one stockholder of such corporation, and such stockholder has, by his fraudulent conduct, made an action against such corporation impracticable and a vain undertaking, involving much circuity, and entailing unnecessary delay and expense, the sole cred-

[64] Aransas Pass Harbor Co. vs. Manning, 94 Tex. 558; 63 S. W. 627. The better rule is that a stockholder cannot convey his interest in a particular piece of corporate property. Sec. 85, infra.

itor of such corporation, under such circumstances, may maintain his action in the first instance directly against the sole stockholder of the corporation to recover upon the supposed corporate liability, without first bringing any action against the corporation.[65]

In an analogue to the conclusion reached in the case of Louisville & Nashville Railroad Company vs. Nield,[66] it has been held by the Supreme Court of the United States that where the plaintiff was the sole owner of a corporation, that he might maintain an action for breach of contract with the corporation in his own name.[67] The contrast between these holdings and the holdings in such cases as Button vs. Hoffman,[68] and Baldwin vs. Canfield,[69] and Barnes vs. Smith,[70] is indeed marked.

§ 76. When Corporations Organized to Conduct the Owners Business, Its Acts Are the Owners'

Where a corporation is organized for the sole purpose—and there is no other justification for its existence than owning and operating its sole stockholder's business, then the acts and conduct of such stockholder in connection with such business are the acts and conduct of the corporation itself, and it follows always that the corporation under such circumstances is estopped to complain of the acts of its sole owner. This position does not in any sense overlook that a corporation in general is an entity separate and distinct from its stockholders, with distinct liabilities and obligations, but is simply a case where the facts warrant it and the courts disregard the corporate entity.[71]

[65] Louisville & Nashville Railroad Co. vs. Nield, 186 Ky. 17; 216 S. W. 62. See sec. 20, supra, as to set-off between stockholders and corporate debtors. See sec. 411, infra, for set-off against receiver of corporation of claim against only stockholder.

[66] Supra.

[67] Camp. vs. Gress, 250 U. S. 308; 39 S. Ct. 478; 63 L. Ed. 997; 244 Fed. 121; 156 C. C. A. 549; 245 U. S. 655; 38 S. Ct. 14; 62 L. Ed. 533.

[68] 61 Wis. 20; 20 N. W. 667; 50 A. R. 131.

[69] 1 N. W. 261; 26 Minn. 43.

[70] 48 Mont. 309; 137 Pac. 541.

[71] Wenban Estate vs. Hewlett, 227 Pac. 723; 193 Cal. 675.

However, it is regrettable that in the wonderful development and pronouncement of the rule, that in proper cases the corporate entity will be brushed aside by the courts, that some of the courts, and even the same courts, allow themselves to take reactionary steps. It seems that in the case of Hess vs. Cedarhome Lumber Company,[72] the court maintained the corporate entity to the fullest extent and refused to declare its acts as the acts of the principal, if not the sole stockholder.

The appellate courts of California have made the most progress in accordance with the modern trend of decisions to declare the corporation and its stockholders as one, or in other words, to ignore and override the corporate entity in cases calling for such relief, but yet it is hard, indeed, to reconcile a very late case from that jurisdiction.[73] In that case the court held—and what appears to be contrary to the decisions of that jurisdiction, and the modern authorities in general—that in an action to recover on an assigned claim against a corporation, that during all of the times that the plaintiff's assignor was making advancements to the corporation, that such assignor was the sole owner of the stock of such corporation, would not call for a disregard of the corporate entity. Of course, the court placed its decision upon the ground that it would do so in the absence of fraud, or injustice, but it is indeed hard to reconcile such position with the pronouncements of the court in the cases of Wenban Estate vs. Hewlett,[74] Llewellyn Iron Works vs. Abbot Kinney Co.,[75] Commercial Security Co. vs. Modesto Drug Co.,[76] Minifie vs. Rowley,[77] Erkenbrecher vs. Grant,[78] Deming vs. Maas,[79] and Bryan vs. Banks.[80]

[72] 139 Wash. 107; 245 Pac. 753; 47 A. L. R. 71.
[73] Kniese vs. Fairfax Incline Railway Co., 274 Pac. 382; 96 Cal. App. 427; see also 277 Pac. 347.
[74] 227 Pac. 723; 193 Cal. 675.
[75] 172 Cal. 210; 155 Pac. 986.
[76] 43 Cal. App. 162; 184 Pac. 964.
[77] 187 Cal. 481; 202 Pac. 673.
[78] 187 Cal. 7; 200 Pac. 641.
[79] 123 Pac. 204; 18 Cal. App. 330.
[80] 277 Pac. 1075; 98 Cal. App. 748; see sec. 82, infra.

§ 77. Entity Not Disregarded Where a Corporation Is Formed by an Agent at the Instance of His Principal

In proper cases, the courts will look behind the corporate entity and see who are the real and substantial parties in interest whenever it becomes necessary to promote justice, or obviate inequitable results and this is true whether, it is an action at law, or a suit in equity. But, however, the corporate entity will not be disregarded, or overridden where an individual is an agent for another concern and which principal required the agent to form a corporation in order to handle the business of the principal, there being nothing to challenge the good faith of the party, or parties in the formation of the corporation, and where the stock of such corporation is actually paid for.[81]

Where the general manager of a corporation owns practically all its stock and is virtually the corporation itself, and he may execute notes either in his own name or the name of the corporation, the validity of such notes executed by him will be upheld.[82]

§ 78. Where One Owns All, or Even Practically All of the Stock of a Corporation, Is Regarded as the Corporation's Double

Where one owns all but five of the one thousand shares of stock for which the corporation was capitalized, and the shares thus otherwise owned had been given, or transferred to the holders thereof for the single purpose of completing the machinery necessary to the operation of the corporation, such a stockholder is practically the corporation itself, or, as it has been put, he constitutes the corporation's double.[83] Under such circumstances the subscription of the corporate

[81] Midwest Air Filters Pacific vs. Finn, 258 Pac. 382; 201 Cal. 587.

[82] Baines vs. Coos Bay Ry. & E. R. & Navigation, 45 Ore. 307; 77 Pac. 400; see sec. 70, supra.

[83] Kelley vs. Campbell, 134 Cal. 175; 66 Pac. 220; Rutz vs. Obear, 15 Cal. App. 435; 115 Pac. 67; Deming vs. Maas, 123 Pac. 204; 18 Cal. App. 330.

name to a writing by such stockholder was at one and the same time both the act of the corporation and his act as an individual.[84] However, it seems that this perhaps will not be true unless it is to redress fraud, or broadly stated, to prevent injustice.[85]

§ 79. Organizers of a Corporation May Recover For Breach of Contract to Furnish Financial Aid to the Corporation

It has been held that the organizers of a corporation have a cause of action which they may assert in court for a breach of contract for failure to furnish financial aid to the corporation when organized. In other words, the fact that the corporation was not in existence at the time of the making of the contract will not serve to bar a cause of action arising from a breach of such contract.[86] This holding, of course, recognizes the rule that a corporation and its stockholders may be regarded as one.

§ 80. A Group of Persons of the Same Family May Choose to Form One or More Corporations For Conduct of Business and the Entities Will be Held Separate

A group of persons belonging to the same family may choose to form themselves into one or more corporate entities for the convenient conduct of such business as they may see fit to undertake and they may, with good faith and without fraudulent intent, adopt and maintain such separate corporate entities for the purpose of conducting several lines of business which are in some degree connected, but are not in the nature of things inseparable, and in such case the

[84] Deming vs. Maas, supra; Bryan vs. Banks, 277 Pac. 1075; 98 Cal. App. 748.

[85] Kniese vs. Fairfax Incline Ry. Co., 274 Pac. 383; 96 Cal. App. 427; see also 277 Pac. 347. We have heretofore taken occasion to critically analyze Kniese vs. Fairfax Incline Railway Company; see sec. 76, supra.

[86] Eden vs. Miller, 37 Fed. (2d) 8.

corporate entities will be held to be separate and not disregarded.[87] However, in order for this rule to hold good there must be the utmost of good faith.

§ 81. Where Corporations Attempt to Consolidate in the Absence of Statutory Authority the Corporation Having the Assets Is Liable For Obligations of Both

It seems that where two corporations attempt to consolidate, and there is no statutory authority for such action, then the corporation, or body acting as a corporation, and having the assets of such consolidating companies, will not be heard to defend on the ground that there was no statutory authority for such consolidation when it is called upon to respond on a liability of one of the consolidating companies. The court in such case will invoke the principle that its organization cannot be attacked collaterally in suits by or against it based upon dealings with it.[88] However, the contrary of this principle has found sanction in some cases and it has been held that where a mutual benefit society, by which the plaintiff's wife was insured for his benefit, made an abortive attempt to consolidate with the defendant company, and the defendant company attempted to take over the assets of one of the consolidating companies, and the one that had issued the policy of insurance, but received nothing of value belonging to the plaintiff, or the deceased, his wife and made no agreement with the plaintiff in such action, it was held the plaintiff could not recover for the death of his wife upon such policy of insurance.[89] So, also, it has been held that where a foreign corporation attempted to consolidate with an Illinois corporation—there being no statutory authority for such consolidation—that such foreign corporation was not liable for the debts of the corporation with which it at-

[87] Pioneer Express Co. vs. Riley, 284 Pac. 663; 208 Cal. 667.

[88] Shadford vs. Detroit Y. & A. A. Ry., 130 Mich. 300; 89 N. W. 960; Wilson vs. C. & O. Ry. Co., 21 Grat. 654.

[89] Whaley vs. Bankers Union of the World, 88 S. W. 259; 39 Tex. Civ. App. 385.

tempted to consolidate, and this holding was announced in spite of the fact that there existed a statute in Illinois providing that in case of consolidation of corporations, the consolidated company shall be liable for the debts of the original company, the court going on record on the very untenable grounds that the statute while prescribing liability in case of consolidation, did not authorize a consolidation and was intended to apply only to consolidations otherwise authorized.[90] That the decisions allowing consolidated or merged corporations to plead illegality of their own acts as a defense, are unsound, to say the least of it.

§ 82. *Equity Will Not Hesitate to Look Through One-Man Corporations*

The doctrine of corporate entity is not so sacred that courts of equity will not look through forms to substance of things and in a proper case the court will ignore the corporate entity in the interest of justice and preservation of rights. The courts no longer hesitate to refuse to sanction that mere form or fiction of law introduced for the sake of justice, should work a wrong contrary to the real truth and substance of things. So where it appears that one man is the inspiration and soul of the corporation, the court will readily and properly look through such corporation and will render judgment against the one man composing the same.[91]

It is a little difficult sometimes to harmonize the cases upon very similar states of facts. The principle enunciated in Gamer Paper Company vs. Tuscany[92] is undoubtedly sound and certainly is in time and step with the modern march of authority, but at the same time it is a little difficult to harmonize that holding with Kniese vs. Fairfax Incline Railway company.[93]

[90] Kavanagh vs. Omaha Life Ass'n, 84 Fed. 295; see sec. 146.
[91] Gamer Paper Co. vs. Tuscany, 264 S. W. 132.
[92] Supra.
[93] 274 Pac. 383, 96 Cal. App. 427; see also 277 Pac. 347; see sec. 76, supra.

§ 83. Sole Owner of a Corporation May Pay His Debts With Corporate Securities

The law has reached that state that where the sole owner of the stock of a corporation and the corporation itself are so regarded as one, that such sole owner may pay his individual obligations with corporate checks, or securities provided, however, there are no corporate creditors at the time. The rule in such cases being that where it is a one-man corporation, he may do what he will with the assets and credits of the corporation and no one but creditors may complain.[94] Moreover, this rule limits the complaint on the part of creditors to those existing at the time of such transaction and subsequent creditors, who became such afterwards, may not raise the question.[95]

§ 84. Effect of All Stock Owned by One Person

An early Maryland case laid down the rule to be that where all of the stock became concentrated in the hands of a single individual, that upon the happening of such event, the corporation became *ipso facto* dissolved.[96] However, the better rule seems to be at the present day that perhaps the corporate functions are suspended or in abeyance when all the stock is owned by one.[97] The reason often assigned as underlying the

[94] Scales vs. Holje, 183 Pac. 309; 41 Cal. App. 733; First National Bank vs. Winchester, 119 Ala. 168; 24 Southern 351; 72 A. S. R. 904; Schilling & Schneider Brewing Co. vs. Schneider, 110 Mo. 83; 19 S. W. 67; Sargent vs. Palace Cafe Co., 175 Cal. 737; 167 Pac. 146; Bear Creek Lumber Co. vs. Second National Bank, 120 Md. 566; 87 Atl. 1084.

[95] Scales vs. Holje, supra; see sec. 485, infra.

[96] Bellona Co., 3 Bland (Md.) 442.

[97] Scott vs. Prescott, 69 Mont. 540; 223 Pac. 490; Swift vs. Smith, 67 Md. 428; 57 A. R. 336; 5 Atl. 534; Barnes vs. Smith, 48 Mont. 309; 137 Pac. 541; Louisville Banking Co. vs. Eisenman, 94 Ky. 83; 19 L. R. A. 684; 14 Ky. L. R. 705; 42 A. S. R. 335; 21 S. W. 531, 1049; Hanson Sheep Co. vs. Farmers & Traders State Bank, 53 Mont. 324; 163 Pac. 1151; Templeman vs. Grant, 227 Pac. 555; 75 Colo. 519. In this case in dealing with results of all stock becoming centered in the hands of a single individual, the court observed: The Delaware Corporation, as the sole stockholder, however, possessed the right to dispose of its stock to others, and by so doing to make it possible

position that when stockholders of a corporate entity are reduced to one, that the suspension of corporate functions resulted because there could be no meetings of stockholders, or directors—there being but one—and this would seem to be a satisfactory reason. It should be added, however, that the claim has been made that this reason has been exploded.[98] But such claim is not supported by reason, neither can it be sustained on principle. The position that when all stock of a corporation is owned by a single individual does not dissolve it is based upon the theory—and which is thought to be well grounded in reason—that it is within the power of a single stockholder of a corporation to bring about a palingenesis of the corporate power to function and by transfer of stock to other parties, the corporation again functions in a normal fashion.[99] It has, however, been held that where ownership of all of the stock is lodged in a single individual, but the corporate organization is kept up, it does not even operate to suspend the power of corporate functioning.[100] It is not easy to sustain this position on logical grounds.

In reaching the conclusion that there was no suspension of the corporate franchise by reason of the stock being owned and held by a single individual, if the corporate organization were kept up, the court attempted to distinguish Louisville Banking vs. Eisenman, on the ground that in this case there was no at-

to effect a reorganization and revive corporate functions by election of necessary officers. Until this or similar action should be taken by the sole stockholder, official corporate activity would remain in complete suspension; First National Bank vs. Winchester, 119 Ala. 168; 24 Southern 351; 72 A. S. R. 904; Geo. T. Stagg Co. vs. Taylor, 27 S. W. 247; 68 S. W. 862; 113 Ky. 709; 24 Ky. L. R. 495; Russell vs. McLellan, 14 Pick. (Mass.) 70; Newton Mfg. Co. vs. White, 42 Ga. 148.

[98] State vs. General Stevedoring Co., 213 Fed. 51-77; East vs. Bennett (1911), I Ch. 163.

[99] Parker vs. Bethel Hotel Co., 96 Tenn. 252; 31 L. R. A. 706; 34 S. W. 209; Elliott vs. Sullivan, 156 Mo. App. 496; 137 S. W. 287; Brookline Canning & Packing Co. vs. Evans, 146 S. W. 828; 163 Mo. App. 564.

[100] Louisville Gas Co. vs. Kaufman, 105 Ky. 131; 20 Ky. L. R. 1069; 48 S. W. 434; see sec. 70, supra.

tempt to keep up the organization. It is submitted that this distinction is rather finely drawn and is one that would hardly stand a critical analysis. It seems that the question is not what is done in a particular case, but what the law authorizes to be done in a particular case. If all of the stock is owned by a single individual, and if the effect of that situation is to suspend the corporate functioning of the jural personality, then to say that that individual might evade the effect of the law by the creation of a dummy, it seems exceeds the bounds of reason. In other words, to so hold is to sustain the corporate fiction with the fiction of a dummy. It would seem to follow, as a corollary of the position that all stock becoming in the hands of a single stockholder suspends the corporate functions, that such stockholder would be engaged in business as an individual, using a fictitious or trade name as fully as if there never had been a body politic created. And when the question is raised and it is established that all stock is held and owned by a single individual the matter of the corporation having existed would at once become wholly immaterial. In some states there are statutes requiring persons engaged in business under fictitious or trade names, to register same with the county recorder where the business is carried on. It is difficult to advance any reason why the individual owner of all stock of a corporation, and therefore the corporate functioning is in abeyance, should not be required to comply with such statutes and record such corporate name with the proper officer where the business is transacted.

What is the result where a single individual obtains a charter of incorporation from the state, by merely using dummies to make up the requisite number of applicants or signers of the articles? When the substance of the transaction is regarded, and form ignored, it would seem for effectual purposes a corporate entity never issued out of the sovereign authority. The only reason that can be advanced why this would not be true is that by law when certain conditions are complied with

—regular on the face of compliance—no inquiry will be made and what is termed a conclusive presumption attaches that a valid corporation has been created.[101] Yet it is not easy to understand why this presumption should utterly tie the hands of the judiciary to ascertain the facts upon which such compliance rests. It is submitted that no rule should be sanctioned that lends its aid to the perversion of truth.

But the rule clothing such compliance with laws regulating organization of corporations with a conclusive presumption does not obtain in all jurisdiction.[102] So where the presumption of due organization does not apply, it would seem that where in truth and fact a single individual was in substance and reality the sole applicant—the others being dummies—for a charter of incorporation the situation would be that a legal corporate entity was not created; that such individual to all legal intents and purposes would be doing business under an assumed name—the purported corporate name.

It is established by the authorities that in form one cannot apply for a charter of incorporation even though the statute provides any number of persons may become incorporated.[103] Then if one may not under any conditions apply for a charter how can the form of dummies be used to take the place of substance? It is submitted that that cannot be. However the

[101] Casey vs. Galli, 94 U. S. 673; 24 L. Ed. 168; Bailey vs. Tillinghast, 86 Fed. 46; 99 Fed. 801; First National Bank vs. Almy, 117 Mass. 476; Boatman's Bank vs. Gillespie 209 Mo. 217; 108 S. W. 74; Dolbear vs. American Bell Tel. Co., 126 U. S. 1; 8 S. Ct. 778; 31 L. Ed. 863; Sun River Stock & Land Co. vs. Montana Trust & Savings Bank, 262 Pac. 1039; 81 Mont. 222; Thatcher vs. West River National Bank, 19 Mich. 196; Lindenberger Cold Storage & Canning Co. vs. Lindenberger, 235 Fed. 542; Sun River Stock & Land Co. vs. Montana Trust & Savings Bank, 262 Pac. 1039; 81 Mont. 222.

[102] Tarr River Nav. Co. vs. Neal, 10 N. C. 520; 3 Hawks 520; see sec. 16, supra.

[103] Swift vs. Smith, supra; Louisville Banking Co. vs. Eisenman, supra. See able dissenting opinion of Buckley L. J. in Continental Tyre & Rubber Co. Ltd. (1915), I K. B. 893 (1915); W. N. 441; 84 L. J., K. B., N. S. 927; 20 Com. Cas. 209; 59 Sol. Jo. 232; 5 B. R. C. 304. The case was affirmed by the House of Lords, however. 6 B. R. C. 269 (1916); 2 A. C. 307; 85 L. J., K. B., N. S. 1333; 114 L. T., N. S. 1049; 32 Times L. R. 624; 60 Sol. Jo. 602; 22 Com. Cas. 32; 1917C A. C. 170.

question has not in so far as our research has gone, been made, and therefore there are no adjudications on it.

The situation of all stock finding lodgment in the hands of a single individual is fraught with difficult legal questions; suppose all stock is transferred to one, then as we have seen the corporate functions are suspended or are in abeyance. Then where does the legal title to corporate property reside? Does the acquisition of all stock work a metamorphosis of such title from the body politic to the single stockholder? Such stockholder is already equitable owner of the corporate property,[104] but what happens to the pure legal title? Of course the stockholder's equitable ownership would not be affected by transmutations of the legal title under such circumstances. It is indeed a *quodlibet* as to the mutations, if any, that the legal title undergoes under such circumstances. It suggests itself that perhaps such legal title remains in the corporate name for the use of such stockholder, but then this assumption runs counter to the proposition that such corporate functions are in abeyance and the effect of such concentration of all the stock in a single individual is to create a situation where such single stockholder is doing business under an assumed name—the name of the corporation. It would seem to follow that the legal title to the corporate property would be united with the equitable ownership in such single stockholder. But this position has encountered difficulties. It has been held that all the stock becoming centered in the hands of one was not sufficient to defeat liability on insurance policies in the name of the corporation on a destruction by fire of property covered thereby; therefore, impliedly, at least, holding there had been no such change of possession or ownership of the property as would work a forfeiture of such policy.[105] But in spite of this, it is submitted that such title passes to such stockholder. This must be true. It could hardly remain in the corporate entity, with its functions suspended, and since the single stockholder must have thrust upon him the position of doing business

[104] See sec. 379, infra.
[105] See sec. 429, infra.

under an assumed name—the corporate name—it must follow that the legal title to corporate property attaches to him. If the legal title remains in the corporation, and its power to function as a corporation is in abeyance, then the legal title to such property must remain there, so far as the body politic is concerned; for if its powers as a corporation be in a state of suspension, it could do no act to dislodge the title from it, for it must take a corporate act to divest the corporation of the legal title to its property, or some effective act by the stockholder or stockholders; such act of the stockholders is discussed in the next section. The sequacious postulate must be apparent that if it could function for the purpose of transmutation of the legal title to property vested in it, when all the stock finds lodgment in the hands of one, then it could function generally for other purposes and could in the same manner perform other corporate functions. If the corporation could wield its power for the purpose of transferring its property under such circumstances, then it is submitted it could just as well function for any and all purposes, and continue to transact all its business as before such suspension. To say that the legal title to property standing in the corporate name at the time one acquires all of its stock could be dislodged therefrom by a corporate act, is to deny that the corporate functions are suspended thereby. Therefore, while the position that all stock being owned by one does not avoid policies of insurance in the corporate name reaches a just result, yet it must be apparent that legally speaking such holding is unsound.

It is less difficult to ascertain the true situation with respect to the title to property acquired after the date of acquisition of all of the stock by one; in such case we have already suggested that such stockholder occupies the position of doing business under an assumed name—the corporate name. Then doubtless, the title to property acquired under such circumstances would be vested in such stockholder the same as if the corporation had never been formed.

§ 85. Where One Person Is Sole Owner of the Corporate Stock, He May Mortgage or Convey Corporate Property; All Stockholders May Bind Corporation by Contract

It seems reasonably well settled at this day that where all the stock has found ownership and lodgment in a single individual, that individual may, in his own name, or in the name of the corporation, without any authority from any dummy directors, if such there be, execute a valid mortgage upon the corporation's property.[106] Or where he is substantially the owner of a corporation, the same rule is applied and the corporate property will pass by deed, or become encumbered by mortgage executed in the name of such substantial owner of the stock of a corporation.[107]

Mr. Wormser criticizes this position and states that outside of Maryland, fortunately there are but few heterodox decisions and there cites First National Bank vs. Winchester as such illustration, but entirely overlooked the Texas cases following the very sensible lead of Maryland.[108]

The learned author in that work predicates his criticism upon the ground that there would be a confusion in the title to corporate property, and that confusion and uncertainties would arise, but that reasoning is manifestly unsound for the same reasoning would apply to the cases of administration of estates where the title to the real estate is in the name of the decedents and conveyance in some states is made by the heirs, or other proper representatives. The same is true in conveyances by guardians of minors and persons of unsound mind. A like situation would arise from the conveyances by masters in chancery, or receivers appointed by courts. In short, the same criticism that Mr. Wormser makes

[106] The Bellona Co., 3d Bland (Md.) 442; Swift vs. Smith, 65 Md. 428; 57 A. R. 336; 5 Atl. 534; Toyaho Creek Irrigation Co. vs. Hutchins, 52 S. W. 101; 21 Tex. Civ. App. 274.

[107] Phoenix Assurance Co. vs. Deavenport, 41 S. W. 399; 16 Tex. Civ. App. 283; First National Bank vs. Winchester, 119 Ala. 168; 24 Southern 351; 72 A. S. R. 904; see secs. 70, 74, supra.

[108] Wormser on the Disregard of the Corporate Fiction, 79 et. seq.

of conveyances by the sole stockholder of a corporation could be made of any case where a conveyance is authorized and made by another than the record title holder. It is readily understood that the confusion in conveyance of lands of decedents, and by guardians, masters in chancery, and receivers, is avoided by a mere matter of indexing the conveyances and could readily be done with the conveyance by the sole owner of a corporation.

It is true that Swift vs. Smith[109] has been criticized,[110] but on the other hand it has been approved by the courts so often and the rule of the case been so frequently sustained that it would seem little consideration need be given to the criticism that is found in occasional cases.[111] Judge Seymor D. Thompson in the first edition of his work approved Swift vs. Smith as expressing a sound conclusion and queried that if one stockholder might sell the corporate property, why all of the stock-

[109] Supra.

[110] State Trust and Savings Bank vs. Hermosa Land & Cattle Co. 240 Pac. 469; 30 N. M. 566; Parker vs. Bethel Hotel Co., 34 S. W. 209; 96 Tenn. 252; 31 L. R. A. 706; Home Fire Insurance Co. vs. Barber, 67 Neb. 644; 93 N. W. 1024; 60 L. R. A. 927; 108 A. S. R. 716. It cannot be said that Home Fire Insurance Co. vs. Barber in reality criticized Swift vs. Smith for the reason that the decision in Home Fire Insurance vs. Barber is in a great measure predicated upon the rule enunciated in Swift vs. Smith.

[111] Taylor Feed Pen Company vs. Taylor National Bank, 181 S. W. (Tex.) 534; see, however, 215 S. W. 850; 177 S. W. 176; Farmers Loan & Trust Co. vs. Pierson, 222 N. Y. Supp. 532; Templeman vs. Grant, 227 Pac. 555; 75 Colo. 519; Llewellyn Iron Works vs. Abbot Kinney Company, 155 Pac. 986; 172 Cal. 210; Shumpert vs. National State Bank of Columbia, 231 Fed. 82; Carozza vs. Federal Finance and Credit Co., 131 Atl. 332; 149 Md. 223; Minch vs. Minch & Eisenbrey Co., 115 Atl. (Md.) 702; Mathews vs. Headley Chocolate Co., 100 Atl. 645; 130 Md. 523; Aransas Pass Harbor Co. vs. Manning, 63 S. W. 627; 94 Tex. 558; Turner vs. Kingston Lumber & Manufacturing Co., 59 S. W. 411; 58 S. W. 854; 106 Tenn. 1; Toyaho Creek Irrigation Co. vs. Hutchins, 52 S. W. 101; 21 Tex. Civ. App. 274; Louisville Banking Co. vs. Eisenman, 21 S. W. 531, 1049; 19 L. R. A. 684; 94 Ky. 83; McKleroy vs. Gadsden Land & Lumber Co., 126 Ala. 184; 28 Southern 660; First National Bank vs. Winchester, 119 Ala. 168; 24 Southern 351; 72 A. S. R. 904; Blum vs. Whitney, 185 N. Y. 232; 77 N. E. 1159; Cotten vs. Tyson, 121 Md. 597; 89 Atl. 113; Bear Creek Lumber Co. vs. Second National Bank, 120 Md. 566; 87 Atl. 1084; Mason vs. Carrothers, 105 Me. 392; 74 Atl. 1030; Pott vs. Schumucher, 84 Md. 535; 36 Atl. 592; 35 L. R. A. 392.

holders might not do so.[112] However, the editors revising Judge Thompson's work have since eliminated not only the approval by the author of that case, but the whole section containing it was deleted. A deed of trust executed by an individual as president of a corporation purporting to be a corporate document is good even as against creditors.[113] Of course it is recognized in consonance with the rules announced in this section that one owning all of the stock of the corporation may convey or encumber the corporate property but it should be borne in mind that the rule has no such expansive application as to allow a stockholder to convey his interest in any particular piece of corporate property, there being more than one substantial or bona fide stockholder.[114] Likewise a general manager of a corporation, who is substantial owner of it, may sell its property without the concurrence of any dummy directors.[115] At an early date in Massachusetts it was held that the individuals composing a corporation covenanting in behalf of such jural creation for themselves and their heirs, that the body politic would do certain acts that they are personally bound on such convenant.[116] It is likewise true that one owning all the stock of a corporation is bound by his acts in reference to the property standing in the corporate name.[117] So also where all of the stockholders of the corporation enter into an agreement or contract, such an agreement or contract may not be repudiated by the corporation.[118] The operation of the principle discussed in this section has been approved by other courts, it having been held that the only stockholder of a defunct corporation may bring an action to assert rights that are vested in the statutory trustees. Such stockholder being one of such trustees, the

[112] Thompson on Corporation (1st Ed.) sec. 5096.
[113] Turner vs. Kingston Lumber & Manufacturing Co., supra.
[114] Cotten vs. Tyson, supra.
[115] Fort Worth Publishing Co. vs. Hitson, 14 S. W. 843; 80 Tex. 216; 16 S. W. 551.
[116] Tileston vs. Newell, 13 Mass. 406.
[117] Cotten vs. Tyson, supra.
[118] Breslin vs. Fries Breslin Co., 70 N. J. L. 274; 58 Atl. 313; Stokes vs. Detrick, 75 Md. 256; 23 Atl. 846; Minch vs. Minch & Eisenman Co., supra.

corporation having gone defunct for the non-payment of the license tax.[119] It also has been held—which is certainly in accord with the rule of the text of this section—that the only stockholder may convey the corporate property of a defunct corporation without the statutory trustees joining with him in such conveyance.[120] Certainly no good reason could be urged why, if the only stockholder can convey the corporate property if it has gone defunct, without the concurrent act of the statutory trustees, that the same thing may not be done by the only stockholder or all of the stockholders before such corporation has become defunct. The general rule, doubtless, is that upon a corporation going defunct, the statutory trustees stand in its shoes and represent it.

§ 86. To Do Justice Between Parties a Court of Equity Will Regard Even a Substantial Owner of the Corporate Stock and the Corporation as One

That while it is generally considered to be true that for most purposes a corporation is a separate entity from those who own its stock, and this is theoretically true, but when the court is endeavoring to adjust the rights between the parties, it looks to the merits rather than to the form and to that end it has frequently been held and will be held now that the court will disregard the fiction of separate entity of a corporation where justice requires this should be done. And where in the action it appears that the corporate entity is involved, and the property standing in the name of the corporation is, in effect, the property of an individual, there being no sanctity hedged about a corporation, then the courts will brush aside the corporate entity and deal with the property of the corporation as if it belonged to the stockholders in their own right, and this is true when an individual is substantially the owner of the corporation.[121]

[119] See secs. 497, 520, infra.
[120] See sec. 498, infra.
[121] Goss vs. Goss, 147 App. Div. 698; 132 N. Y. Supp. 76; 207 N. Y 742; 101 N. E. 1099.

§ 87. Corporation Is Obligated For Acts of Its Owners As If It Did Not Exist

Upon a sufficient showing that the corporation is but the instrumentality through which an individual, who is the sole stockholder of the capital stock, and who, for convenience, transacts his business through and by the instrumentality of such corporation, both at law and in equity the courts will look to the substance rather than the form of the relation and will hold such corporation obligated for the acts of the sole owner of the corporation to the same extent and just as he would be bound if the corporation were not in existence. It suffices to bring into operation this principle when the proof establishes that the individual owns all of the stock of the corporation that the corporation is, in truth, and in fact, but the corporate double of the owner of the stock, in conjunction with the further showing that as a result of such double relationship, fraud or injustice will be worked as to third parties where these facts appear, the separate entity of the corporation will be dissipated. In reaching this result, where it appears the rights of third persons are involved, the law finds itself entirely without any compunction in holding such corporation obligated on the undertakings of the owner of it.[122]

§ 88. Corporate Entity and Transactions Scrutinized in Sales Between a Corporation and Its Subsidiary

The rule of law undoubtedly is that where one corporation deals through another, which it privately owns and directs, and the transaction in its last analysis amounts to merely making a sale to itself, the burden of proving the fairness of the transaction in such case, and the adequacy

[122] Llewellyn Iron Works vs. Abbot Kinney Co., 172 Cal. 210; 155 Pac. 986; Commercial Security Co. vs. Modesto Drug Co., 43 Cal. App. 162; 184 Pac. 964; Minific vs. Rowley, 187 Cal. 481; 202 Pac. 673; Porter vs. Lassen County Land & Cattle Co., 127 Cal. 261; 59 Pac. 563; Schuyler vs. Pantages, 54 Cal. App. 83; 201 Pac. 137; Swartz vs. Burr, 43 Cal. App. 442; 185 Pac. 411.

of the price paid, devolves upon the parent corporation.[123] So where a corporation owned and operated a property in its business, and changed the manner of its holding and the method of its operation by organizing another corporation to which it conveyed the property with which it cooperated in raising money on the property conveyed, and through which it thereafter indirectly conducted the same business which it had before conducted directly, that corporation is held to the strictest account and to the observance of the highest rectitude in its transactions with its subsidiary.[124] In the ordinary transaction of a purchase and sale between independent corporations, it is the interest and right of the vendee to acquire the property at the lowest price possible and of the vendor to sell it at the highest, but in a transaction of purchase and sale between interrelated corporations, where the control of the one by the other is active and complete, and where the acting officers of the two are indentical, or in other words, where a parent corporation undertakes to deal in the double capacity of vendor and vendee with respect to which third parties have an interest, and where the transaction is possible only by obtaining the consent of the representatives of those equitably interested, who is one of its own officers, something more is required of the purchaser than to obtain the property on the terms most advantageous to itself. A corporation in such a relation bears a duty to those whose securities it is taking to pay for it, and makes the purchase at the peril of being called upon to prove the good faith of the transaction and the adequacy of the consideration.[125]

It is a principle of law that every purchase implies two distinct persons—a buyer and a seller, and a mere shadowy cor-

[123] Goodin vs. The Cincinnati & W. Canal Co., 18 Ohio St. 169; 98 Am. Dec. 95; Sage vs. Culver, 147 N. Y. 241; 41 N. E. 513; Farmers Loan & Trust Co. vs. N. Y. & N. Ry. Co., 150 N. Y. 410; 44 N. E. 1043; 34 L. R. A. 76; 55 A. S. R. 689; Stebbins vs. Michigan W. & T. Co., 212 Fed. 19; 129 C. C. A. 471; Barrie vs. United Ry. Co., 125 Mo. App. 96; 102 S. W. 1078; Geddes vs. Anaconda Copper Mining Co., 197 Fed. 860; Penn. Canal Co. vs. Brown, 229 Fed. 444; 149 C. C. A. 89; 235 Fed. 669; 242 U. S. 646; 37 S. Ct. 240; 61 L. Ed. 543.

[124] Penn. Canal Co. vs. Brown, supra.

[125] Penn. Canal Co. vs. Brown, supra.

porate entity or fiction cannot serve in the capacity of a buyer or seller where it is controlled by the opposite party in the transaction.[126]

No reason presents itself why a party organizing himself into a corporation, and turning his business over to such corporation, and taking therefor stock in such corporation, should not be held to the same strict accountability as in the case of one corporation dealing with another that it owns. Neither is any reason perceived why the *onus probandi* of the fairness of such transaction should not be cast upon the organizer of a corporation under such circumstances. Authority is abundant holding such corporation and its organizer as one and making the corporation liable for the debts of its creator antedating its creation.[127] It seems, however, that the courts thus far have been somewhat hesitant about application of the no doubt wholesome rule in such case in the same manner as it would be if the transaction were between two corporations. If the reason suggested herein with respect to an individual organizing himself into a corporation, is sound, then, of course, the rule would apply to partnerships converted into a corporation.

§ 89. The Rule of Brushing Aside the Corporate Entity in a Proper Case Cannot Be Used by Stockholder For Purpose of Deceit

While it is a rule equitable in character that the form of corporate fiction may be disregarded where the ownership of all of its stock is in one person, and in other situations where it is justified, but the application of this rule is commonly limited to those instances in which it becomes necessary to disregard a formal corporate existence to prevent

[126] Andres vs. Morgan, 62 Ohio St. 236; 78 A. S. R. 712; 56 N. E. 875.
[127] Blumenthal vs. Schneider, 186 Wis. 588; 203 N. W. 393; Ziemer vs. C. G. Bretting Mfg. Co., 147 Wis. 252; 133 N. W. 139; 1912D A. C. 1275; Curtis Jones & Co. vs. Smelter National Bank, 43 Colo. 391; 96 Pac. 172; in re W. J. Marshall Co., 3 Fed. (2d) 192; Andres vs. Morgan, 62 Ohio St. 236; 56 N. E. 875; 78 A. S. R. 712; First National Bank vs. Trebein Co., 59 Ohio St. 316; 52 N. E. 834; Breman Savings Bank vs. Branch-Crook Co., 104 Mo. 425; 16 S. W. 209; see also sec. 130, n. 20.

fraud, or stay imposition, or in the aid of the enforcement of paramount and superior equity, but to allow the wholesome operation of this equitable principle to be resorted to, to accomplish an end that would be unjustifiable perversion, or by way of surprise, or furtherance of deceit, would give to the rule a scope and purpose never intended and, in fact, would be using the rule for the opposite purpose for which it was created, and so where the rule is sought to be invoked by one who dealt in the name of the corporate entity in his attempt to assert that the transaction was between himself as an individual, and not the corporation, will not be allowed if to do so would give him an advantage.[128]

§ 90. The Corporate Entity Will Be Disregarded to Prevent a Recovery Against Joint Maker of Note

Where a corporation is merely a form through which the principal debtor handles his private affairs where it is convenient for him to do so, and such corporation and another executed a note with the owner of such corporation as the principal debtor, such corporation will not be permitted to take the note by assignment and recover against the joint maker who signed it with the principal debtor. The courts will disregard corporate form in such case, justice requiring it, and look to the substance and not to the shadow. Therefore as such corporation is but an *alter ego*—a shadow of the principal debtor, it cannot recover against such signer.[129]

§ 91. Corporate Entity Disregarded to Prevent a Release of a Firm That the Corporation Succeeded and Likewise the Corporation

Where a partnership was organized into a corporation, and assumed the debts of the partnership, and a creditor was

[128] Carozza vs. Federal Finance & Credit Co., 131 Atl. 332; 149 Md 223; 43 A. L. R. 1.

[129] Phoenix Safety Inv. Co. vs. James, 237 Pac. 958; 28 Ariz. 514.

thereafter induced to accept the note of an individual member of the firm and then surrender the firm notes, corporate shares having been deposited to secure such individual note, the creditor surrendering the firm notes had no intention of releasing the firm and had supposed that the note of the individual member of the firm and the corporate stock were collateral to the firm notes, and at a later time the creditor demanded payment of the corporation that had been organized by converting the firm into the same, and there was a promise on the part of the corporate directors that the note would be paid as one that had been assumed by the corporation, it follows under these circumstances that it could not be held that the creditor had released the firm and consequently the corporation, and held the corporation liable upon the individual note of the member of the firm who was likewise a stockholder in the corporation. In other words, the court dealt with the stockholders and the creditor as in their individual rights and capacities, brushing aside the corporate entity and refusing to permit it to stand in the way of doing substantial justice to the parties.[130]

§ 92. Rule Applied to Prevent Cancellation of Certain Notes Between Three Interlocked Corporations

The directors of one corporation adopted a resolution authorizing the borrowing of money for its business and giving bonds issued by it as collateral to the evidence of such loan. The loan was obtained by the treasurer of another corporation but instead of being used in the business of the borrowing corporation, it was diverted to pay notes held by the treasurer's corporation and the treasurer himself against an insolvent corporation. The stockholders of the insolvent corporation and the borrowing corporation were the same. No

[130] Williams vs. Colby, 6 N. Y. Supp. 459; 53 Hun. 637; 24 N. Y. St. Rep. 793; 3d Silvernail 337.

consideration in the transaction moved to the borrowing corporation and it was also a creditor of the insolvent corporation. It appearing that the stockholders of the borrowing corporation and the insolvent corporation sold all of their holdings in both companies to another, it being a part of the agreement that the notes for said loan were to be deducted in effect from the purchase price. Under this state of the case the court reached the conclusion, and brushing aside the corporate entity so to do, declared that neither the stockholders nor their purchaser could thereafter maintain an action on behalf of the borrowing corporation for a cancellation and return of the notes and bonds.[131]

§ 93. Corporate Entity Disregarded to Sustain a Tender of the Stock of the Corporation

Where a corporation entered into a contract for the sale of certain of its stock to an individual, and all of the authorized stock of the corporation had theretofore been issued to its principal stockholder, a tender of the stock by such stockholder, and stock that had theretofore been issued to such stockholder, to the purchaser, complies with the contract, the court disregarding the corporate entity when it was sought to invoke the same to defeat the tender of such stock in compliance with the contract entered into with the corporation.[132] The defense in the case, cited in the footnotes, was predicated upon the grounds that since the corporation had issued all of the stock it was authorized by its charter to issue, it had rendered itself powerless to fulfill the contract, but this contention by the court was denied and a tender by one of the stockholders of stock that had theretofore been issued to such stockholder was held a compliance with the contract.

[131] Remington & Son Pulp & Paper Co. vs. Caswell, 126 App. Div. 142; 110 N. Y. Supp. 556.

[132] Burchill vs. Hermsmeyer, 230 S. W. 809 (Tex.); see, however, 262 S. W. 511.

§ 94. An Officer of a Corporation Will Be Held Liable on Worthless Corporate Security Given in Exchange For Money

An officer or controlling manager of a corporation cannot use its name for the transaction of his own private business and escape personal liability on his part. He will not be permitted to defend an action on the ground that the liability was that of the corporation and not his. So where the officer of such corporation gave worthless securities of the corporation to a third party, and obtained such third party's money therefor, such officer will be liable at the suit of the third party. The rule that the fiction by which an ideal legal entity is attributed to a duly formed incorporated company existing separate and apart from the individuals composing it, will not be allowed to be invoked in such case to defeat a recovery. The court in this case observed that corporations are often organized as a cloak for fraud, and that cases such as that before the court at the time are becoming common and the courts are becoming more and more inclined to ignore the corporate existence when necessary in order to circumvent fraud.[133]

§ 95. A Corporation Not Authorized To Do Business Within a State May Not Avoid the Statute of Such State by the Organization of Another Corporation For That Purpose

A domestic corporation organized for the purpose of soliciting insurance under the laws of the state of its creation, will be denied a license to do business in such state when the bulk of its stock is owned by a foreign corporation engaged in the insurance brokerage business and such foreign corporation is not entitled to a license in the domicile of its subsidiary corporation. While it is true that one corporation may own and

[133] Donovan vs. Purtell, 216 Ill. 629, 1 L. R. A. N. S. 176, 75 N. E. 334; 119 Ill. App. 116.

control the stock of another corporation, yet both courts of law and equity will not permit corporate forms to be used for injury or wrongdoing and where it appears that such domestic corporation, owned and controlled by a foreign corporation, is organized to evade the insurance laws of a state, the domestic corporation will not be permitted to transact insurance business therein.[184] So, also, a corporate fiction may not be resorted to for the purpose and convenience in handling and managing the property of its owner and payment by a corporation of interest charges to its stockholder is not a payment required to be made as a condition to continued use or possession of property within the meaning of the United States Tax Act of August 5, 1909, Section 38, Compiled Statutes, Section 6307, and such payment is not deductible in determining the tax on the net income, the corporation and its owner being treated as one and the same. In other words, the taxes laid by the United States law cannot be evaded by the means of the creation of a corporate fiction and to reach the actual parties and collect the tax that is properly due, the entity will be disregarded.[185]

§ 96. Corporate Entity Disregarded to Relieve a Legatee or Devisee of an Indebtedness of a Corporation Where Such Legatee Is Sole Owner Thereof

Where a testatrix provided in her will that her nephew should not be required to liquidate to her executor any indebtedness that might be in existence at the time of her death, after disregarding the separate corporate entity from such nephew of a corporation of which he was the sole owner, such provision will operate to cancel the indebtedness that stands against the name of the corporation in favor of such decendent's estate. In reaching this conclusion the court was guided by principles announced by the same court in prior adjudi-

[184] State vs. Safford, 159 N. E. 829; 117 Oh. St. 576.

[185] U. S. vs. Barwin Realty Co., 25 Fed. (2d) 1003; 29 Fed. (2d) 1019; N. Y. Trust Co. vs. Bermuda A. T. L. S. S. Co., 211 Fed. 989; Palmolive Co. vs. Conway, 43 Fed. (2d) 226.

cated cases to the effect that the existence of a corporation, independently of its shareholders, is a fiction and that the rights and duties of an incorporated association are in reality the rights and duties of the persons who compose it.[136]

§ 97. A Corporation Without Right of Eminent Domain May Not Circumvent the Law by Organizing a Dummy Corporation

A corporation of such character that it is not embraced within the constitutional provisions and statutory enactments conferring the right of exercising eminent domain cannot obviate the bar of the statute, or prohibition of the constitution, by the organization of a dummy corporation to take property under the exercise of the right of eminent domain which is really intended for such corporations so organizing the dummy. In other words, the corporate entity will not be permitted as a screen behind which a corporation not clothed under the law, of the power of eminent domain to appropriate property of another, and when it is made to appear that the attempted condemnation is in the interest of a corporation not entitled to exercise the right, the entities will be disregarded and both corporations treated as one and the right of condemnation denied.[137]

It may be stated generally, that in actions to appropriate private property under the power of eminent domain, when the existence of the corporation for such purpose is in issue, the courts will look through the corporate forms to ascertain the real parties in interest where it would be unjust to invade the right of private property for public use unless the corportation seeking to exercise the power had the power invested in it by law and is the real party in interest. This is but an application of the general rule announced in many cases to prevent injustice, the courts will go behind

[136] Nashville vs. Ward, 84 Tenn. 27; 16 Lea 27; Fidelity Trust Co. vs. Service Laundry Co., 22 S. W. (2d) 6; 160 Tenn. 57.

[137] Parkside Cemetery Ass'n vs. Cleveland B. & G. Lake T. Co., 93 Ohio 161; 112 N. E. 596; 1918C A. C. 1051.

mere corporate forms and deal with the real parties in the transaction.[138]

§ 98. One Corporation Organizing Another to Sell Its Stock, Responsible For the Acts of the Stock-selling Company and Notes and Mortgages Given It Will Be Cancelled in the Hands of the Parent Corporation

Where a fire insurance corporation was organized and on the same day a brokerage company was organized by practically the same corporators as those of the fire insurance company, the brokerage company being organized for the purpose of selling the stock of the fire insurance company, a note and mortgage given to the brokerage company for stock in the fire insurance company will be cancelled for fraud of the brokerage company in the transaction. And it is sufficient to warrant the court in disregarding the corporate entity of the two companies and treating them as one where it appears that the brokerage company gave to the fire insurance company, a note for a block of its stock but the stock was not actually issued until the brokerage company resold the same, and accordingly, it was held that the note and mortgage made to the brokerage company therefor would be cancelled in the hands of the insurance company. In such case the court announced the rule to be that a court of equity will not permit mere corporate forms to serve as a cloak and shield to the perpetration of a fraud, but will examine the whole transaction, looking through corporate forms to the substance of things to protect the rights of innocent parties, or to circumvent fraud.[139] In such case it is no defense to essay to invoke the rule of separate corporate entity that the transaction was had with another corporation where it appears both coroporations were organized on the same day and had the same stock-

[138] Kardo Co. vs. Adams, 231 Fed. 950; 146 C. C. A. 146; American Ball Bearing Co. vs. Adams, 222 Fed. 967; Scilley vs. Red Lodge Rose Bud Irrigation Co., 272 Pac. 543-551; 83 Mont. 282.

[139] Ehlers vs. Bankers Fire Ins. Co., 189 N. W. 159; 108 Neb. 756; Lutz vs. Bankers Fire Ins. Co., 189 N. W. 161; 108 Neb. 760.

holders and the fraud of one is chargeable to the other.[140] It would seem to follow that where the issue is whether or not a corporation is a holder in due course of negotiable paper, the corporate forms will be ignored and substance examined to determine the issue. One who is substantially a corporation could not negotiate a note to it so as to make it a holder in due course. So one corporation substantially the same as another could not place the latter in position of a holder in due course of negotiable paper by transferring to it such paper.

§ 99. Corporate Entity Disregarded to Hold Practical Owner of Its Stock on Oral Guaranty of Payment of Mortgage

Where one is the practical owner of all of the stock of a corporation, and orally guarantees its mortgage and holds himself out as one with the corporation, and kept no record evidencing the corporation's actions, and fraudulently transfers the corporate assets to himself, and the credit was actually given to him upon his oral guarantee of a mortgage, he will not be permitted to deny the debt was his, and the courts will hold him and the corporation as one and render judgment against him upon the corporate note and mortgage.[141] Of course this rule is applicable on a guaranty of any indebtedness of corporation whether secured by mortgage or not if the facts warrant holding the owner of the corporation is one with it.[142]

[140] Ehlers vs. Bankers Fire Ins. Co., supra; Lutz vs. Bankers Fire Ins. Co., supra.

[141] Quaid vs. Ratkowski, 183 App. Div. 428; 170 N. Y. Supp. 812; 224 N. Y. 624; 121 N. E. 887; Almirall & Co. vs. McClement, 207 App. Div. 320; 202 N. Y. S. 139.

[142] Secs. 100, 434, infra.

CHAPTER VI

COURTS OF EQUITY MOVE TO DISREGARD CORPORATE FICTION ON THE GROUNDS OF FRAUD

CONTENTS

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§ 100. Fraud Actuates Courts of Equity to Move

Courts of equity have from the very earliest times decided that even an act of parliament shall not be used as an instrument of fraud and if, in the machinery of perpetrating a fraud, an act of parliament intervenes, courts of equity, it is

true, do not set aside the acts of parliament, but it fastens on the individual who gets a title under that act and imposes on him a personal obligation, and he is not protected by the application of an act of parliament as an instrument for the accomplishment of his fraudulent ends.[1]

If then, in a case, the adoption of equitable estoppel may be resorted to for the purpose of breathing vitality and life into a contract, void under a statute or parliamentary enactment, upon the principle that not even an act of parliament, or, in this country, a legislative enactment, shall be used as an instrument of fraud, certainly a mere charter of incorporation cannot be availed of successfully for the purpose of accomplishing fraudulent ends. And so where one has guaranteed verbally the debts of a corporation and represented at the same time that the corporation and himself were substantially identical, he will not be permitted to hide behind the corporate charter and he will be estopped from assuming a different attitude.[2]

§ 101. Courts Will Be Moved to Disregard Corporate Fiction For Fraud, Actual or Constructive

The rule is generally established that courts will readily be moved to disregard corporate fiction and deal with the substantial rights of the parties where it is made to appear that failure so to do would lend approval to fraudulent conduct and the fraud that actuates courts in disregarding corporate entities may be actual or constructive.[3] It seems clear enough that the court in American Railway Express Company vs.

[1] McCormick vs. Grogan, 4 H. L. 82; National Mortgage Co. vs. Hurst, 231 N. W. (Neb.) 519; Jacoby vs. Duncan, 247 N. Y. S. 318.

[2] McCormick vs. Grogan, supra; see sec. 99, supra.

[3] Kellogg vs. Douglas County Bank, 58 Kan. 43; 62 A. S. R. 596; 48 Pac. 587; Higgins vs. Cal. Pet. & Asphalt Co., 147 Cal. 363; 81 Pac. 1070; Hamilton Ridge Lumber Sales Corp. vs. Wilson, 25 Fed. (2d) 592; 23 Fed. (2d) 398; see also 26 Fed. 893; Williams vs. Com. National Bank, 49 Ore. 492; 11 L. R. A. N. S. 857; 90 Pac. 1012; 91 Pac. 443; Spadra-Clarksville Coal Co. vs. Nicholson, 93 Kan. 638; 145 Pac. 571; 1916D A. C. 652; Schmitt vs. No. Counties Land & Cattle Co., 292 Pac. (Cal.) 173.

Com.,[4] could have bottomed its decision upon the impregnable foundation of constructive fraud and have been sustained by reason, fortified by precedent, and upheld by logic and principle.

§ 102. Corporate Fiction Disregarded if Refusal to Do So Would Work Inequitable Results

Clearly the modern tendency of the judicial decisions of the courts is to even extend the rule beyond the requirement of the existence of fraud, actual or constructive, and it is now sufficient to move the court to dissipate the corporate entity if to recognize it would bring about an inequitable result. And so relief will be denied in a case where the corporation seeks to have its bonds and securities annulled but to do so would redound to the benefit of its sole stockholder and would work an inequitable result. Courts refuse to lose sight of the fact that to assert rights of an equitable nature, or to seek relief upon the rules or principles of equity, the shareholders of the corporation are the real and substantial beneficiaries, and if the stockholders have no standing in court and are not equitably entitled to the remedies sought to be enforced by the corporation itself in their behalf and for their advantage, the corporation will not be permitted to recover.[5] In the light of modern authorities, and upon consideration of the very just and equitable grounds underlying them, it is indeed hard to reconcile and harmonize a case like Briggs vs. Harper Clay Products Company.[6] In that case it appeared that the president and general manager owned four hundred ninety-eight out of five hundred shares of the corporate stock of the cor-

[4] 190 Ky. 636; 228 S. W. 433; 30 A. L. R. 543; 273 U. S. 269; 71 L. Ed. 639; 47 S. Ct. 353; 263 U. S. 674; 42 S. Ct. 47; 44 S. Ct. 4; 68 L. Ed. 500.

[5] Wenban vs. Hewlett, 227 Pac. 723; 193 Cal. 675; Southern Pacific Co. vs. Bogert, 250 U. S. 483; 39 S. Ct. 533; 39 S. Ct. 492; 63 L. Ed. 1099; Home Fire Ins. Co. vs. Barber, 67 Neb. 644; 93 N. W. 1024; 60 L. R. A. 927; 108 A. S. R. 716; see also Kniese vs. Fairfax Incline Ry. Co., 274 Pac. 382-383; 96 Cal. App. 427.

[6] 272 Pac. 962; 150 Wash. 235.

poration. That he had made advancements to his corporation—to his *alter ego*—to his other self, and yet the courts scrutinized the transaction and adhered to the corporate entity and stood him up along the side of general creditors. It certainly appears that the court there failed to comprehend the spirit and significance of the rule of equity that is so frequently finding sanction and approval in the opinions of courts in this enlightened day. It seems too clear for argument that to allow an individual, who owns and controls and dominates a corporation, to come in and share in the proceeeds of its property along with general creditors recognizes the corporate fiction in the extreme and that, though its recognition leads to inequitable results. Such a holding allows Dr. Jekyll to escape the consequences of the misdeeds of Mr. Hyde. The dialectics of the court in making this pronouncement are not easy to understand.

§ 103. Corporate Entity Disregarded For Procedural Purposes

Further, in development and extension of the principle that we have under consideration that courts may be moved to disregard corporate fiction for fraud, actual or constructive,[7] or where to recognize the corporate entity would work an inequitable result,[8] the courts have reached the stage that the corporate forms will be brushed aside in the interest of justice where merely a question, procedural in character, is involved, so that it is now the law that if necessary purely as a matter of procedure in dealing with different corporate entities they will be treated as one, or the stockholder or stockholders will be treated the same as the juristic body or disregarded.[9]

Some interesting questions could arise in adhibition of the rule that corporate forms will be put aside for purely procedural purposes. In most states are found statutes enacting

[7] See. 101, supra.
[8] See. 102, supra.
[9] Steiner vs. Stotter, 154 N. E. 66; 23 Ohio App. 249.

that it shall be ground for peremptory challenge to a proposed juror if it shall appear that the relationship of debtor and creditor, or attorney and client, and the like exists between a party litigant and such juror, or in case of one of the attorneys of record and such proposed juror. It is submitted that if it shall be made to appear that the relationship of attorney and client exists between one of the attorneys of record and a corporation of which the proposed juror is a substantial owner, that the corporate entity will be ignored, and the ground held good; and if it shall appear that the relationship of debtor and creditor exists between a party litigant and such venireman, that the challenge ought to be allowed. It is certainly true that the operation of the rule under consideration cannot be escaped if substance is regarded and form brushed aside.

§ 104. It Is Enough to Call For Disregard of Corporate Entity to Determine Whether One Corporation Is Agent or Instrumentality of Another

Further extended, the principle is now operative that the courts will, nothing else appearing, for the purpose of determining whether in truth and in fact one corporation is the agent, tool, or instrumentality of another, look through form to substance and ignore mere colorable corporate entity to the end that the rights of third persons shall be protected.[10] This perhaps is but a different way of saying corporate forms will be brushed aside in interest of procedural matters.

§ 105. Equity Will Strip Aside Corporate Fiction to Prevent Fraud and to Sustain a Contract on Specific Performance

The rule or fiction of law that a corporation is a separate entity, separate and apart from its members, does not always

[10] Old Ben Coal Co. vs. Universal Coal Co., 248 Mich. 486; 227 N. W. 794.

obtain in courts of equity, or in courts of law, for that matter,[11] where to do so would result in putting it within the power of the shareholders of a private corporation, who substantially own and who control the corporation affairs, to perpetrate fraud upon those dealing with them, or the corporation.[12] The application of this principle is well illustrated by the case cited in the footnotes to the effect that where a corporation is virtually owned and controlled by husband and wife, and they make a contract without conforming to the by-laws, they will not be heard to say that they did so in violation of the by-laws and, therefore, the corporation is not bound but, on the contrary, such contract will be specifically performed at the hands of a court of equity.[13]

§ 106. Equity in Case of Fraud Will Strip Aside the Corporate Entity and Go as Far as Necessary to Run Down. Fraud and Reach Property For Creditors

Where a corporation has been organized and used as an instrumentality in the hands of a debtor for fraudulent purposes, as where an individual incorporates himself in order to hinder and, if possible, defraud creditors, courts will go as far as necessary in disregarding the corporation and its doings in order to accomplish justice. Such a corporation is a mere parasitic growth, a mass of fungus which will be lopped off clean whenever necessary to sound results. Differently stated, the difference in legal personalities between a corporation and a debtor who organizes it for fraudulent purposes gives the corporation no greater rights than its creator. The corporation cannot be a party to a fraud engineered by its creator, or set up a title to which its creator will have substantially the whole benefit. Neither can such corporate sham be invoked to forestay an adjudication at the

[11] See sec. 113, supra.

[12] South Florida Citrus Land Co. vs. Walden, 61 Fla. 766; 55 Southern 862; 59 Fla. 606; 51 Southern 554. (Cited as South Florida Citrus Land Co. vs. Waldin, 61 Fla. 766, 55 Southern 862.)

[13] South Florida Citrus Land Co. vs. Walden, supra.

hands of a court that would otherwise be made, and set at naught the attempted perpetration of fraud.[14] So where a debtor organizes himself into a corporation and resorts to a thaumaturgic manipulation of titles to property from himself to third parties and from a third party to the other self of the debtor in the form of a juristic creation and in such case, and in order to reach the property and see that it is properly applied in the liquidation of the obligations of the debtor, the court will to that end set at naught corporate entities that are put in the way of the hand of justice in its attempt to halt its reach in the interest of creditors, to property that should be applied there.[15]

§ 107. Corporate Entity Cannot Be So Sacred as to Protect an Administrator in His Fraudulent Attempts to Benefit Himself by Reason of His Trust Capacity

No corporation can be so securely organized and protected as a legal entity as to become a cover for wrong and fraud and thereby defeat the rights of innocent parties. A corporation cannot be greater than law and equity, nor by reason of its legal entity be immune from answering for fraud and wrong. In such case, the protecting hands of equity will brush aside the outward forms of corporate entity and analyze the foundation, purpose, and intent of the corporation, and if the purpose and intent of the corporation are not embedded in good faith and are but a cover for wrong and fraud against the innocent, the corporate entity will afford no protection for such wrong or fraud in the courts. Corporations in transaction of business have a legitimate use as a matter of business and when so used for the accomplishment of a legitimate purpose are not looked upon with disfavor either by courts of law or equity, and the legal entity of such corporations, when engaged in a legitimate enter-

[14] *Matchan vs. Phoenix Land Investment Co.*, 198 N. W. 417; 159 Minn. 132.

[15] *Matchan vs. Phoenix Land Investment Co., supra.*

prise, is recognized both at law and in equity, but neither law nor equity will ever recognize the right of a corporate entity to become the receptacle or cover for fraud or wrong based upon deception for the purpose of defeating the rights of innocent parties. So in a case where an administrator attempted to manipulate the trust funds and property in his hands in the interest of a corporation dominated and controlled by him, and of which he was the majority stockholder, the courts will brush aside the corporate forms and require the administrator to account for the property that he has thus placed in his fiduciary capacity in his own hands as substantial owner of the corporation.[16]

§ 108. Corporate Entity Will Not Be Disregarded at Instance of One Who Has Done Corporation Wrong

It is now well recognized as a general proposition meeting with little or no dissent that courts of equity will not permit corporate forms to be used as a shield for injustice and wrongdoing, or to cover up crime, protect fraud, or inflict upon the public inconvenience, but no case has been found—and very probably it could be asserted with safety from contradiction that none exist—in which a court has been moved to brush aside corporate forms in response to the prayer for relief and at the instance and for the benefit of one who has committed a wrong against the corporation. The rule has no application to such a case.[17]

§ 109. Corporate Form Will Not Be Disregarded If to Do So Works Fraud

If such a state of facts is presented that if the corporate existence is disregarded the result will be to sanction the fraud of one party against another and permit the one party, by reason of such disregard of the corporate fiction, to

[16] McFadden vs. Jenkins, 40 N. D. 422; 169 N. W. 151.
[17] Kardo Co. vs. Adams, 231 Fed. 950; 146 C. C. A. 146; see also American Ball Bearing Co. vs. Adams, 222 Fed. 967.

become enriched by his own dishonesty and deceit, the court will not give its sanction or approval to such conduct and if to adhere to the separate corporate existence will defeat such result, then it certainly follows as readily that the court will follow the corporate forms and sustain the corporate fiction of the separate, distinct identity.[18] So where two brothers own the whole of the stock of a corporation and one is in possession of and fully acquainted with the facts of its true financial condition but misrepresents to the other stockholder the financial condition of the corporation for the purpose of manipulating its property and rights, the corporate entity will be adhered to to the end and for the purpose that the stockholder that is unacquainted with the condition of the corporation shall receive his share of the corporate profits.[19]

§ 109a. Corporate Entity Not Brushed Aside If to Do So Works a Detriment to Creditors

We have already seen in the preceding section that, if to brush aside the corporate entity would work a fraud, the courts will not do so, and it may be said with safety that the courts will even go farther than this. That even in a case where it would operate to the detriment of the creditors of a corporation to disregard its entity, the corporate fiction will be adhered to. However, the court in deciding this, made a statement more or less loosely that it is a general principle that equity would disregard the corporate fiction for the purpose of preventing the successful perpetration of fraud, and attempted to state the rule, as if it were restricted to the limited class of cases involving fraud, and left the implication that the rule is applicable where the corporation was owned by one or many. In other words, the court left the impression that whether a corporation was composed of one stockholder or many was a matter of small consequence. Some rather loose language crept into the opinion.

[18] Con. Securities Inv. Co. vs. Rawson, 280 Pac. 954; 208 Cal. 228.
[19] Con. Securities Inv. Co. vs. Rawson, supra.

The court held also that the fact a joint property statement had been issued by two corporations—they being owned by one stockholder—was not controlling nor sufficient to demand a disregard of entities.[20]

§ 110. Corporate Entity Not Denied to Defeat Lien Against Corporate Property Although Stock Owned by a Single Individual

Where all of the stock of a corporation becomes concentrated in the hands of a single individual, and a judgment is rendered against the corporate entity, such judgment is a lien upon the real estate standing in the name of that corporate entity and the fact that all of the shares of stock are merged in one owner does not operate to destroy the identity of the corporation as such so as to redound to the benefit of the single stockholder and defeat the lien of the judgment creditor.[21] This seems to be but another application of the rule that the courts will not disregard the corporate entity if to do so, instead of preventing fraud, would work a fraud.[22]

[20] Security Savings & Trust Co. vs. Portland Flour Mills, 261 Pac. 432; 124 Ore. 276; Jackson vs. H. Thomas Inv. Co., 46 Fed. (2d) 252.
[21] Voll vs. Zelch, 201 N. W. 33; 198 Iowa 1333.
[22] Voll vs. Zelch, supra.

CHAPTER VII

COURTS OF EQUITY REGARD SUBSTANCE RATHER THAN FORM. COURTS OF LAW FOLLOW EQUITY IN THIS REGARD

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114. Courts of equity and courts of law will not be trammeled by legal entity.
115. The courts in applying the rule of brushing aside the corporate entity will not be hampered by any name that subsidiary company may be called.

§ 111. Courts of Equity Should Adopt Their Practice to Cope With Progress of Society

It is the duty of courts of equity to adopt their practice and course of proceeding, as far as possible, to meet the demands and requirements of the existing state of society and to apply its jurisdiction to all those new cases and questions which from the progress made daily in the affairs of men must be continually arising and not from its strict adherence to forms and rules established under far different circumstances, decline to administer justice and to enforce rights for which there is no other remedy. As a corollary of this principle, it has been declared that under many circumstances the court of chancery has jurisdiction to prevent corporations acting in various ways or contrary to the intent for which

they have been created.[1] With a principle of this sort embedded in the system of equitable jurisprudence, it is readily seen that it could be applied in such fashion as to disregard the mere form of corporate entity and to deal with the persons who actually form, and who are the moving spirit and controlling heads of the corporate fiction.

§ 112. Equity Regards Substance Rather Than Form

As a general rule, equity regards substance rather than form and it is by no means confined to cases disregarding the corporate fiction but equity will look through the forms of any transaction and adjust the equities of the parties with a view to its substance rather than its mere form so long as so doing no superior equities of third parties will be impaired by such an adjustment.[2] In application of this principle, where the corporate stock is owned by one party, and that party in interest is the stockholder, fiction of corporate entity may be disregarded where justice requires it, and so accordingly a set-off was allowed between a creditor of a corporation of a debt that such creditor held against the single stockholder of the corporation.[3] While the courts of equity have ever occupied a place well in advance of the procession in the parade of progress, yet the courts of law have found little difficulty in the interest of justice in following the lead of courts of chancery. So it is now well recognized as a principle of law that the law, as well as equity, refuses to be a worshipper of formalities, and in emulation of the exalted example of equity, the law now looks rather to substance than to form.[4]

[1] Columbian Athletic Club vs. State, 143 Ind. 98; 52 A. S. R. 407; 40 N. E. 914; 28 L. R. A. 727; Gibbs vs. Morgan, 9 Idaho 100; 72 Pac. 733.

[2] Smith vs. Felton, supra; see secs. 20, supra, 439, infra; Knight vs. 482; 154 N. E. 345.

[3] Smith vs. Felton, supra; see secs. 20, supra, 439, infra; Knight vs. Burns, supra.

[4] Hoskins vs. Hotel Randolph Co., 203 Iowa 1152; 211 N. W. 423; 65 A. L. R. 1125; 275 U. S. 566; 72 L. Ed. 429; 48 S. Ct. 122.

§ 113. Originally, Court of Equity Only, Disregarded Corporate Forms But Law Now Follows Equity in That Regard

Formerly, only courts of equity felt themselves possessed with that strength and vigor that have always attended courts of equity and that were required to brush aside the corporate forms and look to substance. It seems that the tendency of courts of equity at first was to regard a corporation merely as an association of individuals and when they once reached the point where they regarded the corporation as such an association, it was but a step to a position that the courts would, in a proper case, ignore or brush aside the fictional means by which this association was bound together.[5] As time went on, a great number of cases found their way into the courts and, there appearing no sufficient reason for the disregard of the corporate entity, in a proper case, should be the exclusive province and jurisdiction of courts of equity, but courts of law assumed for themselves the right to follow equity in this regard, and it is now well settled that the disregard or brushing aside of the corporate entity will as readily be accomplished, if the facts justify it, in a court of law as in a court of equity.[6]

The rule by which courts have been guided in brushing aside the corporate entity has been frequently denominated as the equitable rule but in its modern application, and since the courts of law now apply as readily as courts of equity, this is seen to be slightly inaccurate to offer it as a rule finding application in courts of equity only.[7]

[5] First National Bank vs. Winchester, 119 Ala. 168; 72 A. S. R. 904; 24 Southern 351; Marine National Bank vs. Swigart, 262 Fed. 854; Home Fire Insurance Co. vs. Barber, 67 Neb. 644; 93 N. W. 1024; 60 L. R. A. 927; 108 A. S. R. 716; State Trust & Savings Bank vs. Hermosa Land & Cattle Co., 240 Pac. 469; 30 N. M. 566; Conway vs. Citrus Belt Land Co., 84 Cal. App. 533; 271 Pac. 525.

[6] Erkenbrecher vs. Grant, 187 Cal. 7; 200 Pac. 641; Midwest Air Filters Pacific vs. Finn, 258 Pac. 382; 201 Cal. 587; Com. Security Co. vs. Modesto Drug Co., 184 Pac. 964; 43 Cal. App. 162; Bryan vs. Banks, 277 Pac. 1075; 98 Cal. App. 748; Bethlehem Steel Co. vs. Raymond Concrete Pile Co., 118 Atl. 279; 141 Md. 67.

[7] Carozza vs. Federal Finance & Credit Co., 131 Atl. 332; 149 Md. 223; 43 A. L. R. 1.

§ 114. Courts of Equity and Courts of Law Will Not Be Trammeled by Legal Entity

It is thought that the courts have, since the rendition of the decision in Anthony vs. American Glucose Company,[8] refused to be hampered in the administration of justice by the corporate forms or fiction and this position declared at that time by the court of last resort of New York has now such a strong grasp upon the system of jurisprudence prevailing throughout the United States that it may almost be said that it is one of universal application. The development of the rule whereby the courts, both at law and in equity, will disregard the corporate entity has so commended itself as being in the interest of justice that it is clearly understood the rapidity with which it has wended itself into the favor of the courts.[9]

§ 115. The Courts in Applying the Rule of Brushing Aside the Corporate Entity Will Not Be Hampered by Any Name That Subsidiary Company May Be Called

If a corporation carries on its business, or a substantial part of it, through subsidiary companies, when the question is presented to the courts it makes little difference what such subsidiary companies may be called or denominated. The modern trend of decisions, with remarkable unanimity, is toward the position that there is no particular apotheosis attending corporate forms, and when it seems necessary for courts to do so, they will look through the fictional forms of corporate creation to get at the real intent of the association of the individuals of the corporation forming the organization of the parent corporation and its subsidiary and in

[8] 146 N. Y. 407; 41 N. E. 23; 66 Hun. 634; 21 N. Y. S. 667; 49 N. Y. St. R. 857.

[9] Anthony vs. American Glucose Co., 41 N. E. 23; 66 Hun. 634; 49 N. Y. St. R. 857; 146 N. Y. 407; 21 N. Y. S. 667; Bauernschmidt vs. Bauernschmidt, 101 Md. 148; 60 Atl. 437; Seymour vs. Spring Forest Cemetery Association, 144 N. Y. 333; 39 N. E. 365; 64 Hun. 632; 26 L. R. A. 859; 19 N. Y. S. 94; 45 N. Y. St. R. 520.

the interest of third parties, or to accomplish ends of justice, the real effect of the corporation, or organization, will be dealt with in order to perfect square dealing and effectuate justice.[10]

[10] Wabash Railway Co. vs. American Refrigerator Transit Co., 7 Fed. (2d) 335; 270 U. S. 643; 46 S. Ct. 208; 70 L. Ed. 776.

CHAPTER VIII

RIGHTS AND LIABILITIES OF STOCKHOLDERS IN CONNECTION WITH DISREGARDING OF CORPORATE ENTITY

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139. Recovery of judgment after consolidation, consolidated company liable.
140. Early rule was that reorganized company was not liable for debts of old organization.
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§ 116. Where a Corporation Has Gone Defunct and Thereafter Revived, Old Directors Not Liable for Actions of Revived Corporation

The principle that the corporate entity will be disregarded to prevent the perpetration of fraud, or the working of an injustice, has found application in a case where a corporation has become defunct for the nonpayment of its license

tax and later on a palingenesis of the corporation is effectuated by the payment of the delinquent license tax, and a new board of directors is thereafter elected, the new board cannot assert a liability against the old board of directors where to do so would be inequitable or unjust.[1] The court, in such case so far removes from its consideration the existence of the corporate fiction as to deal with the persons operating within penetralia of the jural form.

§ 117. Where There Are No Creditors, Stockholders Can Dispose of Property As They See Fit

Where there are no creditors, and all the stockholders concur in the action, the officers of a corporation may dispose of the property in any manner that they deem proper and in application of this principle it was held that where a single individual became the sole owner of the stock of a corporation and to pay therefor to the selling stockholders, the corporate property was conveyed to such stockholders in payment of their stock, and in the absence of other creditors an action could not be maintained in the name of the corporate entity against the sellers of the stock for receiving the corporate property unlawfully.[2] This is but an illustration of the general principle that is so frequently applied in reported decisions in our time that while in general a corporation has an entity distinct from that of its stockholders, this separate personality created by law will readily be disregarded if necessary to do substantial justice and is but stating the rule differently that the courts now look to substance of transactions and refuse to be hampered by mere form or color.[3]

[1] Talcott Land Co. vs. Hershiser, 195 Pac. 653; 184 Cal. 748; 8 Cal. L. Rev. 435.

[2] Stony Brook Lbr. Co. vs. Blackman, 286 Pa. 305; 133 Atl. 556; Pueblo Foundry & Machine Co. vs. Lannon, 187 Pac. 1031; 68 Colo. 131; Great Western M. & M. Co. vs. Harris, 128 Fed. 321; 63 C. C. A. 51.

[3] Stony Brook Lbr. Co. vs. Blackman, supra.; S. G. V. Co. of Del. vs. S. G. V. Co. of Penn., 107 Atl. 721; 264 Pa. 265; Kendall vs. Klapperthal Co., 52 Atl. 92; 202 Pa. 596; C. S. Goss & Co. vs. Goss, 132 N. Y. Supp. 76; 147 App. Div. 698; 207 N. Y. 742; 101 N. E. 1099.

§ 118. The Intention to Take in New Stockholders in a Reorganized Corporation Is Immaterial in Disregarding the Corporate Entity

The mere intention to take in new stockholders in a reorganized corporation will not serve as a shield to protect and defend such new organization against the claims and obligations of the old company where it is but a reincarnation of the former organization, being organized by the officers and stockholders of the old company, and it is immaterial how many corporations have been organized and intervened between the contracting company, or obligor, and the new organization. It seems to be a rule that is a safe guide to be followed that where the reorganized company is composed of substantially the same stockholders as the old company, no amount of manipulation of the corporate franchise will debar creditors from following the stockholders and officers in the old company, and the courts will fix liability where it properly belongs without regards to the kaleidoscopic manipulation of the corporate entity.[4]

§ 119. Where the Principal Owner of a Corporation Borrow-Money and Gave Corporate Bonds and His Note Therefor, the Corporation Is Liable Therefor

Where a corporation, upon resolution passed by the board of directors, authorized the issuance of bonds and where the secretary of the company, who owned all of the stock except two shares, delivered said shares as collateral to his individual promissory note, the corporate entity will be disregarded and the bonds will be subjected to the satisfaction of the individual note of the principal owner. This position is well sustained by the fact that the secretary was practically the owner of the corporate stock and the corporation was virtually his private property, and in the light of these cir-

[4] *Higgins* vs. *California* Petroleum & Asphalt Co., 147 Cal. 363; 81 Pac. 1070; 109 Cal. 304; 41 Pac. 1087; 122 Cal. 373; 55 Pac. 155.

cumstances the court felt much disinclined to carry too far the legal conception that a corporation is to be regarded as a juristic entity existing separate and apart from the natural persons composing it. The court felt constrained to sustain the position that a corporation, as an artificial person or entity separate and apart from its members, is merely a description in figurative language of a corporation viewed as a collective body.

A corporation is merely an association of persons and no judicial dictum or legislative enactment can alter this fact. It should never be overlooked that the idea that a corporation may be a separate entity in the sense that it may act independently of the natural persons composing it, or abstain from acting where it is their will that it shall, has no foundation in reason or authority and is contrary to fact.[5]

§ 120. Where Sole Owner of a Corporation Seeks to Enforce His Contract With It, Relief Denied If It Would Injure Others

Where the sole or principal stockholder contracts with himself in the form of a corporation that he owns and controls, and it is attempted by such stockholder to assert the rights under the contract against the corporation, and by its terms and provisions to strip the legal entity of its property and leave it a mere fictional existence, the courts will not permit this to be done, if so to do would result in injury to or working of a fraud on the rights of others.[6]

§ 121. Corporate Entity Disregarded to Hold Stockholder on Corporate Note Given in Renewal of His Note

Where an individual signed a note and thereafter organized a corporation, of which he was sole stockholder, and renewed

[5] Buffalo Loan Trust & Safety Deposit Co. vs. Medina Gas & Elec. Light Co., 12 App. Div. 199; 42 N. Y. Supp. 781; 162 N. Y. 67; 56 N. E. 505.

[6] Chicago & Grand Trunk Ry. Co. vs. Miller, 91 Mich. 166; 51 N. W. 981.

the note in the corporate name, both the stockholder and the corporation are liable on that note and the statute of limitation will not avail the individual defendant for the reason that the interest and payments have been made by the corporation, the law being in the particular jurisdiction that a payment stops the running of the statute of limitation up to the date of payment and creates a new period from which the statutory period is computed. It was accordingly held by the court that this was sufficient to call upon the court to disregard the corporate entity and hold both the corporation and its stockholder liable upon the note. The payments made by the corporation were treated as jointly made, thus taking the case out of the operation of the statute.[7]

§ 122. Corporate Entity Disregarded to Prevent Stockholders From Becoming Creditors to Injury of Other Creditors

The corporate entity will be disregarded to prevent stockholders from resorting to a metamorphosis from the situation of a stockholder to that of creditor if so to do would work an injury to other creditors. It is indeed familiar law that the courts will not allow a corporate fiction to destroy the rights of creditors and especially where an element of fraud, either in fact or raised by a legal implication, enters into the matter, and any form or guise resorted to for that purpose will be disregarded and substance will be looked to and form ignored, and if, in the course of the application of this rule, it becomes necessary to ignore the fact that where one corporation is wholly under the control of another, it is a separate entity, this will be done and the latter will not be relieved from liability for the acts of such other corporation and even when one corporation is the owner or proprietor of another, if necessary to do justice the subsidiary company will be regarded as a mere name.[8]

[7] Minifie vs. Rowley, 187 Cal. 481; 202 Pac. 673; see sec. 432, infra.
[8] In re Marcella Cotton Mills, 8 Fed. (2d) 522.

§ 123. Where One Corporation Under the Control of Another, Will Be Regarded As a Mere Trade Name

Where one corporation is completely owned and controlled by another, the owned and controlled corporation and its name may be, in the interest of justice, regarded as a mere trade name under which the other corporation is doing business. The important question in all such cases arising is whether the corporation that it is sought to be held owns, manages, operates and controls the subsidiary company and the fact that the subsidiary company had a valid corporate existence is wholly immaterial.[9]

§ 124. Where a Corporation Is an Instrumentality For Fraudulent Purposes in the Hands of Its Owner, Trustee in Bankruptcy Will Be Decreed to Administer on the Corporation and Its Property

Where an individual causes a corporation to be organized as a means and vehicle through which to transact business, and with the evident purpose to conceal his assets from, and to hinder, delay, and defraud his creditors, and such individual thereafter goes into bankruptcy, the property standing in the name of, and owned by such corporation, will be regarded as the property of the bankrupt and accordingly administered as such.[10]

§ 125. Corporate Entity Disregarded to Prevent Government Employee From Recovering Compensation From a Government-owned Corporation

Where the United States government is the owner of a corporation created by it, such for instance, as the United States

[9] Fourth National Bank vs. Portsmouth Cotton Oil Refining Corp., 280 Fed. 879; 284 Fed. 718; in re Marcella Cotton Mills, 8 Fed. Rep. (2d) 522.

[10] Isaacson vs. Union Trust Co. of San Diego, 275 Pac. (Cal.) 529; see also 273 Pac. 119; 286 Pac. 1017.

Grain Corporation, or other juristic creation by the government for the more convenient administration of its affairs, and an employee of the United States performs service for such corporation, he is not entitled to compensation therefor and to work this result the courts will go behind the mere corporate forms to the substance of the matter and treat the United States government as the real party in interest, or, putting it differently, will look upon such employee of the United States government as attempting to collect from it additional compensation to which such employee is not entitled.[11]

In consonance with the foregoing principle a prosecution will lie for obtaining the payment of fraudulent claims from a government-owned corporation of the United States in the same manner and to the same extent as if the fraud were perpetrated against the United States government itself. This result is only obtained by virtue of brushing aside the corporate forms and dealing with substance in that the United States government is, in truth and in fact, the real party in interest and when its corporation is defrauded, the government itself is the victim, and so the perpetrator of such fraud may be called to account as completely and as fully as if the juristic creation of a corporation had not intervened in between the act of the perpetrator and the government itself.[12]

§ 126. Corporate Entity Disregarded to Prevent Excessive Location on Government Coal Lands

In application of the principle that in proper cases corporations and their owners will be treated as one, has found favor in cases where it is attempted by means of resorting to the jural fiction of separate entity of a corporation to make separate entries on coal lands in violation of the United States

[11] U. S. Grain Corp. vs. Phillips, 279 Fed. 244; 261 U. S. 106; 67 L. Ed. 552; 43 S. Ct. 283.

[12] U. S. vs. Walter, 44 Sup. 10; 263 U. S. 15; 68 L. Ed. 137; Rev. 291 F. 662; see, however, sec. 27, supra.

statute, and so where it is attempted to procure government lands through the means of a corporate fiction, this attempt will not meet with favor when called to an account by a criminal prosecution in the federal courts and the corporate entity and its owners will be regarded as one.[13]

§ 127. In Locating Mining Claims Upon Government Lands, the Individuals Composing a Corporation Looked to and Corporate Form Disregarded

The doctrine is well established that rights with respect to property held by citizens are not lost because they unite themselves into corporate bodies. They are subsequent to such corporate formation as able to invoke the law for enforcement of their rights as if the corporate form had not been adopted. The courts in such cases look through the name in order to protect those whom the name represents. So where a corporation is created under the laws of one of the states and is composed of persons who are citizens of the United States, such corporation is competent to locate in its own behalf or to join with others in location of mining claims upon public lands of the United States in like manner as individual citizens, and in order to determine this right on the part of the corporate creation, the court will look to the substance and not be blinded by a mere form.[14]

§ 128. The Transfer of Assets by a Debtor to a Corporation Formed by Him and Taking in Payment Stock, Does Not Violate Bulk Sales Statute

Sometime questions of nicety arise in connection with the formation of a corporation by a debtor and the transfer of his property to such corporation and taking in payment thereof,

[13] U. S. vs. Munday, 222 U. S. 175; 56 L. Ed. 149; 32 S. Ct. 53; Rev. 186 Fed. 375; U. S. vs. Trinidad Coal & Coking Co., 137 U. S. 160; 11 S. Ct. 57; 34 L. Ed. 640; Rev. 37 Fed. 180.

[14] McKinley vs. Wheeler, 130 U. S. 630; 9 S. Ct. 638; 32 L. Ed. 1048; see also Thomas vs. Chisholm, 13 Colo. 105; 21 Pac. 1019.

stock. This situation in general calls for a disregard of the corporation so formed and a treatment of the corporation and the individual forming it as one and the same.[15] But the question also arises in such cases whether or not this transaction infringes the "bulk sales statutes," having reference to that class of statutes that have been passed by most states more or less similar, prohibiting sales of stocks of merchandise and other mercantile stocks in trade without a notification of creditors. It is thought that the position that such transfer does not violate the bulk sales statute is sustained in reason and is well grounded on principle because if the transaction is to be treated that there is, in fact, no sale but is a mere change of form on the part of the debtor creating the corporation, then no reason would appear for requiring a compliance with the bulk sales law for the very manifest reason that if a sale did not, in fact, take place, there could be no occasion to comply with such law. The law seems to look upon such transaction in about the same manner as if an individual doing business in his own name should adopt a fictitious name and transfer his assets to himself under such fictitious name. The authorities on this question are indeed limited but it is thought that those sustaining the position that such a transfer is not violative of the bulk sales law are sounder and better reasoned.[16]

§ 129. Statutes Requiring a Change of Possession in Sales of Personal Property Not Violated by Owner Organizing Himself Into Corporation

Somewhat analogous to the question discussed in the preceding section as to whether or not a transfer from a debtor to a corporation that he has organized and as to whether or not

[15] See Secs. 130, supra, 234, 246, 248, 251, infra.

[16] Maskell vs. Spokane Cycle & Auto Supply Co., 170 Pac. 350; 1918C L. R. A. 929; 100 Wash. 16; see also Hartwig vs. Rushing, 182 Pac. 177; 93 Ore. 6; Thorpe vs. Pennock Merc. Co., 99 Minn. 22; 108 N. W. 940; 9 A. C. 229.

such transaction offends against the "bulk sales statute" is the question of whether or not a debtor organizing himself into a corporation and transferring his property to the corporation, violates the statutes prevailing in a number of states substantially providing:

"Every transfer of personal property other than a thing in action, and every lien thereon, other than a mortgage when allowed by law, is conclusively presumed, if made by a person having at the time the possession or control of the property, and not accompanied by an immediate delivery and followed by an actual and continued change of possession of the things transferred, to be fraudulent, and therefore void, against those who are his creditors while he remains in possession, and the successors in interest of such creditors, and against any persons on whom his estate devolves in trust for the benefit of others than himself, and against purchasers or incumbrancers in good faith subsequent to the transfer."[17] And it seems that where the question has been up that such organization of a corporation by the debtor, and the transfer of his property to it, and still remaining in possession as the manager of such corporation, offends against these statutes.[18] It is rather difficult on principle to see how the court reached the conclusion that where a debtor organizes himself into a corporation and transfers his property to such corporation, and of which property he continued in possession as manager of such corporation, is a violation of these statutes. By analogy this position certainly contravenes the holding of the court that the organization of a corporation by a debtor and taking stock therefor, and transferring his assets thereto, does not

[17] Idaho Comp. Stat., 1919, sec. 5434; Comp. Laws of Utah, 1907, sec. 2473; Revised Codes of Mont., 1921, sec. 8604; Ore. Laws, 1920, sec. 799, subsec. 40; Comp. Stat. of Neb., 1922, sec. 2461; Revised Laws of Nev., 1912, sec. 1078; Comp. Laws of Colo., 1921, sec. 5113; Revised Stats. of Ariz., 1913, sec. 3276; Cal. Civil Code, 1872, sec. 3440; Kerr's Civ. Code 3440; Revised Stats. of Kan., 1923, sec. 33-103; Comp. Laws of N. D., 1913, sec. 7221. These statutes are merely declaratory of the common law. 27 C. J. 573-74.

[18] McKee Stair Bldg. Co. vs. Martin, 126 Cal. 557; 58 Pac. 1044; White vs. Kincaid, 179 Pac. 685; 180 Cal. 135; Jos. Herspring Co. vs. Jones, 203 Pac. 1038; 55 Cal. App. 620.

violate the bulk sales law. On reasoning it would seem that the conclusion reached as announced in this section is not well founded.

§ 130. Where a Corporation Is Organized to Take Over the Business of an Old Corporation, Partnership, or Individual, It Ordinarily Becomes Liable For Debts

It seems to have been fairly well settled in the adjudicated cases that where the circumstances attending the succession of a new corporation to the assets and business of an old corporation warrant the conclusion that the new corporation is simply a continuation of the old, it becomes liable for the debts of the corporation to the business and assets of which it has succeeded.[19] While more difficulty has been encountered on the part of courts with the question of the assumption of liability when the corporation has succeeded to the business and assets of a copartnership or individual, yet it may now be safely said that the same rule prevails where copartners incorporate themselves, or an individual incorporates himself simply for the purpose of taking over their own assets and continuing their own business.[20]

[19] In re Johnson Hart Co., 34 Fed. (2d) 183; Skirvin Operating Co. vs. Southwestern Elec. Co., 71 Okla. 25; 174 Pac. 1069; 5 A. L. R. 1104.

[20] In re W. J. Marshall Co., 3 Fed. (2d) 192; in re Stone Moore West Co., 292 Fed. 1004; in re C. W. Aschenbach Co., 174 Fed. 396; 98 C. C. A. 290; DuVivier & Co. vs. Gallice, 149 Fed. 118; 80 C. C. A. 556; in re A. G. Crosby Co., 199 Fed. 344; Andres vs. Morgan, 62 Ohio St. 236; 56 N. E. 875; 78 A. S. R. 712; Ziemer vs. Bretting Mfg. Co., 147 Wis. 252; 142 Wis. 224; 125 N. W. 318; 133 N. W. 139; 1912D A. C. 1275; First National Bank vs. Trebein Co., 59 Ohio St. 316; 52 N. E. 834; Curtis Jones & Co. vs. Smelter National Bank, 43 Colo. 391; 96 Pac. 172; Breman Savings Bank vs. Branch-Crook Co., 104 Mo. 425; 16 S. W. 209; Star Brewing Co. vs. Flinn, 158 N. E. 891; 261 Mass. 426; in re Berkowitz, 173 Fed. 1012; Roberts vs. W. H. Hughes Co., 86 Vermont 76; 83 Atl. 807; Kellogg vs. Douglas County Bank, 58 Kan. 43; 62 A. S. R. 596; 48 Pac. 587; Forbes vs. Thorpe, 209 Mass. 570; 95 N. E. 955; Terhune vs. Skinner, Terhune vs. Hackensach Savings Bank, 45 N. J. Eq. 344; 19 Atl. 377; Bennett vs. Minott, 28 Ore. 339; 44 Pac. 288; 39 Pac. 997; Blumenthal vs. Schneider, 186 Wis. 588; 203 N. W. 393; Isaacson vs. Union Trust Co. of San Diego, 275 Pac. 529; see also 273 Pac. 119; 286 Pac. 1017; 95 Cal. App. 633.

§ 131. Where a Corporation Is Organized to Take Over Business of Another Corporation, Partnership, or Individual, Creditors Not Required to Resort to Stock

Where a corporation is organized for the purpose of taking over the business and assets of another corporation, or a partnership, or an individual, and the transfer of the business to the corporation is of such character as to bring it within the rule making the succeeding corporation liable for the debts of the business that it has taken over, the courts will not require or compel a creditor of the business to waive his right to enforce his claim against the visible and tangible property of the corporation and to run the chances of following and recovering the value of shares of stock after they are placed upon the market. The courts will not permit one who has stripped the debtor of practically all its available property to tell the creditors of that debtor that the stock that was issued for the assets of such debtor is the creditors' only resort and especially is this true when in many cases that stock is worthless. The law cannot permit this under any circumstances to be an adequate response to the creditors' demand for the satisfaction of their claims. Every principle of equity and fair dealing and, what might be said, almost uniform precedents in such cases, must emphatically say that in such case the creditor will not be required to resort to the stock issued for the assets of the debtor.[21]

There are some intimations, however, that when an individual or partnership organizes himself, or themselves into a corporation, and takes stock for the assets transferred to such corporation, the creditors must follow the stock or exhaust their remedies against such stock before resorting, under

[21] Hibernia Ins. Co. vs. St. Louis & N. O. Transportation Co., 13 Fed. 516; 4 McCrary 432; First National Bank vs. Trebein, 59 Ohio St. 316; 52 N. E. 834; Luedecke vs. Des Moines Cabinet Co., 140 Iowa, 223; 32 L. R A. N. S. 616; 118 N. W. 456; Carstens & Earles vs. Hofius, 41 Wash. 456; 87 Pac. 631; McIver vs. Young Hdwe. Co., 144 N. C. 478; 119 A. S. R. 970; 57 S. E. 169; Jennings Neff & Co. vs. Crystal Ice Co., 128 Tenn. 231; 47 L. R. A. N. S. 1058; 159 S. W. 1088; see also sec. 499, infra.

any circumstances, to the new corporation.[22] The court in the case of National Union Bank of Maryland vs. Hollingsworth,[23] undoubtedly rested its intimation that resort must be had to the stock first, upon the theory suggested in Hibernia Insurance Company vs. St. Louis & New Orleans Transportation Co.,[24] that a distinction with respect to transactions of this character exists between a corporation and a natural person; a natural person may sell his property for a fair consideration if the transaction is bona fide, and the buyer will not be required to take care that the seller provides for and pays all his debts. It is submitted that in the light of modern authority,[25] the reasoning of the courts in such cases cannot longer be sustained. It is thought that the language of the court in McIver vs. Young Hardware Company,[26] would apply with equal force whether the debtor concern was a corporation, partnership, or individual, and there the court very forcibly states that,

"When he, creditor, seeks to hold the parties who have thus stripped the debtor corporation of practically all its available capital, he is told that the stock of the insolvent defendant, the Young Hardware Company, now, of course, worthless, is his only resort, can the court permit this, under the circumstances, to be any adequate response to the creditor's reasonable demand for satisfaction of his claim where bound by every principle of equity and fair dealing, and by uniform precedents in such cases to answer this question emphatically in the negative."

If any sound reason can be advanced why the creditors of a corporation have a position of advantage before the courts over the creditors of an individual in identically the same circumstances, this position might be justified but it is respectfully submitted that no such reason can be found.

[22] McLellan vs. Detroit File Works, 56 Mich. 579; 23 N. W. 321; National Union Bank of Maryland vs. Hollingsworth, 135 N. C. 556; 47 S. E. 618.
[23] 135 N. C. 556; 47 S. E. 618.
[24] 13 Fed. 516; 4 McCrary 432.
[25] See secs. 130, supra, 234, 246, 248, 251, infra.
[26] 144 N. C. 478; 119 A. S. R. 970; 57 S. E. 169.

It has been further suggested that as to whether or not the court would compel a resort to the stock issued in payment of the assets of the debtor by a corporation formed to take over the business and assets of such debtor, would depend upon the circumstances of the particular case but just what circumstances would warrant such action it is difficult to understand. It has been further suggested, however, that if the court could do complete equity by impounding the shares of stock there would seem to be no necessity for interfering with the property of the corporation,[27] but it is respectfully submitted that this rule would result in more difficulty and hardship if it is to be ascertained first whether or not the creditor may or may not resort to the assets or to the liability of the corporation taking over the assets of his debtor. Undoubtedly, the cases holding that resort may be had in the first instance against the corporation taking over the assets of a debtor, whether that debtor be a corporation, individual, or partnership, are the sounder and juster and announce the rule that is in consonance with modern authority and with the tendency to deal with corporations as an association of individuals and in proper cases to override the corporate entity. But finally the difficulties attendant upon a correct solution of the questions arising in such cases is dissipated and disappear if the court will simply refuse to allow issue to be obscured by the interposition of matter of the corporate entity. If the debtor, whether that debtor be a corporation, partnership, or individual, and the succeeding corporation be regarded as one, then liability attaches and the perplexing issue is solved.

§ 132. Creditor Not Required to Exhaust Remedies Against the Old Organization

It seems sound that where a corporation, partnership, or individual reorganizes itself, themselves, or himself, into a new corporation, or a corporation, that the creditors of the

[27] Baker Furniture Co. vs. Hall, 76 Neb. 88; 111 N. W. 129; 113 N. W. 267; 107 N. W. 117.

business that is so turned to the corporation will by no means be confined in their remedies to the old organization, or the partnership or individual that incurred the indebtedness nor required to exhaust remedies against original debtor or debtors but that such creditors may resort in the first instance to an action against the new corporation.[28]

§ 133. Creditors May Maintain Direct Action Against Succeeding Corporation

It is undoubtedly true, as indicated in the last two preceding sections, that the creditors are not hampered in any way in their right to maintain a direct action in the first instance against a corporation taking over the property and assets of another corporation, partnership, or individual, and paying therefor in stock from maintaining a direct action either at law or in equity against such succeeding corporation.[29]

§ 134. Corporations Succeeding to the Rights and Property of Another Corporation, Partnership, or Individual, and Assuming the Obligations Thereof, Still Subject to Suit at Instance of Creditors

Where a corporation is organized for the purpose of taking over, and does take over the property and assets of another corporation, partnership, or individual, upon a consideration, the substantial portion of which is the assumption by the succeeding corporation of the debts of such former organization, or individual, thereby terminating the business of the transferor or transferors, is not deemed a purchaser in good faith and for value to such an extent as to deprive the creditors of the transferring concern, to assert their rights

[28] Central Improvement Co. vs. Cambria Steel Co., 120 C. C. A. 121; 201 Fed. 811; 210 Fed. 696; 240 U. S. 166; 60 L. Ed. 579; 36 S. Ct. 334; 127 C. C. A. 184; Central of Georgia Ry. Co. vs. Paul, 93 Fed. 878; 35 C. C. A. 639; see also secs. 145, 222, 499, infra.

[29] Luedecke vs. Des Moines Cabinet Co., 140 Iowa 223; 118 N. W. 456; 32 L. R. A. N. S. 616; see also secs. 145, 222, 499, infra.

against the property in the hands of the transferee.[30] The contrary to this position, however, has been held,[31] but it would seem that such contrary position is not sustained by sound ratiocination. A position that will allow third parties to contract with each other and affect the rights of creditors will not bear analysis.

§ 135. Creditor Accepting Benefits of Stockholders May Still Assert Rights Against the New Corporation

Where a creditor was likewise a stockholder in an old corporation, the fact that he took stock in the new organization in pursuance of arrangements by which such new organization was created, does not preclude him from asserting his rights against the new organization seeking a satisfaction of his indebtedness.[32]

§ 136. Creditor Not Barred by Laches

A creditor who knows and is intimately acquainted with each step of the reorganization of the corporation, and not only remains silent, but in fact, tacitly consents to such reorganization, but sets up his claim as a creditor in the action, does not by reason of such silence or tacit consent become barred from asserting rights against the reorganized corporation, in his capacity as a creditor.[33]

§ 137. Rule of Disregarding the Corporate Entity When Corporation Takes Over Partnership Assets Denied Where Partnership Still Owned Real Estate

Where partners formed a corporation and transferred to

[30] Cole vs. Millerton Iron Co., 133 N. Y. 164; 28 A. S. R. 615; 30 N. E. 847; 59 Hun. 217; 13 N. Y. S. 851; 38 N. Y. St. R. 34; Montgomery & Western Pacific Ry Co. vs. Branch Sons & Co., 59 Ala. 139.

[31] Francklyn vs. Sprague, 121 U. S. 215; 30 L. Ed. 936; 7 S. Ct. 951; Hervey vs. Ill. Midland Ry. Co., 28 Fed. 169.

[32] Kansas City S. R. Co. vs. Guardian Trust Co., 240 U. S. 166; 36 S. Ct. 334; 60 L. Ed. 579; 120 C. C. A. 121; 201 Fed. 811; 127 C. C. A. 184; 210 Fed. 696.

[33] Kansas City S. R. Co. vs. Guardian Trust Co., supra.

the corporation the partnership personalty and then attempted, as directors of the corporation, to have it assume the partnership obligations, it was held the attempted assumption was without consideration and not enforceable and the court likewise refused to ignore the corporate entity and, hold the corporation liable for the partnership debts contrary to the general rule that where a corporation formed by partners takes over partnership assets, paying therefor in stock that the corporation will be liable for partnership debts. The court held that the partnership creditors would have to resort to the partnership real estate first.[34]

§ 138. Where One Corporation Takes Over the Property of Another or the Property of an Individual, or Partnership, the Fact That the Creditor's Claim Is Unliquidated, or Arose From a Tort Is Immaterial

The fact that at the time of the taking over of the property from one corporation by another under such circumstances as to make the succeeding corporation liable, that the plaintiff was a creditor at large is immaterial and will not operate as a bar of his remedy against the newly formed organization.[35] In the cases cited in the footnotes to this section it involves the taking over of one corporation by another but essentially there is no difference in principle of whether the new organization takes over the assets of a corporation or individual, if the other elements are present necessary to fix the liability upon the new organization. The only possible theory upon which there could be any difference would be upon the supposed controlling influence of the trust-fund doctrine, but since it is apparent that the trust-fund doctrine has fostered the growth and development of the rule under

[34] Smith vs. Bowker Torrey Co., 207 Fed. 967; 199 Fed. 985. The soundness of this case may well be questioned. See secs. 131, 132, 133, supra, secs. 145, 222, 499, infra.

[35] Barrie vs. United Ry Co., 138 Mo. App. 557; 119 S. W. 1020; Sweeney vs. Heap O'Brien Mining Company, 194 Mo. App. 140; 186 S. W. 739.

discussion, the distinction necessarily disappears.[36] So it is generally held that where a statute provides for the consolidation of corporations and that the consolidated company shall be liable for contracts, debts, liabilities, and duties or indebtedness, all debts, liabilities, duties, and the like, are sufficiently broad to embrace claims arising from the commission of torts and that such consolidated company will be liable for tort so committed by the corporations going into consolidation.[37] Moreover it is true that where there is a reorganization of an old corporation into a new company, the property in the hands of such new formation will not be freed from the claims of persons against whom the old corporation has committed torts and this is true even though the reorganization is handled through a decree of foreclosure.[38]

§ 139. Recovery of Judgment After Consolidation, Consolidated Company Liable

It may be stated generally that at common law, or under statutory enactments or constitutional provisions, the fact a judgment is recovered after the consolidation, either upon contract or tort, will not affect the rights of the creditor or holder of such judgment to enforce payment against the consolidated organization.[39]

[36] See secs. 41, 42, supra.

[37] Zealy vs. Birmingham Ry. & Elec. Co., 99 Ala. 579; 13 Southern 118; Jones vs. Seaboard Airline Ry. Co., 67 S. C. 181; 45 S. E. 188; Chicago St. P. M. & O. Ry. Co. vs. Lundstrum, 16 Neb. 254; 49 A. R. 718; 20 N. W. 198; Coggins vs. Central Ry. Co., 62 Ga. 685; 35 A. R. 132; Stewart vs. Walterboro & W. R. Co., 64 S. C. 92; 41 S. E. 827; Pickett vs. Southern Ry. Co., 69 S. C. 445; 48 S. E. 466; International & G. N. R. Co. vs. Edmundson, 185 S. W. 402; 222 S. W. 181 (Tex); Batterson vs. Chicago & G. T. R. Co., 53 Mich. 125; 18 N. W. 584.

[38] Mt. States Power Co. vs. A. L. Jordan Lbr. Co., 286 Fed. 217; 293 Fed. 502; 264 U. S. 582; 44 S. Ct. 332; 68 L. Ed. 860; Northern Pacific Ry. Co. vs. Boyd, 228 U. S. 482; 33 S. Ct. 554; 101 C. C. A. 18; 57 L. Ed. 931; 177 Fed. 804.

[39] Chicago S. F. & C. Ry. Co. vs. Ashling, 160 Ill. 373; 56 Ill. App. 327; 43 N. E. 373; Chicago & J. Elec. Co. vs. Ferguson, 106 Ill. App. 356; Cooper vs. Utah Light & Ry. Co., 35 Utah 570; 136 A. S. R. 1075; 102 Pac. 202.

§ 140. Early Rule Was That Reorganized Company Was Not Liable For Debts of Old Organization

Some of the early cases are indeed difficult to harmonize with even a substantial sense of justice and such cases are like that of Bellows vs. Hallowell & Augusta Bank,[40] in which Justice Story, the father of the trust-fund doctrine, reached the conclusion that where a new bank was incorporated with the same name as the old—the charter of the old expiring—and composed of substantially the same stockholders, the new bank was not liable for the indebtedness of the old. Of course, it is needless to say that in the light of modern authority, and the high sense of justice that prevails in our day, would prevent the following of any such rule in general in our time. It is regrettable, however, that such decisions are not evidenced only by the pages of ancient reports, but we find modern courts lapsing into positions that are so readily vulnerable to attacks when reason and justice are applied; and so it has been held that a corporation, formed by the owner of a business and his wife, and another, that such corporation was not liable for the indebtedness of the owner of the business. It is indeed difficult to see how a court in an enlightened age could reach such a conclusion. To do so the court must worship at the shrine of the fetish of the corporate entity.[41] So again, in McLellan vs. Detroit File Works,[42] the court reached the conclusion that a corporation was not liable even upon renewal notes signed by it for a partnership indebtedness, the partnership having been converted into the corporation. However, it remained for the Supreme Court of Wyoming to go the greatest length in relieving an embarrassed debtor of his obligations by the mere act of prestidigitation of removing his coat as an individual and assuming the garb of the corporate entity in the case of Durlacher vs. Frazer.[43] In that case a merchant, heavily

[40] 2 Mason 31; 3 Fed. Cases 144, Case No. 1279.
[41] Church vs. Church Cementico Co., 75 Minn. 85; 77 N. W. 548.
[42] 56 Mich. 579; 23 N. W. 321.
[43] 8 Wyo. 58; 80 A. S. R. 918; 55 Pac. 306.

in debt, organized himself into a corporation and transferred all of his property, by appropriate transfer papers, to the corporation, and took in payment of his property that he had transferred to the corporation, practically all of the stock of the corporation and by the same strategic stroke, he provided in the by-laws that he should have complete control of the corporation but refused, in his corporate capacity, to assume his debts in his individual capacity, and it was held that the corporation was not liable. However, it is thought that these decisions are more or less sporadic.

§ 141. Rule in Georgia Is That Generally a Corporation Not Liable For Debts Created Prior to Its Incorporation

In the last preceding section we have discussed some cases that we have thought to be more or less sporadic and as not marking a consistent course of adjudication or establishing rules even in the particular jurisdiction, but not so in Georgia for in the main the courts there have consistently and persistently clung to the rule that a corporation cannot be liable for any indebtedness created prior to its being brought into existence.[44] So a corporation of the same name as a partnership, transacting the same business that was carried on prior to the act of incorporation, is not the same person as such partnership and to make the corporation liable for a partnership debt there must be a writing signed by the corporation, or it must be shown that the corporation received the consideration for which the indebtedness was incurred.[45] It is encouraging to recognize that even in some cases the courts of Georgia have refused to follow such an archaic rule as has

[44] Bludwine Bottling Co. vs. Crown Cork & Seal Co., 14 Ga. App. 285; 80 S. E. 853; Georgia Co. vs. Castleberry, 43 Ga. 187; Greenberg Miller Co. vs. Everett Shoe Co., 138 Georgia 729; 75 S. E. 1120; Culberson vs. Ala. Construction Company, 127 Ga. 599; 56 S. E. 765; 9 L. R. A. N. S. 411; 9 A. C. 507; Odum vs. South Atlantic Casket Co., 30 Ga. App. 166; 117 S. E. 275.

[45] Bludwine Bottling Co. vs. Crown Cork & Seal Co., supra; Georgia Co. vs. Castleberry, supra; Greenberg Miller Co. vs. Everett Shoe Co., supra; Culberson vs. Ala. Construction Co., supra; see secs. 37, supra, 273, infra.

obtained in a majority of the Georgia opinions; and it has accordingly been held in Johnson Battle Lumber Company vs. Emanuel Lumber Company,[46] that where one corporation took over another under a new charter, having for its object the same purpose, using the same name, and continuing the same business, having the same stockholders, such corporation was, in fact, a mere continuation of the old and was liable for its debts and obligations; and in an action by such new corporation, a defendant was permitted to set off damages against it, which damages were against the old organization. But even in spite of the holding in the case of Johnson Battle Lumber Company vs. Emanuel Lumber Company,[47] the court, in the case of Taylor Lumber Company vs. Clark Lumber Company,[48] felt itself constrained to follow the lead of the old case of Georgia Company vs. Castleberry,[49] and held that a corporation could not be liable for the debts of a partnership, although to all intents and purposes and sustained by every sense of reason and justice, it was a mere continuation of the partnership. It is difficult to perceive how there is any difference in holding the continuation of a corporation liable for the debts of the old organization, and blindly refusing to hold the continuation of a partnership or an individual in the form of a corporation, not liable for such debts. It is interesting to note that, in the case of Atlantic & B. Railway Company vs. Johnson,[50] where two corporations in effect consolidated and one of them went out of business, and no arrangements were made respecting its liabilities, the resulting consolidated corporation was entitled to all of the property and must answer for all of the liabilities of the corporation thus absorbed, even going to the extent—contrary to the rule announced in some cases, that the consolidated corporation's liability is circumscribed by the amount of the property that it has received—and held that such consolidated

[46] 126 S. E. 861; 33 Ga. App. 517.
[47] 126 S. E. 861; 33 Ga. App. 517.
[48] 127 S. E. 905; 33 Ga. App. 815.
[49] 43 Ga. 187.
[50] 127 Ga. 392; 56 S. E. 482; 11 L. R. A. N. S. 1119.

corporation is liable for all the debts of its component organizations.[51] However, it is recognized by the federal courts in Georgia that the holdings of the courts in that state that a corporation is not liable for the debts of an individual, or partnership, which corporation was organized by such individual or partnership, and is, in truth and in fact, a mere continuation of the former business, is contrary to the common law, or is not a common-law rule.[52]

[1] See sec. 184, infra.
[2] In re W. J. Marshall Company, 3 Fed. (2d) 192.

CHAPTER IX

RIGHTS AND LIABILITIES OF CORPORATION ORGANIZED OUT OF ANOTHER CORPORATION, OR BY A PARTNERSHIP OR INDIVIDUAL

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177. Where a corporation is organized with an agreement between stockholders and promoters of a new corporation taking the property of the old and paying therefor in stock to the stockholders of the old and to promoters, new corporation liable.

178. Where a corporation takes over assets of an old of the same name with the exception of the prefix "the" and receives the property for which an obligation is incurred, it is a question for the jury as to whether the new corporation is liable.

179. Where one corporation transfers all of its assets to another and the facts warrant a finding that it is a continuance of the former, this alone seems sufficient to hold new corporation liable for debts of old.

180. Where a new corporation receives all the stock of an old and practically all of its property by a transfer, and pays part of the debts of the old, and an officer of the new corporation executes a note for the balance, the new corporation will be held liable thereon.

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186. Where the trust-fund doctrine prevails the claims of creditors of the transferor are superior to rights of creditors of the transferee.

187. Ordinarily a corporation acquiring the property of another at a judicial sale cannot be held liable for the debts of the original company.

188. Where there is a combination, conspiracy, or understanding, that reorganized corporation is to take over the business of the old, the new corporation is liable.

189. Where property is sold to one of the corporations' directors who thereafter reorganizes the old corporation, the new organization is liable for debts of the old.

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194. Reorganized corporation by bondholders, purchase at foreclosure sale liable for indebtedness incurred while trustee is in charge.

195. Where a corporation pays to the creditors an amount equal or in excess of a reasonable value of the assets received from a former corporation it is not liable in addition thereto.

196. New corporation may be formed by stockholders and bondholders for the purpose of buying in property of a corporation at judicial sale.

197. It is held that in case there is a reorganization scheme which permits all creditors to come in and share alike and is approved by the court, such reorganization will be sustained.

198. It has been held that a director of a corporation may not become a purchaser of its property at a sale thereof.

199. Corporation having absorbed former corporation and assumed supervision of the execution of a contract with such former corporation will be held liable upon such contract.

200. Where one corporation leases its assets to another and the lessee assigns such lease to a third corporation, such assignee of the lease will be held liable for mortgaged indebtedness against such assets.

201. Where a corporation transfers all of its property to another in consideration of issuance of stock to its stockholders and assumption of its debts, the receiving corporation will be held liable for the debts by virtue of such agreement.

202. Where an insolvent bank had offered a composition with its creditors and then a new organization takes over the business of the bank to pay the composition, the new organization is liable for all of the debts of the bank, there being no change in franchise.

203. Liability generally on merger.

204. The illegality or lack of legislative authority for merger no defense to liabilities of predecessor.

205. The rule of liability of successor corporation on consolidation or merger will be enforced in admiralty.

206. Where a corporation ceases to do business and its stockholders, with one other person, organize a new corporation, take its assets, the new corporation is liable for the debts of the old.

207. Where two corporations consolidate and continue the business under the name of one, such corporation is liable for debts of the other.

208. Where a corporation takes over the property of another and issues stock to the transferor company's stockholders for such assets, the succeeding corporation is liable for the debts of the transferor.

209. Where partnership and a corporation combine to form a new corporation such new corporation will be liable for the contracts of the constituent corporation and the partnership.

210. Where a public-service corporation is possibly liable in a number of personal injury actions and thereafter conveys its property to another corporation, either the original or new company may be sued in such personal-injury actions.

211. Extent of liability of merged corporation on contracts of predecessor corporations.

212. Where a new corporation is permitted to absorb the assets of the old and do business in its name, the old will be responsible for the debts of the new.

213. Where an individual owns a controlling interest in a corporation and contracts with the other stockholders thereof to exchange their stock for stock in another corporation, the succeeding corporation would be liable for the debts of the old.

214. Where one corporation takes over only a part of the assets of another, the rule holding liability under a merger or consolidation is inapplicable.

215. Where a number of stockholders agree to transfer their assets to a new corporation in exchange for stock to be issued by the new to the stockholders of the old, such stockholders may compel issuance.

216. Where a merger, absorption, or consolidation takes place and the succeeding corporation assumes liability for contractual obligations, but no mention is made of tortuous liability, the succeeding corporation will be liable therefor.

217 Consolidated corporation liable for nuisance.

218 Within the rule that in a proper case the succeeding corporation is responsible for the torts of its predecessor, comes the proposition of liability to abutting property owners.

219 What liabilities come within the provision for assumption of indebtedness?

220. Where an old corporation is succeeded by a new, it taking all of the assets and composed largely of members of the former, successor liable for negligence or torts.

221. New corporation composed of same stockholders continuing same business, it will be held liable for obligations of old.

222 Where a new corporation is in reality organized out of an old, the new corporation will be liable for the obligations of the old and may be sued directly therefor.

223 Reorganized, merged, succeeding or consolidated corporation liable on leases of old.

224 Liability attached by reason of reincorporation or reorganization is not affected by the jurisdiction granting new charter.

225 One corporation may be successor of another and both continue a technical existence.

226 New corporation is generally liable when it takes over the assets of the old and pays in stock or mortgage.

227 New corporation formed by stockholders and taking a lease of substantially all of the property of old, liable for obligations.

228 Two corporations controlled by practically the same stockholders, one surrendering a lease to the other, lessor may be liable for obligations of lessee.

229 The corporate entity will not be disregarded to prevent a forfeiture of a lease where the lessee has held out the corporation as a separate entity.

230. A lessee corporation may not organize a new corporation to maintain a supposed cause of action against the lessor.

231. It may be said to be generally true that where one corporation gives a long lease to another, this amounts to consolidation.
232. A sublessee is liable for obligations of lessee.
233. If succeeding corporation is composed of different stockholders it is not liable.

§ 142. Corporation Reorganized Out of an Old Corporation, or Consolidated Therewith, New Corporation Liable

Intimately connected with the subject we have heretofore had under discussion, is the liability of a new corporation organized out of, or recreated as a sort of a reincarnation of a former organization and in many such cases it becomes necessary for the courts to limit, or brush aside the corporate entity for the purpose of establishing the identity of the old with the new; for the purpose of tracing the course pursued in the issuance of stock for the purpose of following assets and of identifying liabilities.

Corporations insolvent or financially embarrassed often find it necessary to scale their debts and readjust stock issues with an agreement to conduct the business with the same property under a reorganization and it is not to be doubted that this may be done in pursuance of private contract between all parties affected thereby, and when the reorganization is the product of contractual assent, even though the new organization has the same shareholders, the transaction is binding, but if such reorganization amounts to nothing more than a transfer by stockholders as vendors to themselves as vendees, such colorable transfer cannot be used as a shield to protect the new organization which is but the old under a different name, or a new assent from the state against the attacks of nonassenting creditors. As against such creditors, the sale is void and this is true regardless of the motive with which it is made. In other words, it is immaterial whether the reorganization was fraudulent in fact, or not. Regardless of the good faith that may surround such a transaction, if the interests of the nonassenting creditor is affected thereby, it will be decreed a nullity. Neither may such a transaction be panoplied by a

consent decree of a purported foreclosure, there essentially being no difference in principle if the reorganization instead of being effectuated by private sale is consummated by a master's deed under a consent decree.[1] Though a corporation purchases the assets of another corporation, it does not contractually assume the payment of any of the debts of the selling corporation, yet it is responsible for them—and it is immaterial whether those debts are contractual or arising out of the commission of tort, liquidated or unliquidated—if the sale was without consideration, or bad faith may be imputed to it for the purpose of defeating creditors of the selling corporation, or if there was a consolidation or merger, or if the purchasing corporation took over all of the stock of the selling corporation, or if the transaction amounts to a mere reorganization or reincorporation of the old corporation.[2]

Where a corporation that is bound for a liability ceases to have an independent and separate existence, the consolidated or absorbing corporation will be held liable. The basis for such liability has been assigned upon the ground of the continuance of the original corporation under a new guise and this liability will be sustained when asserted, whether the action be one in equity or at law.[3] Other courts have bottomed the liability upon an assumption of the obligations raised by implication.[4]

[1] Northern Pac. Ry. Co. vs. Boyd, 101 C. C. A. 18; 177 Fed. 804; 228 U. S. 482; 33 S. Ct. 554; 57 L. Ed. 931.

[2] Valley Bank vs. Malcolm, 23 Ariz. 395; 204 Pac. 207; Burkholder vs. Okmulgee Coal Co., 82 Okla. 80; 196 Pac. 679; Spring Creek Oil Corp. vs. Dillman, 90 Okla. 129; 215 Pac. 1053; Shadford vs. Detroit Y. & A. A. Ry. Co., 130 Mich. 300; 89 N. W. 960.

[3] Meyer Trustees vs. Johnson & Stewart Trustees, 53 Ala. 237; Wolff vs. Shreveport Gas, Electric Light & Power Co., 138 La. 743; 1916D L. R. A. 1138; 70 Southern 789; Morrison vs. American Snuff Co., 79 Miss. 330; 89 A. S. R. 598; 30 Southern 723; Memphis Water Co. vs. Magens & Co., 15 Lea (Tenn.) 37; Langhorn vs. Richmond Ry. Co., 91 Va. 369; 22 S. E. 159; Sharples Co. vs. Harding Creamery Co., 78 Neb. 795; 11 L. R. A. N. S. 863; 111 N. W. 783; Quinn vs. American Bankers Assurance Co., 183 Mo. App. 8; 165 S. W. 823; Miss. Cottonseed etc. Co. vs. Planters Mfg. Co., 132 Southern (Miss.) 96; see sec. 203, infra.

[4] Texas Seed & Floral Co. vs. Chi. Set & Seed Co., 187 S. W. (Tex.) 747; Louisville N. A. & C. Ry. Co. vs. Boney, 117 Ind. 501; 3 L. R. A.

§ 143. Consolidation and Merger Defined

What is a "consolidation" in this country, is an "amalgamation" in England.[5] The line of demarcation between a transaction that constitutes a merger on the one hand and a consolidation on the other is indeed hazy and shadowy and cannot clearly be followed.[6] It has been said that there never can be a consolidation of corporations except where all the constituent companies cease to exist as separate corporations and a new corporation, to-wit: the consolidated corporation, comes into being. That a merger is not equivalent to a consolidation at all but exists where one of the constituent companies remains in being, absorbing or merging in itself all of the other constituent companies.[7] So it would seem under some authorities the principal distinction between a consolidation and a merger is that a consolidated corporation is a newly organized corporation, combining within itself corporations existing at the time of its creation while a merger is a combining of two or more existing corporations without the formation of a new entity for that purpose.

It may be said generally that a consolidation takes place when two or more corporations, by agreement and under proper sanction of law, combine their franchises, privileges, and property, in a single legal entity organized for that purpose which may or may not be composed of the stockholders of the original organization or organizations.[8] A merger takes place, as suggested above, when one of the constituent companies remains in being, absorbing or merging into itself all of the constituent companies.[9]

435; 20 N. E. 432; Berry vs. Kansas City Ft. S. & M. Ry Co., 52 Kan. 774; 39 A. S. R. 381; 36 Pac. 724.

[5] Shadford vs. Detroit Y. & A. A. Ry. Co., 130 Mich. 300; 89 N. W. 960.

[6] Collinsville National Bank vs. Esau, 176 Pac. 514; 74 Okla. 45.

[7] Vicksburg & Y. City Telephone Co. vs. Citizens Telephone Co., 79 Miss. 341; 30 Southern 725; 89 A. S. R. 656.

[8] Atlantic & G. Ry. Co. vs. Georgia, 98 U. S. 359; 25 L. Ed. 185; Wasley vs. Chicago R. I. & P. Ry. Co., 147 Fed. 608; Chicago S. F. & C. Ry. Co. vs. Ashling, 160 Ill. 373; 43 N. E. 373; 56 Ill. App. 327.

[9] Lee vs. Atlantic Coastline Ry. Co., 150 Fed. 775; Reversed 166 Fed. 850; 94 C. C. A. 128.

The Supreme Court of Illinois held that where one corporation takes over all of the property and assets, and succeeds to the franchise of another corporation, and issues stock in the new corporation to the stockholders of the old in exchange for an equal amount held by them in the old, and the officers of the old become officers of the new, such transaction amounts to a consolidation of the two entities.[10] However, the Supreme Court of Oklahoma criticizes such a definition of consolidation and insists that it was a merger.[11]

It is submitted that the Supreme Court of Oklahoma is correct in its stricture placed upon this definition of the Supreme Court of Illinois for the reason that the definition by the Supreme Court of Illinois wholly fails to take into account the bringing into existence of a new corporate entity which is essential to effecting consolidations.

§ 144. Where There Has Been Neither a Consolidation Nor Merger, But a Sale, New Organization Not Liable

It is difficult sometimes to distinguish in all cases where the new organization has acted so as to make it liable for the obligations of the old, but where there has been neither a consolidation nor a merger, but a mere sale by one corporation of its property to another, that sale, if lawful, and if made for a valuable consideration in good faith, will pass the property of the selling corporation to the purchasing corporation free from claims of creditors.[12] A controlling circumstance in all such cases is the character of payment and it is thought to be a rule of almost universal application that a corporation, whether a reorganization or an already existing corporation, takes the property of another corporation and pays therefor to the stockholders of the transferring corpora-

[10] Chicago S. F. & C. Ry. Co. vs. Ashling, 160 Ill. 373; 43 N. E. 373; 156 Ill. App. 327.

[11] Collinsville National Bank vs. Esau, supra.

[12] Vicksburg & Y. City Telephone Co. vs. Citizens Tel. Co., 79 Miss. 341; 89 A. S. R. 656; 30 Southern 725; Hawkins vs. Central Ry. Co., 119 Ga. 159; 46 S. E. 82; Spear Mining Co. vs. Shinn & Co., 93 Ark. 346; 124 S. W. 1045.

tion in stock of the transferee corporation, such transferee corporation remains liable for the debts of the transferring corporation.[13]

§ 145. Where a Corporation Consolidates With Another, the Consolidated Company May Be Sued in Its Name on Note of Old Company

Where a corporation executes a note and thereafter consolidates with another corporation, and assuming a new or different name, the new corporation may be sued upon a note of the old organization and it will be estopped from denying the name in which it is sued, for the name of the old company executing a note has by force of the consolidation been assumed by the new organization.[14] Indeed, it is not necessary to even invoke the doctrine of estoppel for the new corporation is liable upon the simple ground that it is a mere continuation of the old and is, in fact, the old merely parading under another name.[15]

§ 146. Consolidated Company Cannot Defeat Liability Upon Ground That Consolidation Was Illegal

Where a corporation is the result of and composed of con-

[13] San Francisco & N. P. Ry. Co. vs. Bee, 48 Cal. 398; Blanc vs. Paymaster Mining Co., 95 Cal. 524; 29 A. S. R. 149; 30 Pac. 765; Boyd vs. Northern Pac. Ry. Co., 101 C. C. A. 18; 177 Fed. 804; affirmed in Northern Pac. Ry. Co. vs. Boyd, 228 U. S. 482; 33 S. Ct. 554; 57 L. Ed. 931; Loughlin vs. U. S. School Furniture Co., 118 Ill. App. 36; W. F. Taylor Co. vs. Gulf Land & Lumber Co., 119 La. 426; 44 Southern 187; Douglas Printing Co. vs. Over, 69 Neb. 320; 95 N. W. 656; Berthold vs. Holladay Klotz Land & Lumber Co., 91 Mo. App. 233; Grenell vs. Detroit Gas Co., 112 Mich. 70; 70 N. W. 413; Friedenwald Co. vs. Asheville Tobacco Co., 117 N. C. 544; 23 S. E. 490; Montgomery Web Co. vs. Dienelt, 133 Pa. 585; 19 A. S. R. 663; 19 Atl. 428; Vance vs. McNabb Coal & Coke Co., 92 Tenn. 47; 20 S. W. 424; Long vs. Fisher Typewriter Co., 1 Tenn. Ch. App. 668; Carstens & Earles vs. Hoflus, 87 Pac. 631; 44 Wash. 456; Blair vs. St. L. H. & K. Ry. Co., 22 Fed. 36; 24 Fed. 148; Hibernia Ins. Co. vs. St. L. & N. O. Transportation Co., 4 McCrary 432; 13 Fed. 516.

[14] Columbus Chicago & Ind. Central Ry. Co. vs. Skidmore, 69 Ill. 566.

[15] Stanford Hotel Co. vs. M. Schwind, 180 Cal. 348; 181 Pac. 780; see secs. 133, supra, and 203, 499, infra.

solidation of other corporations, and such consolidated company has received and retains all of the property of the consolidating companies, the consolidated corporation will not be permitted to assert its nonliability on an obligation of one of the consolidating companies on the ground that such consolidation was illegal. The rule seems to be that the illegality of such consolidated company is a matter for the state only to consider and cannot be raised in a proceeding to assert the liability of the consolidated corporation. The law will not permit creditors of two corporations to be deprived of their rights in the assets of such corporations for the payment of their debts and turn them over to suits in equity against the stockholders when the union or consolidation with another corporation is effected without the passage of a dollar or other valuable consideration exchanged between the corporations.[16] Closely connected with the foregoing rule is the contention that a purported corporation may escape liability for the debts and obligations of a predecessor—a partnership—by pleading that such corporation never became a legally incorporated body politic.[17] But of course, as may be assumed the court denied such contention.

§ 147. A Corporation Will Not Be Permitted to Contend That the Consolidating Companies Were Insolvent and That Their Creditors, Therefore, Were Not Injured

The consolidated company will not be permitted to raise the question that the consolidating companies were insolvent and, therefore, the creditors of such consolidating companies were not injured or prejudiced by reason of the consolidation.[18] The court held in Shadford vs. Detroit Y. & A. A. Railway that by consolidation, the new company is burdened

[16] Shadford vs. Detroit Y. & A. A. Ry. Co., 130 Mich. 300; 89 N. W. 960; see also sec. 204, infra.
[17] Lamkin vs. Baldwin & Lamkin Mfg. Co., 72 Conn. 57; 43 Atl. 593 1042; 44 L. R. A. 786; see also sec. 81, supra.
[18] Shadford vs. Detroit Y. & A. A. Ry. Co., supra, see also 184, infra.

with the debts of the old and the sole question then is: Has the new corporation sufficient assets to pay its debts, which then include those of the old companies?

§ 148. Ordinarily, Transfer of All Stock Does Not Affect Liability of Corporation for Corporate Debts

It is perhaps not necessary to suggest that the transfer of all stock of the corporation does not in any way affect the liability of the corporate entity for its debts unless, of course, it becomes necessary in the interest of justice in a proper case to brush aside the corporate entity and deal with the individuals composing such an entity.[19]

§ 149. New Corporation Held Not Liable on Consolidation When Paid For Property in Money, Bonds, and Assumption of Liability

It has been held that where the consolidated company paid the consolidating company the full value of its property in money, bonds, and by assumption of mortgage liens, such consolidated company is not liable for a judgment or other debt against the consolidating company.[20] Such holding is highly doubtful in the light of modern authority and when tested by the simplest equitable principles. In this same case the court fell into the error of holding that the creditors' only right of action is against the stockholders of the old company who received the purchase money and securities. This is contrary to the great weight of modern authority.[21]

[19] Erickson vs. Revere Elev. Co., 110 Minn. 443; 126 N. W. 130; Gallagher vs. Germania Brewing Co., 53 Minn. 214; 54 N. W. 1115.

[20] Chesapeake Ohio & S. W. Ry. Co. vs. Griest, 85 Ky. 619; 4 S. W. 323; 9 Ky. L. R. 177.

[21] Luedecke vs. Des Moines Cabinet Co., 140 Iowa 223; 118 N. W. 456; 32 L. R. A. N. S. 616; Hibernia Ins. Co. vs. St. L. & N. O. Transportation Co., 4 McCrary 432; 13 Fed. 516; McIver vs. Young Hdwe. Co., 144 N. C. 478; 119 A. S. R. 970; 57 S. E. 169; see also secs. 50, 132, 146, supra, 222, infra.

§ 150. Consolidated Company Held Liable Though Conveyance From Consolidating Company in Satisfaction of Debt and Free From Fraud

While the authorities are not uniform, but the more sound and just rule would seem to dictate the liability of the consolidated company, even though the conveyance from the consolidating company was made in satisfaction of a debt and in perfect good faith and free from fraud.[22] It is indeed hard, however, to reconcile Higgens vs. California Petroleum & Asphalt Company with Atkinson vs. Western Development Syndicate Company,[23] but it is submitted that Higgens vs. California Petroleum & Asphalt Company is an exposition of the sounder and juster rule and is the one that, in the light of the more recent cases, ought to be followed in preference to Atkinson vs. Western Development Syndicate Company. A rather unusual case, and one that is thought cannot be sustained on principle, is that of Justice vs. Catlettsburg Timber Company.[24] In that case it was held that a consolidation or a transaction, whereby one corporation took over all of the assets of another in satisfaction of a mortgage held by such consolidated company on the property and assets of the consolidating company, would be sustained, it only being necessary to show that the debtor company had attempted to sell the mortgaged property and was unable to do so for more than the mortgage debt; it further appearing that the stockholders received nothing whatever out of the transaction and lost the value of their stock but it likewise appearing that the president of both corporations was the same. It is submitted that such transactions ought not to have the sanction of the courts.

[22] Higgens vs. California Petroleum & Asphalt Co., 122 Cal. 373; 55 Pac. 155; 147 Cal. 363; 81 Pac. 1070; 109 Cal. 304; 41 Pac. 1087.

[23] 170 Cal. 503; 150 Pac. 360.

[24] 168 Ky. 665; 182 S. W. 831. In view of the holding in Chesapeake Ohio & S. W. Ry. Co. vs. Griest, 85 Ky. 619; 4 S. W. 323; 9 Ky. L. R. 177, and also the holding in Justice vs. Catlettsburg Timber Co., it seems rather hard for the Kentucky court to get in line and march with the advance of authority.

§ 151. New Corporation Liable If It Assumes Debts

It is law of the most elementary character that a corporation succeeding to the rights of another by consolidation, or any other means, is liable for the debts of its predecessor where it contractually assumes the same.[25] A consolidated company which has assumed the liabilities of the consolidating companies will not be permitted to reduce its obligations and responsibility by attempting to divide up the assumption of liabilities among other participants in the act of consolidation.[26]

§ 152. It Has Been Held That a Valid Transfer May Be Made by New Organization Assuming Liability of the Value of the Property Taken Over

It has been held—but it is submitted that it is of doubtful soundness—that where one corporation takes over all of the assets of another and assumes liability of equal value of the property taken over, the transferee corporation will not be liable for obligations of the transferor corporation in excess of those it assumed. The theory on which this position was attempted to be sustained was that the old organization received no benefit from the transaction. The principal objection to this position is that it opens the door to let in fraudulent transactions under the guise of fair dealing.[27] If such transaction is to be sustained upon any consideration whatsoever, it ought to be thoroughly scrutinized. It has been held, however, that the burden is on the new organization to establish the bona fides of the transaction.[28]

[25] Collinsville National Bank vs. Esau, 176 Pac. 514; 74 Okla. 45; Spear Mining Co. vs. Shinn & Co., 93 Ark. 346; 124 S. W. 1045; Good vs. Ferguson & W. Land, Lumber & Handle Co., 107 Ark. 118; 153 S. W. 1107; 1915A A. C. 544.

[26] Smith vs. Los Angeles & P. R. Co., 98 Cal. 210; 33 Pac. 53.

[27] Evans vs. Unity Inv. Co., 196 S. W. 49 (Mo.); Burkholder vs. Okmulgee Coal Co., 196 Pac. 679; 82 Okla. 80.

[28] Wolff vs. Shreveport Gas Elec. Light & Power Co., 138 La. 743; 70 Southern 789; 1916D L. R. A. 1138; see sec. 531, n. 59, infra.

§ 153. Debtor and Creditor Form New Corporation, It Is Liable For Debts of Old Corporation

Where a debtor corporation and some of its creditors organize a new corporation under the laws of a different state, but with the same name as the old company, such organization showing that it was the understanding between the organizing parties to deal with and dispose of the assets and business of the old corporation in the same manner as if they were the organizer's own, the intent being clearly manifest to create normally an independent business successor to the old corporation, in such case the new organization will be held responsible for the liabilities of the old. Where this situation is brought about and the arrangement and transaction effected, it is impossible to create such new organization under the law and free it of the liabilities of its predecessor, and the new company, so organized, holds the assets and property of the old company in trust for the creditors of old.[29]

Where, however, a new corporation is formed by creditors of the old corporation under a plan by which all of the creditors are given an option to receive for their debts stock in the new company at par value of one hundred cents on the dollar or cash at fifty cents on the dollar on the total of such indebtedness, to which new corporation all the assets of the old are transferred in consideration of the full liquidation of its debts, and such new organization is not liable for the debts of the old, except in so far as they have been expressly assumed.[30]

No doubt in Wheeler vs. Acme Harvester Machine Co., the court was actuated in making this decision by the equitable principle that equality is equity, the option being given to all creditors to come in on the same basis and share with each other equally.

[29] Crozier vs. Menzies Shoe Company, 103 Kan. 565; 175 Pac. 376; Landes Bros. vs. Eastern Export & Mill Co., 12 Pa. Dist. Rep. 625; 27 Pa. Co. Ct. 630; 19 Montgomery Co. L. Rpt. 54.

[30] Wheeler vs. Acme Harvester Machine Company, 175 Ill. App. 69.

§ 154. Where a Corporation Is Organized For Purposes of Taking Over a Number of Other Corporations, and Takes Over One of Such, Issuing Stock Therefor, the New Corporation Is Liable For Judgment Against the Old

Where a corporation is organized for the purpose of taking over a number of existing corporations, and one of such existing corporations enters into an agreement with the new organization by which the old company conveyed to the new all its property upon the consideration that the new company should issue a certain amount of its stock to the stockholders of the old company and should assume and pay certain of the indebtedness of the old company, the stockholders in both corporations being the same, although there was no provision as to the bonded indebtedness of the old company, yet such an arrangement makes the new corporation liable for a judgment against the old.[31]

§ 155. Where New Corporation Assumes Obligations for Full Amount of Property, It Has Been Held That It Will Not Be Liable For Debts of Old, There Being No Continuance, Reincarnation, Merger of, or Consolidation With the Old Company

Where a corporation's plant and property has been destroyed by the elements and such corporation was under obligation to continue its plant and supply its customers with its products, which it was unable to perform unless it could reconstruct its plant and rehabilitate its equipment and was unable financially to do this, and thereupon transferred its property to a new corporation in consideration of the reconstruction of the plant and the rehabilitation of its property, the new organization is not liable for the debts of the old

[31] Howell vs. Lansing & Suburban Traction Co., 146 Mich. 450; 109 N. W. 846; see sec. 192, infra.

company, it being held that the case did not amount to a continuation of the old or a reincarnation of it and was not a consolidation with, or merger of, the old company.[32]

§ 156. A Corporation May Not, Where the Rights of Creditors Intervene, Sell Its Property to Another Corporation For Stock to Be Issued to Its Stockholders, and the New Corporation Escape Liability

Where a corporation attempts, in spite of the rights of the creditors of the corporation, with consent of its stockholders, to sell its plant, assets, and equipment and ceases to do business, takes in payment thereof the stock of the purchasing corporation, causing such stock of the purchasing corporation to be issued to an individual stockholder of the old, without any provision for the payment of the old company's debts, the new company will be liable therefor.

The transaction, when stripped of all speculations and assumptions, amounts simply to a case where a corporation is in debt, and while thus indebted, its officers enter into an agreement under which substantially all of its assets are transferred to another corporation which is thereafter to continue the business. In payment of this transfer the purchasing corporation issues some of its capital stock and under such circumstances the new corporation will be held liable, especially in view of the fact that the stock was issued to a stockholder of the old corporation in his individual capacity.[33] In other words the rule simply amounts to this, that the court will draw aside the corporate mantle and ascertain who is there concealed and if it is the stockholders of the old corporation or the former corporate organization, then it will not serve as a panoply for themselves.

[32] Beaver Park Co. vs. Hobson, 86 Colo. 559; 283 Pac. 772; Denver & S. F. Railway Co. vs. Hannegan, 43 Colo. 122; 95 Pac. 343; 16 L. R. A. N. S. 874; 127 A. S. R. 100.

[33] Hurd vs. New York and Commercial Steam Laundry Company 167 N. Y. 89; 60 N. E. 327; 65 N. Y. S. 125; 52 App. Div. 467.

§ 157. New Corporation Organized to Take Over Old, Pays For Property in Stock, New Corporation Liable For Debts of Old

Where a new corporation is organized to take over the property and assets of an old company and pays the stockholders of the old corporate organization in stock, the new company amounts to substantially the old under a new name. This is true where half or more of the stock of the new corporate organization is issued to and held by the stockholders of the old corporate entity by virtue of their ownership of stock, there being no other consideration. It is readily seen why the issuance of one-half or more of the stock in the new corporation to the old corporation or its stockholders will impel the courts to hold the new the same as the old, for by so doing the same hand as directed the old controls the new.

It was contended that the law is the same as to the use of corporate assets to pay its debts as that applicable to an individual and that the right of making preferences among creditors should be the same. This contention was ably answered by the court with the ratiocination that the court took the view that in the case of an individual transferring his assets to his wife or his agent or anybody who should merely represent the individual, the transaction amounted to a transfer to himself under another name and would undoubtedly be avoided as to creditors and that this principle operates as vigorously when dealing with corporate affairs as when dealing with individual transactions. A corporation cannot change its name or assume the form of a new corporation and by this simple metamorphosis escape its obligations.

The transferring of property from an old corporation to a new corporate organization, paying therefor in stock to the stockholders of the old without any arrangement for the payment of the liabilities of the old, makes a case sufficient to visit liability upon new organization and the question of fraud and bad faith may not enter into the transaction at all, or if considered as an essential ingredient of the creditor's case,

fraud in law raised by construction will be imputed to the transaction and the new corporate organization held liable for the obligations of its predecessor.[34]

§ 158. The Mere Fact That a New Corporate Organization Agrees to Save Harmless the Old Corporation, the New Taking the Property of the Old and Paying in Stock, Does Not Suspend Legal Remedies

The legal status of a new corporation taking over the assets and business of an old corporate organization and agreeing to save the old harmless upon its liabilities, is not affected by such an agreement; in other words, such an agreement does not in any way change the rights of creditors to pursue the legal remedies and rights given by law against the new corporation.[35]

§ 159. New Corporation Taking Transfer of Assets of Old and Paying in Stock Is Liable For Debts of Old to Extent of Property Received, Though Not a Successor of the Old

Where an individual is the majority stockholder of a corporation and is cognizant of the indebtedness of such corporation and that at a time when certain indebtedness of a corporation is matured, the corporation being insolvent, such majority stockholder organizing a new corporation for the purpose of taking over the business of his company along with the business of other companies, firms and individuals engaged in the same line of business, and therefore, such new organization is not a successor of the former but such new organization paying for the business of the corporation controlled by the majority stockholder in stock, such new organization is liable for the debts or liabilities of the corporation so

[34] Montgomery Web Co. vs. Dienelt, 133 Pa. St. Rep. 585; 19 A. S. R. 663; 19 Atl. 428; see sec. 161, 167, infra.

[35] Couse vs. Columbia Powder Mfg. Co., 33 Atl. (N. J.) 297.

taken over regardless of the fact that the new corporation is not a successor of the old; however, the liability in such case is limited to the amount of property received by the new organization.[36] If any other rule were recognized it would be an invitation for fraud to enter into transactions between or among corporations.

§ 160. Corporation Organized by All Stockholders But One of an Old Corporation Transferring Property and Taking Stock, New Corporation Liable

Where a corporation is organized by all of the stockholders of an old corporation and one additional party, and taking the assets of the old company, and paying therefor in stock, the new corporation will be held liable upon the obligations of the old and this is true to the extent that even though the indebtedness upon which an action is brought has not accrued at the time of such transfer but a contract was in existence between the old corporation and the creditor from which the indebtedness of the old corporation resulted. This is sufficient as indebtedness to bring the new corporation within the principle fixing its liability under such circumstances.[37]

The court in the case of Schaake vs. Eagle Automatic Can Company, cited in the footnotes to this section, was influenced to some extent by the statute of California that substantially provides that the directors of a corporation must not take dividends except from the surplus profits arising from the business thereof, nor must they divide, withdraw, or pay to the stockholders, or any of them, any stock of the capital stock and further providing that this provision shall not be construed to prevent a distribution of a surplus of the capital

[36] Sharples Co. vs. Harding Creamery Co., 78 Neb. 795; 11, L. R. A. N. S. 863; 111 N. W. 783; see secs. 172, 184, infra.

[37] Schaake vs. Eagle Automatic Can Co., 135 Cal. 472; 63 Pac. 1025; 67 Pac. 759.

stock after the payment of its debts and upon its dissolution, or the expiration of its charter term.[38] It also seems, under this same section, that, contrary to the general rule prevailing, the question of whether or not a new corporation pays the stockholders of the old in stock, or money, is immaterial, the court maintaining that the liability of the new corporate organization would follow as readily when the stockholders of the old corporation are paid by the new organization in stock as when paid in money.[39]

§ 161. The President and Manager Who Is Owner of All Stock of a Corporation, Transferring the Same to Another For Four-Fifths of Its Stock, the New Corporation Is Liable For Obligations of Old

Where the president and manager of a corporation is one and the same, and likewise the owner of all of the stock thereof, and such president, manager and stockholder transfers all of the stock to a new corporation of which he is likewise president, business manager, director, and owner of four-fifths of the corporate stock of the new corporate entity, which stock is issued to him individually and in payment of the assets that are transferred to the new corporate organization, full knowledge of the existence of the indebtedness against the old corporation will be imputed to the new by reason of such fact and the new corporate entity will be held chargeable as a trustee of the assets of the old corporate organization for the benefit of its creditors, who will be permitted to follow such assets in the hands of the new corporate organization and subject the same to the satisfaction of the obligations of the old.[40]

[38] Cal. Civ. Code, sec. 309.

[39] Martin vs. Zellerbach, 38 Cal. 300; 99 A. D. 365; Schaake vs. Eagle Automatic Can Co., supra.

[40] Wesco Supply Co. vs. Eldorado Light & Water Co., 107 Ark. 424; 155 S. W. 518. This, in accord with the rule that if the stockholders of the old corporation receive half or more of the stock of the new, will make it liable for the debts of the old. See sec. 157, supra.

§ 162. Where Corporations Unite For the Purpose of Combining Their Business and Property, Transaction Not a Sale, New Organization Liable

Where two or more corporations enter into a combination for the purpose of combining and uniting under one corporate entity the business and properties of all the contracting corporations, such a transaction cannot be construed to be a sale and the new corporate entity will be held liable for the debts of the old under such an arrangement.[41]

§ 163. Where There Is an Exchange of Stock, New Corporation Liable For Debts of Old

Where an agreement is made between two corporations, that the stockholders of one will exchange their stock for that in the other in consideration of one corporation transferring to the other all its property, the transaction does not amount to a sale and the receiving corporation will be liable to the creditors of the transferring corporation for the obligations of the transferor.[42] Of course it is not easy to see how this end may be attained without the court so far dissipating the corporate entities as to ascertain the stockholders therein, and the nature of the transaction. This could hardly be said to be a sale of assets from one corporation to another or a consolidation or merger, but undoubtedly liability rests upon the operation of the principle that corporate forms will be overridden in interest of justice and individuals dealt with.

§ 164. Change of Stock and Assumption of Bonded Indebtedness Sufficient to Hold Transferee Liable

Where a transaction merely amounts to one corporation conveying its property to another corporate organization in

[41] Bruce McBeth Engine Co. vs. J. P. Ustis Mfg. Co., 8 Ohio App. 341.
[42] Chicago & Joliett Elec. Ry. Co. vs. Ferguson, 106 Ill. App. 356; Swing vs. American Glucose Co., 123 Ill. App. 156; Shadford vs. Detroit Y. & A. A. Ry. Co., 130 Mich. 300; 89 N. W. 960.

consideration of the assumption by the transferee of the transferor's bonded indebtedness, together with the issuance by the transferee of its stock to the stockholders of the transferor in exchange for their stock in the transferring corporation, the result of such transaction being to leave the transferor corporation without property, corporate rights, or franchise, and a uniting and combining of the stockholders of each corporation, in one, is such to hold the transferee corporate entity liable for the obligations of the transferor. Such transaction cannot be held to be a sale and purchase but is a merger under such circumstances as to make the merged corporation liable.[43]

§ 165. Organization of New Corporation to Take Over an Old, Paying Therefor in Stock, New Held to Be the Old

Where a corporation is formed with the express object in view of purchasing all of the property of the existing corporation, and such purchase was actually made but was paid for in stock of the new organization issued directly to the stockholders of the original company, the new corporation will be held liable for all of the debts and obligations of the corporate organization that it was organized to succeed. Such transaction does not amount to a sale but in legal contemplation the new corporation will be held to have stepped into the shoes of the old. It seems also that in such a case the new corporate organization will be held for all of the debts of the former corporate entity and that its liability is not limited to the amount of the property received by it.[44] So, also, where the officers of an existing corporation organize a new corporation,

[43] Chicago San Fransisco & C. Ry. Co. vs. Ashling, 160 Ill. 373; 43 N. E. 373; 156 Ill. App. 327. (The court in this case apparently fell into the error of characterizing what is generally understood to be a merger as a consolidation.) See secs. 143, 163, supra. This sort of transaction as is stated in sec. 163, supra, is neither a sale consolidation or merger, but is simply a disregard of the corporate entity.

[44] Otis vs. Ohio Mines, 15 Ariz. 264; 138 Pac. 777; see sec. 184, infra.

and take over the assets of the old corporation in exchange for stock in the new organization, without the payment of any other consideration therefor, and the officers of the old corporation become the officers of the new corporate formation which continues to transact the same business at the same place as did the old, having acquired all of the assets and property of the old, this transaction cannot be held to amount to a sale. The law will not permit parties managing a corporation to contract debts and obligations in its name and then by some legerdemain of high financing, strip the corporation of all its property and assets by transferring them to a new corporation which the same parties manage and thereby render it powerless to pay its debts. When the case is analyzed it simply amounts to this—that parties controlled the corporation and the corporation owed the debts but by a transfer, the parties still control the corporation but the corporation owes no debts. The law has no toleration for such financial jugglery.[45]

§ 166. New Corporation May Not Take Over Assets of Old and Pay Stockholders in Bonds

An existing corporation owing debts may not transfer all of its property to a new corporation in consideration of such new corporation paying for the surplus of the property of the old organization over and above a bond issue, such payment to be in bonds to the stockholders, and in such case the new corporation will be liable for the debts of the old organization.[46] There is essentially no difference, when a corporation trans-

[45] Collinsville State Bank vs. Esau, 176 Pac. 514; 74 Okla. 45; Seymour vs. Boise Ry. Co., 24 Idaho 7; 132 Pac. 427. In the last cited case the court suggested that the new corporate organization would be liable for the debts of the plaintiff, Seymour, but the case was based primarily on a constitutional provision in Idaho and only the property of the old corporate entity was to be subjected to the satisfaction of the plaintiff's claim.

[46] Chattanooga R. & C. R. Co. vs. Evans, 14 C. C. A. 116; 31 U. S. App. 432; 66 Fed. 809; Shadford vs. Detroit Y. & A. A. Ry. Co., 130 Mich. 300; 89 N. W. 960; Jennings & Neff Co. vs. Crystal Ice Co., 150 S. W. 1088; 128 Tenn. 231; 47 L. R. A. N. S. 1058.

fers its property to another and takes stock in payment thereof, which stock is issued to its stockholders, and in the case where it takes in payment for such transfer bonds of the transferee corporation which are issued to its stockholders.

In such case where the payment is in stock or in bonds, the principle is applicable that any device by which the assets of an insolvent corporation are to be parcelled out among shareholders, leaving creditors unpaid, is a circumstance giving cause of complaint to the creditors. The creditors may follow the property of the corporation, or what stands in lieu thereof, thus wrongfully paid into the hands of the stockholders, the rights of the shareholders being only to the surplus after all debts are paid. These principles are familiar law and sustained upon the most equitable basis, fortified by right, and finding frequent application in the courts.[47]

§ 167. New Corporation Organized by Transferor, Corporation's Stockholders Liable For the Debts Thereof Even Though No Fraud

The management of one corporation may organize another and transfer the property of the old corporate organization to the new corporate entity but even if this is done with the consent of all of the stockholders, the new corporation will be held liable for the debts of the others, at least to the extent of the value of the property received. This is true even though it be conceded that the transfer was not made for fraudulent purposes, or for the purpose of hindering or delaying the creditors of the old corporate organization. This is true even if it be contended that the transfer is not void. The creditors of the old corporate organization have a right to follow the property which has been thus transferred and subject the property to the satisfaction of their claims.[48]

[47] Chattanooga R. & C. R. Co. vs. Evans, supra; Chicago R. I. & P. Ry Co. vs. Howard, 7 Wall. 392, 74 U. S. 392; 19 L. Ed. 117; Shadford vs. Detroit Y. & A. A. Ry. Co., supra; Jennings, Neff & Co. vs. Crystal Ice Co., 128 Tenn. 231; 47 L. R. A. N. S. 1058; 159 S. W. 1088.

[48] Hoggan vs. Price River Irrigation Co., 55 Utah 170; 184 Pac. 536; see sec. 157, supra.

The court, in the case cited in the footnote, of Hoggan vs. Price River Irrigation Company, merely makes the pronouncement that the new organization formed out of the old, and to which the property of the old is transferred, that such new will be liable for the debts of the old without assigning any dialectics therefor, but it seems that the Supreme Court of Tennessee assigns a sufficient reason for such holding that the transfer in such a case is out of the ordinary course of business and is such to impute to the transferee corporation full knowledge of all of the facts and circumstances under which the transferor conveys its property.[49] When this is conceded, then naturally liability follows.

§ 168. Any Reorganization by Which the Stockholders of the Reorganizing Corporation Have an Interest in the Reorganized Corporation, Sufficient to Hold New Organization Liable For Debts of Old Even in Absence of Fraud

The law will not countenance any plan, scheme, or device of whatever sort, kind, or character whereby a corporation may be reorganized into a new corporate entity and the stockholders of the old retain an interest in the new, whether it is by way of stock holdings or bond ownership, or otherwise, and the new corporation be freed from the obligations of the old. In such circumstances the courts will fasten liability upon the new to the extent at least of the property received by it and this is true in spite of the best of good faith that may surround the transaction whereby the transfer is made. The stockholders of a corporation may not devise any scheme, plan or arrangement whereby they are entitled to any share of the capital stock or to any dividend on the properties until the debts of the corporation are paid.[50]

[49] Jennings & Neff Co. vs. Crystal Ice Co., 128 Tenn. 231; 47 L. R. A. N. S. 1058; 159 S. W. 1088.

[50] Chicago R. I. & P. Ry. Co. vs. Howard, 74 U. S. 392; 7 Wall. 392; 19 L. Ed. 117; Pittsmont Cooper Co. vs. O'Rourke, 49 Mont. 281; 141 Pac. 849; Louisville Trust Co. vs. Louisville N. A. & C. Ry. Co., 174

§ 169. The Rule Is the Same in Holding a Successor Corporation Liable on Consolidation or Merger Whether the Corporations Are Private or Municipal

There is essentially no difference in the operation of the principle holding a new corporate organization liable for the debts of the old on a merger or consolidation, whether the corporations are municipal or private.[51] So a municipality will be liable for teachers' salary incurred by a township subdistrict which has been thereafter merged into a municipal district for school purposes.[52] Likewise, one school district passing into another, is liable for the debts of the extinct school district where the debts are less than the value of the property received by the merged district.[53]

Where a town passes out of existence and its territory is embraced within the extended lines of another town, such action taking place by legislative enactment, which, however, is silent as to the liquidation of the liabilities of the extinct town, the town acquiring the territory will be held liable therefor.[54]

There can be no criticism of the principle that a municipal corporation taking over the property, territory, and rights of another municipal corporation by consolidation or merger or otherwise is liable for the debts of the consolidating or merging corporation. Yet, one of the principal conditions upon which private corporations are held liable on a merger or consolidation does not exist, and that is the payment for the transfer in stock but a similar situation is present in the

U. S. 674; 19 S. Ct. 827; 84 Fed. 539; 28 C. C. A. 202; 43 L. Ed. 1130; Luedecke vs. Des Moines Cabinet Co., 140 Iowa 223; 118 N. W. 456; 32 L. R. A. N. S. 616. See sec. 184, infra, as to extent of liability of receiving corporation of assets of another. See also secs. 157 and 167, supra, as to fraud in such transaction being an element therein.

[51] Mt. Pleasant vs. Beckwith, 100 U. S. 514; 25 L. Ed. 699; School Dist. No. 3 vs. Greenfield; 64 N. H. 84; 6 Atl. 484; Knight vs. Ashland, 61 Wis. 233; 21 N. W. 65; Walker vs. Rome, 6 Ga. App. 59; 64 S. E. 310; Thompson vs. Abbott, 61 Mo. 176.

[52] Thompson vs. Abbott, supra.

[53] School Dist. No. 3 vs. Greenfield, supra.

[54] Knight vs. Ashland, supra; Mt. Pleasant vs. Beckwith, supra.

case of a merger or consolidation of municipal corporations in that the municipal corporation does not pay anything for the property that it acquires and if the municipal corporation escapes liability for the debts and obligations of the merging or consolidating corporation, it would be taking the property rights and immunities without parting with any consideration whatsoever.

§ 170. Whether the Creditor Has a Contract With Consolidated Company Immaterial If a Consolidating Company Owes the Obligation

Whether a creditor has a contract with the consolidated company is immaterial when such creditor establishes that he has a valid contractual obligation against one of the consolidating companies or one of the constituent corporations going in to form the new consolidated company. It is not competent for a corporation to consolidate itself with other corporate organizations and thus form a new and consolidated corporation and by this simple process escape the payment of the debts of the corporations consolidating. So where there has been a consolidation the new organization is presumed to have taken with notice of the rights of creditors, the property of the constituent companies, and such consolidated corporation cannot claim for itself the position of vantage that attaches to a bona fide purchaser for value. There is a very marked dissimilarity between a bona fide sale for value of the assets of a corporation and the consolidation of corporations. It is now well established that where corporations are united into one and the property of the old companies is vested in the new the latter is liable both at law and in equity for the debts and obligations of the constituent corporations. This liability is sometimes limited to the extent of the property received by the new corporate organization. The controlling principle that dictates the liability of the new organization in such case is that such corporation will not be permitted to

give way and strip itself of its assets to the prejudice of the rights of its creditors, but such assets will be followed as a trust fund in the hands of the new corporation, and it will not be heard to say that it is a bona fide purchaser under such circumstances. The liability of the consolidated corporation is measured by that of the consolidating companies and is co-extensive therewith and therefore the obligee of such consolidating corporation is not required to establish contractual liability of the consolidated company in order to have judgment against it.[55]

§ 171. Some Courts Declare the Rule to Be That a New Corporation Is Liable on Agreement on Consolidation or Continuance of the Old Corporation or That the Transaction Is Fraudulent in Fact

The court of last resort in the state of Oklahoma has attempted to lay down a rule that a new corporation taking over the assets of an old will be liable if it appears that there is an agreement to assume the debts of the old or the circumstances surrounding the transaction warrant a finding that it was a consolidation of two corporations or that the new corporation is a mere continuance of the transferring corporation or that the transaction was fraudulent in fact.[56] This statement of the rule is subject to criticism. It may readily be seen that if there be an agreement, assuming the debts of the old corporation, the new organization will be liable therefor, and if the circumstances surrounding the transaction warrant a finding that there was a consolidation of two corporations, of course, necessarily liability follows but before the corporation is liable for the debts of the old, all of the elements as defined by law must be present. It is not doubted in the light of modern authority that any sort of arrange-

[55] Morrison vs. American Snuff Company, 79 Miss. 330; 30 S. 723; 89 A. S. R. 598.

[56] Burkholder vs. Okmulgee Coal Company, 82 Okla. 80; 196 Pac. 679; Spring Creek Oil Corporation vs. Dillman, 215 Pac. 1053; 90 Okla. 129.

ment whereby the new corporation is, in fact, a mere continuance of the old such new corporation will be liable for the debts of the old, and it is unnecessary that there should attach to such a transaction the stigma of fraud in fact.[57] The better reasoned rule and the one sustained by enlightened modern authority is that fraud is no element of the case against a new organization succeeding to the rights of a corporation, taking over its property and paying therefor to the stockholders of the old organization in stocks, bonds, and other securities.[58] Of course, if fraud in fact on creditors' rights is in the transaction, no other element need be present and this is true as an elementary proposition of law whether the transaction is between corporations, individuals, or partnerships.

§ 172. Where a New Corporation Is Organized and Its Stock Issued to the Stockholders of an Old Corporation in Consideration of Substantially All of the Assets of the Old, It Is Liable For the Debts of the Old Even Though the Old Continues to Exist and Holds Some Property

Where a new corporation is organized and all of the assets of an existing corporation are transferred to the new and the only consideration paid therefor is the stock of the new, issuing to the stockholders of the old, the new corporate organization is liable for the debts of the old company, and this is true notwithstanding the fact that the old company may retain some assets and may continue to exist as a corporation. Especially is the new organization liable where the managing head, directors and officers of the two corporations are prac-

[57] Hoggan vs. Price River Irrigation Co., 55 Utah 170; 184 Pac. 536; Jennings Neff & Co. vs. Crystal Ice Co., 128 Tenn. 231; 47 L. R. A. N. S. 1058; 159 S. W. 1088.

[58] Pittsmont Cooper Co. vs. O'Rourke, 49 Mont. 281; 141 Pac. 849; Berthold vs. Holladay Klotz Land & Lumber Co., 91 Mo. App. 233; San Francisco and N. P. Ry. Co. vs. Bee, 48 Cal. 398; see secs. 157, 167, 168, supra.

tically the same and the business continued in the same manner as it had theretofore.[59]

§ 173. State Bank Changing to National Bank Is Liable in the Same Manner As If Change Had Not Taken Place

Where a state bank changes from that form of state corporate organization to the privilege granted by the national government under the National Banking Law, such national organization is responsible for the debts and liabilities of the state bank, where the national organization takes over the property and business of the state corporation. It amounts simply to this, that all property and rights which the state bank had before organizing itself into a national bank, continues to be vested in the same parties when the corporate entity is brushed aside. In such case the liability of the national bank is by no means limited to actual accrued indebtedness but extends to and includes executory contracts and binding guarantees. The transaction is that the property and rights of the state bank purport to be transferred to the national bank, yet in substance there is nothing actually transferred from one party to another, and when the corporate entity is pierced and the real parties in interest are discovered, it is found but a continuation of the same persons under the authority of a different jurisdiction. The law declares as between the national bank and those who have contracted with its other self when it was operating under a state charter, it retains its identity but has merely accepted the privileges attendant upon organizing under the National Banking Act. No real change takes place, the bank does not close its business of banking, but there is simply a continuance of the same body with the same officers and stockholders, same property, assets and banking business, and it must follow in view of the established enlightened rule that the cor-

[59] Goldmark vs. Magnolia Metal Co., 29 App. Div. 264; 51 N. Y. S. 68. Such liability would no doubt be confined to the amount of property received; see sec. 159, supra.

porate entity will be brushed aside, that such a change does not prevent it from being the same bank and going on and doing the same business without interruption. The same principle operates in the same way when a national bank changes to a state banking corporation.[60]

§ 174. Corporation Assuming to Buy the Assets of Another Corporation and Pay Therefor in Its Own Stock and by Assumption of Debts Is Liable Upon an Executory Contract

Where the stockholders of one corporation acquiring all of the stock of another in the same line of business thereafter transfer the assets of the purchasing corporation to the other, such transferee corporation is liable upon executory *contract of the transferor corporation.* Where the stockholders of one corporation take money from it and purchase the stock of another corporation engaged in the same line of business and thereafter consolidate the assets of the two corporations and the transferor corporation ceases to do business, the transferee corporation will be held liable on an executory contract entered into to supply its products prior to its consolidation. Such transferee corporation may not escape liability by the invention of devious ways of manipulating the stocks and assets of the two corporations as where the transferee corporation proposes to buy all of the property of the transferor corporation and to assume all of its debts but not to assume any contract for future delivery of its products, for which the transferee corporation gives its promissory notes payable to the transferor corporation, which notes are later surrendered to the stockholders of the transferor corporation in consideration of such stockholder surrendering the stock of the transferor corporation.[61] In such case, the gist of the

[60] City National Bank vs. Phelps, 97 N. Y. 44; Metropolitan National Bank vs. Claggett, 141 U. S. 520; 12 S. Ct. 60; 35 L. Ed. 841.

[61] Standard Distilling and Distributing Co. vs. Jones and Adams Co., 239 Ill. 600; 88 N. E. 236.

situation is easily gotten at by simply stripping aside the veil of corporate entity and dealing with the stockholders as the real parties in interest. In other words, the courts may readily do justice and equity by refusing to be bound and hampered by matters of form and by dealing with substance.

§ 175. Where Stockholders and Officers, in Combination With Others, Form a New Corporation to Take Over Assets of Old, New Corporation Liable For Debts of Old

Where the officers, stockholders, and directors of a business corporation combine and unite with other persons to form a new and different corporation, and when all of the property and assets of the former corporation are transferred to the new organization, the product of this combination, and such transferee corporation pays no consideration for the transfer of the assets of the transferor corporation, except stock of the new corporation to the stockholders of the transferor corporation, in such a case and under these circumstances the transferee corporation will be adjudged to hold the property and assets it has thus received as a trustee for the benefit of the creditors of the transferor corporation and this trusteeship will be enforced by requiring the transferee corporation to account to the creditors of the transferor corporation for the property so received; and so where a corporation is thus organized, and a transfer made, a creditor of the transferor corporation is not by any means estopped from following and asserting his rights in and to the assets so transferred because some of the stockholders in the new organization did not know of the creditor's claim. It was not the duty of the creditor to acquaint the stockholders of the new corporation of his claim but that duty devolved upon the officers of the new corporation to give them such information.[62]

[62] Wilson vs. Aeolian Co., 64 App. Div. 337; 72 N. Y. S. 150; 170 N. Y. 618; 63 N. E. 1123.

§ 176. Where Three Corporations Are Under the Same Management, the Combining of the Properties in a Single Corporation Renders Such Corporation Liable For Debts of Others

Where three corporations are under a single management or are subsidiary corporations, and the property of all three is combined in the hands of one of them, such receiving corporation will be held liable for the debts and obligations of the transferor organizations, and this will be true notwithstanding the fact that the transfers are effected through the medium of one of the corporations and from the transferee to the third corporation, so where corporations are under a single management and the assets of the original debtor are transferred ultimately through the medium of a third corporation and, if paid for at all, are paid for in stock, such receiving corporation takes the assets of the transferor corporations *cum onere*. Corporations will not be permitted by this sort of juristic legerdemain to strip and denude different entities, for all practical purposes being one and the same, of all of their assets and property and leave creditors without a remedy for a satisfaction of their judgments but, on the contrary, the courts will hold the receiving corporation to respond for the liabilities of the transferor corporation. No sort of circuity in the transfer of the property may be resorted to as an effective means of defeating creditors in their attempt to follow the property of their debtor.[63]

It may be stated generally that it is immaterial what method is adopted, or what means are resorted to, to accomplish the purpose of transferring or changing the property from one corporation to another, that such receiving corporation will take the property subject to the debts of the old unless it is purchased in good faith at a valid and fair foreclosure sale, or unless it is purchased for full value without notice. In other words, the property of a corporation cannot be acquired

[63] Harbison Walker Refractories Co. vs. McFarland, 156 Ky. 44; 160 S. W. 798.

by a new corporation by any means whatsoever other than a valid foreclosure sale, or a purchase for full value in money and this is true whether the proceedings be at law or in equity.

§ 177. Where a Corporation Is Organized With an Agreement Between Stockholders and Promoters of a New Corporation Taking the Property of the Old and Paying Therefor in Stock to the Stockholders of the Old and to Promoters, New Corporation Liable

Where a corporation is operating even a nonprofitable business, and the officers, directors, stockholders, and bondholders, who are the same persons, enter into an agreement with other parties and promoters of a new corporation, and such new corporation is organized, issuing its stock and bonds to the stockholders of the old up to a certain amount, and the excess thereof to the promoters of the new, such new corporation will be liable for the obligations and liabilities of the old, such organization being without statutory authority is immaterial. In such case, when a new company is born, and possesses nothing tangible but a name, but has expectations —for in as much as the reason of its existence is to permit one of its parents to convey to the new arrival all of its worldly goods and then vanish—the law will then intrude itself into such a situation in the interest of creditors. The courts will not permit a scheme to succeed that has for its purpose to obtain the property of an old corporation by paying to the stockholders the purchase price, which purchase price is not to be paid by the stockholders to the corporation but to be kept by the stockholders as their own. It may be conceded that a corporation is but another name for the stockholders, but when it is patent that the stockholders are taken care of as individuals and the corporation and its creditors are ignored, then it is time for intervention on the part of the courts and the courts will not, in view of modern decisions, hesitate to intervene.[64]

[64] Meridian Light & Ry. Co. vs. Catar, 103 Miss. 616; 60 Southern 657; see secs. 81, 146, supra.

§ 178. Where a Corporation Takes Over Assets of an Old of the Same Name With the Exception of the Prefix "The" and Receives the Property For Which an Obligation Is Incurred, It Is a Question For the Jury As to Whether the New Corporation is Liable

Where a corporation takes over the assets and business of another corporation of the same name, with the exception that the new corporation has the prefix "The" added to its name, and where the old company is obligated upon a promissory note given to a creditor in payment of a chattel which the new corporation receives upon the transfer, and has disposed of, and the officers and manager of the two companies being the same, which officers and manager have caused the name of the new corporation to be signed to a note evidencing the purchase price of a chattel before the defendant corporation was organized, and upon different occasions had sought and obtained extensions of time for the payment of the note, in such case it is, it has been held, a question for the jury whether or not the note given under these circumstances was executed by the defendant corporation, or its predecessor, and it being for the jury to say, under proper instruction, whether a novation took place or whether there was a ratification of the officers' and manager's act in signing said note, or whether the succeeding corporation's liability arises by an implication of law from having taken over all of the assets and property of its predecessor, and resulting in an estoppel being thereby raised. It seems in such case that the operative principle is, a corporation having taken over the assets of a former company for the purpose of carrying on its business without apparent change in the personnel of the concern, such succeeding company is liable for the payment of the debts of the former concern.

It cannot take the benefits and advantages unless it does so *cum onere*.[65] It should be borne in mind, however, that

[65] Parsons Mfg. Co. vs. Hamilton Mfg. Ice. Co., 78 N. J. L. 309; 73 Atl. 254; Chesapeake Stone Co. vs. Holbrook, 168 Ky. 128; 181 S. W. 953; 1916D L. R. A. 311.

whether or not a new corporation is liable under such circumstances is a question for the jury to determine only when the facts are in dispute. But if there is no issue of fact to be determined as where the facts are admitted, stipulated or not controverted, then such liability or nonliability would be determined by the court as a matter of law.[66]

§ 179. Where One Corporation Transfers All of Its Assets to Another and the Facts Warrant a Finding That It Is a Continuance of the Former, This Alone Seems Sufficient to Hold New Corporation Liable For Debts of Old

Where it appears to the satisfaction of the court of the identity of the two corporations, and of the transfer of all of the property of one to the other, this seems sufficient to raise an implication of assumption of the liabilities of one of the other. The principle is well established by numerous modern authorities that when one corporation takes over the business of another, and succeeds it in its franchise and property, and is, in short, the same entity under another name, the one corporation is liable both at law and in equity for the debts of the other.[67] We have already seen that one of the modern factors in such cases is the payment by the receiving corporation in stock.[68] It seems, however, that if there is sufficient evidence to warrant the court in finding a continuance of the same identity and legal entity the new corporation will be held liable for the debts of the old, and it would seem that it is not indispensable to show that the consideration for the supposed transfer was stock of the new corporation, but this would not be true unless the evidence is sufficient to establish the fact that the new corporation is the old entity under another name.

[66] See sec. 530, infra.
[67] Zachra vs. Am. Mfg. Co., 162 S. W. 1077; 179 Mo. App. 683; see sec. 113, supra.
[68] See sec. 157, supra.

§ 180. Where a New Corporation Receives All the Stock of an Old and Practically All of Its Property by a Transfer, and Pays Part of the Debts of the Old, and an Officer of the New Corporation Executes a Note For the Balance, the New Corporation Will Be Held Liable Thereon

Where a corporation receives all of the stock of another, practically all of its property by appropriate transfers and conveyances, and after such transfers are made the transferee corporation continues the business in its own name, and pays a portion of the debts of the old, and its officers execute notes in their individual capacity for the balance of the indebtedness, such notes will be held to represent an indebtedness of the company which the company will be compelled to pay. The principle underlying such decisions is clearly manifest, that the courts will brush aside the corporate entity when it stands in the way of doing justice and deal with the stockholders and the owners of the corporation as individuals and this is true regardless of the fact of how many different entities may be obtruded in the path of right and to prevent the ends of justice from being obtained.[69]

§ 181. Continuance of the Transferor Corporation No Bar to Suit Against Transferee Corporation

It seems that the continuance in existence of the transferor corporation is no bar to the rights of creditors to assert their claims against the consolidated or transferee company. Any other rule would open the door to the grossest sort of fraudulent transactions as one corporation might retain a negligible amount of property, and by such retention, effectuate a complete bar to the rights of creditors to follow and assert their claims against the substantial property transferred, would be an easy means of accomplishing by a less direct route

[69] W. F. Taylor vs. Gulf Land & Lumber Co., 119 La. 426; 44 Southern 187.

what was denied them if openly and directly done. So it seems there may arise situations similar to a consolidation or merger and neither corporation go out of existence and yet the transferee corporation be held liable for the debts of the transferor corporation.[70] In such cases the result is reached by disregarding the mere technical existence of the transferee corporation and dealing with the mere substance of the transaction and holding the transferee corporation liable as if a merger or consolidation had taken place. It simply amounts to this: That the courts refuse to be hampered by technical corporate entity but deal with substance and disregard forms. It seems, however, that if the question becomes pertinent that a new corporation cannot be regarded as a reincarnation or a palingenesis of the old where the old continues to function as such, and especially this is true if it is presumably solvent.[71] It is not thought, however, that the assumption on the part of some courts that if the old corporation continues, the new cannot be a reincarnation thereof is meant to go to the extent of freeing the assets in the hands of the new organization from liability that such assets would be subjected to if retained by the old. In other words, it is not thought that any special significance that is defining rights and liabilities attaches to the term "reincarnation." On the other hand, it is readily understood and has been held that one corporation for all legal intents and purposes may be the successor of another and at the same time both corporations continue their existence and function as separate and distinct legal entities. Of course it may be understood that in legal contemplation when one corporation will be considered as a successor of another depends upon facts and circumstances surrounding each

[70] American Railway Express Co. vs. Commonwealth of Kentucy, 190 Ky. 636; 228 S. W. 433; 30 A. L. R. 543; Berthold vs. Holladay Klotz Land and Lumber Co., 91 Mo. App. 233; Quinn vs. American Bankers Assurance Co., 183 Mo. App. 8; 165 S. W. 823; Sweeney vs. Heap O'Brien Mining Co., 194 Mo. App. 140; 186 S. W. 739; see sec. 42, supra.

[71] Koch vs. Speedwell Motor Car Co., 24 Cal. App. 123; 140 Pac. 598; 140 Pac. 600; Advance Beneficial Order vs. Pennsylvania Safe Deposit & Trust Co., 195 Pa. 602; 46 Atl. 102.

particular case, but the term "successor" is plastic and in modern acceptations has a broad significance, and there can be no doubt that one corporation may be the successor of another, although, there is neither a merger nor technical consolidation.[72]

§ 182. It Is Sufficient If the Transferor Corporation Becomes Practically Extinct to Hold Transferee Corporation Liable on the Obligations of the Former

In harmony with the rule announced in the last preceding section, it may be safely said that all of the authorities are agreed that where one corporation transfers all of its assets and properties to another and thereafter continues as a corporation but for all practical purposes is extinct, that such receiving corporation will be held liable to the creditors and obligees of the transferor organization and its continuance of a technical existence is manifestly no bar and impediment to the rights of creditors to assert their claims against the new organization.[73]

§ 183. One Corporation Transferring All of Its Property to Another Under Such Circumstances As Make the Transferee Liable to Creditors of the Transferor, the Rights of Creditors Are Superior to Mortgagees' Rights

Many questions difficult of solution have presented themselves to the courts as results of the attempt on the part of corporations to so juggle their assets from one legal entity to another and escape the payment of obligations and in many cases there being no substantial difference in the identity of the individuals composing and in control of the legal entities.

[72] North Texas National Bank vs. Thompson, 23 S. W. (2d) Tex. 494; Lightner vs. Boston A. R. Co., 1 Low. 338; Fed. Case No. 8343; see secs. 159, supra, 182, 225, infra.

[73] Altoona vs. Richardson Gas & Oil Co., 81 Kan. 717; 106 Pac. 1025; 26 L. R. A. N. S. 651; 79 Kan. 466; 21 L. R. A. N. S. 214; 100 Pac. 50.

It may be asserted as a rule readily applying and of well nigh ecumenical application that where one corporation transfers all of its property to another and takes in payment therefor stock of the transferee issued to the stockholders of the transferor, that the receiving corporation will be held to have taken the property *cum onere* and that notice of the rights of creditors will be imputed under such circumstances to the receiving corporation; so where the receiving corporation, after having obtained the property under such circumstances attempts to encumber it by mortgage, the rights of the creditors of the transferor corporation will be held superior to the rights of a mortgagee under such circumstances, if there is any basis whatsoever for imputing to the mortgagee knowledge or notice of the rights of the creditors of the transferor corporation. It is, in some states, prescribed by statute that assets in the hands of a succeeding corporation are impressed with lien.[74]

§ 184. Extent of Liability of Receiving Corporation Limited to the Amount of Property Received

Not a little confusion has arisen in the cases as to whether the receiving corporation on a consolidation or merger or other transaction where one corporation takes the assets of another is liable for obligations of the constituent corporations, or whether that liability is confined and limited in extent to the amount of the property received or whether such liability attaches to the receiving corporation to the full amount of the obligations of the transferor corporation. There is a line of cases that hold that the liability is limited to the property received;[75] while other cases go to the extent of not holding the

[74] Blair vs. St. Louis H. & K. Railway Co., 22 Fed. 36; 24 Fed. 148; Sweeney vs. Heap O'Brien Mining Co., 194 Mo. App. 140; 186 S. W. 739; see sec. 186, 468, 469, infra.

[75] Sharples Co. vs. Harding Creamery Co., 111 N. W. 783; 11 L. R. A. N. S. 863; 78 Neb. 795; Ewing vs. Composite Brake Shoe Co., 169 Mass. 72; 47 N. E. 241; Altoona vs. Richardson Gas & Oil Co., 81 Kan. 717; 26 L. R. A. N. S. 651; 106 Pac. 1025; 79 Kan. 466; 21

new corporation liable at all but merely charge the assets in its hands and, in such case, the right to proceed against the new corporation and charge it with personal liability is not permitted.[76] While there is another long line of cases that hold the corporation personally liable for all of the debts of the transferor corporation and if the principle running through these cases is sound, the question of the amount and extent of property received would hardly be material.[77] Possibly the opposing lines of decisions, present conflicts more apparent than real as it shall be our purpose at present to attempt to show. The leading case sustaining the doctrine that the receiving corporation is liable for all of the debts of the transferor corporation is Atlantic and Birmingham Railroads Company vs. Johnson.[78] The court first quoted Judge Thompson's work on corporations and observed that the work of that leading authority has been quite extensively copied on this subject and inquired what is the exact meaning of the expression that the consolidated company is liable for the debts or torts of its constituent companies, "at least to the extent of the property received from them." The use of the qualifying words the court observes, "at least" shows that this was not intended as limiting entirely the liability. Those words indicate a minimum of liability and where it is so carefully stated that this is the minimum it can hardly be contended

L. R. A. N. S. 214; 100 Pac. 50; Skirvin Operating Co. vs. So. Western Electric Co., 71 Okla. 25; 174 Pac. 1069; 15 A. L. R. 1104; Mahaffey Co. vs. Russell & Butler, 100 Miss. 122; 54 Southern 807-945; Sudakovich vs. Central Bank, 218 Pac. 113; 62 Utah 24; Jennings Neff & Co. vs. Crystal Ice Co., 128 Tenn. 231; 47 L. R. A. N. S. 1058; 159 S. W. 1088; Morrison vs. American Snuff Co., 79 Miss. 330; 89 A. S. R. 598; 30 Southern 723; Wesco Supply Co. vs. El Dorado Light & Water Co., 107 Ark. 424; 155 S. W. 518.

[76] Ewing vs. Composite Brake Shoe Co., supra.

[77] Atlantic & Birmingham Railway Co. vs. Johnson, 127 Ga. 392; 56 S. E. 482; 11 L. R. A. N. S. 1119; Shadford vs. Detroit Y. & A. A. Railway Co., 130 Mich. 300; 89 N. W. 960; Otis vs. Ohio Mines Co., 15 Ariz. 264; 138 Pac. 777; Ferguson & Wheeler, etc., Co. vs. Good, 112 Ark. 260; 165 S. W. 628; Douglas Printing Co. vs. Over, 69 Neb. 320; 95 N. W. 656; Friedenwald vs. Asheville Tobacco & Cigarette Co., 117 N. C. 544; 23 S. E. 490; Seymour vs. Boise Railroad Co., 24 Idaho 7; 132 Pac. 427.

[78] 127 Ga. 392; 56 S. E. 482; 11 L. R. A. N. S. 1119.

with reason that it is also the maximum. The court then inquires if the consolidating company is liable "at least" to this extent how far is its liability at most. While this line of reasoning on the part of the court has substantial basis, yet it is hardly satisfying. The conflict would seem to disappear if each situation is analyzed and it is definitely determined the exact character of the transaction that is before the court. If the corporate entities are brushed aside and the constituent corporations are held to be the same as the consolidated company, then manifestly there is no reason why the consolidated company should not be held liable for the full amount of the indebtedness of its *alter ego*, or *alter egoes*. There could not appear any more reason for exempting the receiving corporation from liability beyond the amount of property received by it than there could be for holding a man liable who has changed his name only to the extent of property he has at the time of such change. If the new corporation is merely the old in another name, then it would seem that the argument limiting its liability must fail. On the other hand, if two corporate entities are separate and there has been a purchase, from one by the other, although under such circumstances as to fix legal liability upon the receiving corporation as in the cases between individuals involving fraudulent conveyances, then the receiving corporation would be liable only to the extent of the property received by it from the transferor corporation. It seems that some of the courts have actually predicated decisions upon the basis that we have suggested. In Ferguson & Wheeler Land & Lumber Company vs. Good,[79] the court there took occasion to observe that if the new organization was but a continuance of the old, it would be held liable for all of the obligations of the old. This is manifestly a decision based upon the soundest of principles.[80] It is indeed difficult to see how a court may justify a pronouncement that a corporation is but a continuance of

[79] 112 Ark. 260; 165 S. W. 628.
[80] Douglas Printing Co. vs. Over, 69 Neb. 320; 95 N. W. 656.

another legal entity or such other legal entity operating under a different charter and a new name is liable only to the extent of the property that it has received from its other self—its *alter ego*. Other courts seem to adopt in a measure both views and announce the position that the corporation may be held liable to the extent of the property received by it or that it may be declared to be a trustee with the property in its hands for the benefit of creditors of the old organization, or that it may be held personally liable for the obligations of the old.[81] It seems of little importance that the liability of the new corporation is predicated upon a tortious act of the transferor corporation.[82] We have taken occasion heretofore to observe that the liability of the new organization may be sustained even though the transaction is surrounded by utmost good faith on the part of the participants therein,[83] and this principle, of course, is operative whether the liability is predicated upon the basis of the full amount of indebtedness of the old organization or is limited to the property actually received by the transferee corporation.[84]

§ 185. The Rule Holding Corporations Liable on a Merger or Consolidation Is Outgrowth of Trust-Fund Doctrine

We have already seen that the trust-fund doctrine is a forbear of the rule dealing with the disregard of the corpo-

[81] Northwest Perfection Tire Co. vs. Perfection Tire Co., 125 Wash. 84; 215 Pac. 360.

[82] Abilene Cotton Oil Co. vs. Anderson, 91 S. W. 607; 41 Tex. Civ. App. 342; Atlantic & Birmingham Railway Co. vs. Johnson, 127 Ga. 392; 56 S. E. 482; 11 L. R. A. N. S. 1119.

[83] See secs. 150, 167, supra, 216, infra.

[84] Hoggan vs. Price River Irrigation Co., 55 Utah 170; 184 Pac. 536; Jennings Neff & Co. vs. Crystal Ice Co., 128 Tenn. 231; 47 L. R. A. N. S. 1058; 159 S. W. 1088; Pittsmont Cooper Co. vs. O'Rourke, 49 Mont. 281; 141 Pac. 849; Sudakovich vs. Central Bank, 218 Pac. 113; 62 Utah 24; Roberts vs. Hughes, 86 Vt. 76; 83 Atl. 807. The rule is that where one corporation is not a successor to another but takes a portion of its property, the corporation receiving the property is liable to the creditors of the transferring corporation to the extent of property received. See sec. 159, supra. But of course this would not apply if the receiving corporation pays full value for such assets to the transferring company and there is no fraud in the transaction.

rate entity,[85] likewise parentage to this particular branch of the subject holding the succeeding corporation liable on a merger or consolidation may be ascribed to the trust-fund doctrine.[86] However, it may be said that in the majority of cases when the court holds that the consolidated corporation or receiving merged corporation is liable for the debts of the old organization, it merely makes application of the general principle that in a proper case the courts will brush aside the corporate fiction and will cause a debouchment of the living and acting human beings behind the corporate fiction to take place.

In National Union Bank of Maryland vs. Hollingsworth,[87] the court adhered to the trust-fund doctrine with such rigidity and tenacity that the vision of the court was completely obscured to the existence of the familiar law that in a proper case the courts would disregard the corporate fiction and deal with the individuals operating behind that fiction, and so where the transferor of the property was not a corporation the court felt itself unable to fix liability for the obligations of the transferor on the transferred property in the hands of the transferee. The position of the court in that case could, it is thought, hardly receive sanction today in the light of progress that has been made in recent years.

In Hibernia Insurance Company vs. St. Louis & New Orleans Transfer Company,[88] the court while giving sanction to the general rule that the corporate entity would be brushed aside in a proper case calling for such action, yet, seemed to feel itself somewhat hampered by the trust-fund doctrine and there observed that a different principle probably would be applicable in dealing with transactions between individuals to that controlling when the transaction was between corporations.

[85] See secs. 41, 42.
[86] Chicago, Milwaukee & St. Paul Railway Co. vs. Third National Bank, 26 Fed. 820; 134 U. S. 276; 10 S. Ct. 550; 33 L. Ed. 900.
[87] 135 N. C. 556; 47 S. E. 618.
[88] 13 Fed. 516; 4 McCrary 442.

§ 186. Where the Trust-Fund Doctrine Prevails the Claims of Creditors of the Transferor Are Superior to Rights of Creditors of the Transferee

Where the trust-fund doctrine prevails, it seems clear enough that when the assets are transferred from one corporation to another—and this would seem to be true when the transaction is that of a consolidation or merger, or otherwise—the assets in the hands of the transferee are impressed with a lien in favor of the creditors of the transferor, and this lien is of such dignity that it is superior to any rights of creditors of the transferee. However, in application of the principles announced by this section, it must be borne in mind that the facts authorizing the application of the trust-fund doctrine must be present.[89] Where the consolidated or succeeding corporation has transferred the assets to a purchaser for value in good faith before any action is taken to actually appropriate the assets to a satisfaction of such lien of creditors of the transferor, such purchaser will take the property free of such lien.[90]

The position has been sustained that the creditors of the transferor corporation and the transferee would stand on the same footing and share alike.[91] In reaching this conclusion it would seem that the court found sufficient facts to authorize it in so doing and merely brushed aside the corporate entity, and dealt with both as if they were one. It could hardly have reached this conclusion upon any other theory. It could not have given force to the trust-fund doctrine and have come to this conclusion, for the very purpose of that doctrine is to give the creditors of the transferor corporation a priority.

[89] Ex parte Romans, 78 S. C. 210; 58 S. E. 614; Cole vs. Millerton Iron Co., 133 New York 164; 28 A. S. R. 615; 30 N. E. 847; 59 Hun. 217; 13 N. Y. S. 851; 38 N. Y. S. 34; Hurd vs. N. Y. & Commercial Steam Laundry, 167 N. Y. 89; 60 N. E. 327; Montgomery & West Point Railroad Co. vs. Branch Sons & Co., 59 Ala. 139; see also sec. 183, supra.

[90] See also Hervey vs. Ill.-Midland Railway Co., 28 Fed. 169.

[91] Livingston County Agriculture Society vs. Hunter, 110 Ill. 155.

§ 187. Ordinarily a Corporation Acquiring the Property of Another at a Judicial Sale Cannot Be Held Liable For the Debts of the Original Company

Where an insolvent corporation's property is about to be sold in pursuance to proceedings properly had in a competent court and free from fraud and collusion, the stockholders thereof may organize a new corporation for the purpose of buying in the property at such sale and the new corporation will take the property freed from the obligations of such insolvent corporation.[92] So where there is a reorganization plan to buy at a judicial sale and all stockholders and all creditors are offered equal opportunity of sharing in the avails of the reorganization plan, those who refuse to accept thereunder will not be permitted to assert rights against the property of the reorganization. On the other hand, where the trust-fund doctrine prevails, the fact that a transfer takes place by and through the operation of law does not seem to affect the efficacy or operation of that doctrine, and it may be resorted to in the interest of unsatisfied creditors notwithstanding the transfer took place in legal proceedings.[93] So any device whether by contract or judicial sale under a consent decree whereby stockholders are preferred before creditors or whereby the original stockholders retain an interest in the property in the hands of the new organization is invalid and this is true, even though such consent decree and the proceedings thereunder are free from fraud and bad faith, but the rule is such that by any arrangement through judicial proceeding

[92] Warren Company vs. Black Coal Company, 85 W. Va. 684; 102 S. E. 672; 15 A. L. R. 1083; Male Trustees vs. Atchison & S. F. Ry. Co., 230 N. Y. 158; 129 N. E. 458; 15 A. L. R. 1098; 179 App. Div. 87; 166 N. Y. S. 593; Sebree vs. Cassville & W. R. Company, 212 S. W. (Mo.) 11; Texas State Fair, etc., Association vs. Caruthers, 8 Tex. Civ. App. 474; 29 S. W. 48; Blue Ridge Electric Co. vs. American Bank Note Co., 150 C. C. A. 509; 237 Fed. 755; Hoard vs. Chesapeake & Ohio Railway Co., 123 U. S. 222; 31 L. Ed. 130; 8 S. Ct. 74; Wiggens Ferry Co. vs. Ohio & M. R. Co., 142 U. S. 396; 35 L. Ed. 1055; 12 S. Ct. 188; Phipps vs. Chicago R. I. & P. R. Co., 284 Fed. 945; 28 A. L. R. 1184; 261 U. S. 611; 43 S. Ct. 363; 67 L. Ed. 826; Oehring vs. Fox Typewriter Co., 272 Fed. 833.

[93] Western N. C. Railway Co. vs. Rollins, 82 N. C. 523.

or courts whereby the stockholders of the original company retain an interest in the property transferred, leaves the property subject still to the claims of nonassenting unsecured creditors of the original corporation who are not parties to or participants in the foreclosure.[94] So where there is a reorganization of a corporation and the property of such corporation is worth enough above the encumbrance against it to pay the claims of unsecured creditors is sold on foreclosure for the amount of the mortgage to a newly formed corporation under a reorganization plan by which the new company is to exchange its stock and bonds for those of the old, the property in the hands of the new company will be held charged with the liabilities of the unsecured creditors of the original corporation and in such case it is not necessary that the complaining creditors should predicate their prayer for relief upon the ground of fraud.[95]

§ 188. Where There Is a Combination, Conspiracy, or Understanding, That the Reorganized Corporation Is to Take Over the Business of the Old, the New Corporation Is Liable

As has been suggested in the preceeding section it is undoubtedly the law, well fortified by a precedent and amply sustained on principle, that where it appears there is fraud, conspiracy, or a combination on the part of the shareholders of a corporation to organize a new corporation for the purpose of engaging in the same line of business, which new corporation takes over the goodwill, assets and property of the original company, and on the formation of such new corporation, the old transferred to it, all of its property and effects,

[94] Louisville Trust Co. vs. Louisville N. A. & C. R. Co., 174 U. S. 674; 43 L. Ed. 1130; 19 S. Ct. 827; 84 Fed. 539; 28 C. C. A. 201; N. Pac. Railway Co. vs. Boyd, 101 C. C. A. 18; 177 Fed. 804; 228 U. S. 482; 33 S. Ct. 554; 57 L. Ed. 931; see secs. 153, supra, 192, 197, infra.

[95] K. C. Southern Railway Co. vs. Guardian Trust Co., 120 C. C. A. 121; 201 Fed. 811; 127 C. C. A. 184; 210 Fed. 696; 240 U. S. 166; 60 L. Ed. 579; 36 S. Ct. 334; see sec. 167, supra.

leaving the old entirely denuded of all its property and assets and without means for the continuance of its business, such showing the new company will be held liable for the obligations of the old.[96] Likewise where the principal shareholders combine for the purpose of creating a corporation to hold the property of the old company and they being the only persons interested therein, such new corporation will not be held to be a purchaser for value but will be treated as a continuance of the old.[97] The contention of creditors that a new corporate formation is but a continuance of the old is strengthened and fortified by the fact that the new continues to occupy the same premises and continues the same business and the old names being properly displayed at the original place of business,[98] and where a corporation is formed for the purpose of continuing and taking over the business of another of the same name is sufficient to hold the new organization liable for the debts of the old.[99] It seems clear enough that the rules announced in this section and applicable under the facts suggested even though the transfer takes place by virtue of a judicial proceeding, and while it is not ordinarily true that valid judgments and decrees can be used as a means to accomplish fraud, it is bad wherever this is done and proof is found adequate to establish it. Courts will be astute to go behind the apparent legality of such judicial proceeding, and lay hands on the assets which have been fraudulently appropriated by persons who are properly chargeable in equity and good conscience with liablity and will compel the application of such assets to the liquidation of the debts which an apparently insolvent corporation has endeavored by such means to place beyond the reach of creditors. So where stockholders and directors of a corporation allow its assets to be sold under a chattel mortgage for the purpose of causing the same to be transferred to a new organization owned and controlled by

[96] Loughlin vs. U. S. School Furniture Co., 118 Ill. App. 36.
[97] York Mfg. Co. vs. Brewster, 98 C. C. A. 348; 174 Fed. 566.
[98] Strahm vs. Fraser, 32 Cal. App. 447; 163 Pac. 680.
[99] Quinlan vs. Almini Co., 191 Ill. App. 568; Crozier vs. Menzies Shoe Co., 103 Kan. 565; 175 Pac. 376.

the same parties, and for the purpose of saving the assets from liabilities or debts, and such assets being in excess of the encumbrances thereon, the rule will be applied, and the new organization and the assets thereof held liable for the claims of the creditors of the original company.[100] Tacitly the court in such cases disregards the corporate forms of technical bodies politic, and holds both corporate organizations as one. True there has been a change on the surface—of form—but substance remains the same. The same stockholders with a different corporate form will not suffice to defeat the just claims of creditors.

§ 189. Where Property Is Sold to One of the Corporation's Directors Who Thereafter Reorganizes the Old Corporation, the New Organization Is Liable For Debts of the Old

Where a corporation's property was sold to one of its directors upon a foreclosure in court of a mortgage thereon, far below the actual value of the property and thereafter such purchasing director along with other stockholders took proceedings to assess the stockholders of the old organization for a sufficient sum to pay the purchase price of property at the foreclosure sale and the debts of the old corporation, but some of the stockholders of the old organization did not respond to the proposed assessment and sufficient money for that reason was not raised to pay all of the debts of the old company, but the purchase price at the foreclosure sale was liquidated with the money so raised, and a new corporation was thereafter formed and property of the old corporation was transferred thereto and stock of the new corporation was issued to the stockholders of the old who recognized the assessment under such facts; the new corporation will be held liable for the debts and liabilities of the old, notwithstanding that

[100] Goddard vs. Fishel-Schlichten Importing Co., 9 Colo. App. 306; 48 Pac. 279.

its title to the property was acquired through judicial proceedings.[101]

§ 190. Where There Is a Plan For Reorganization Agreed to Among Stockholders and Secured Creditors and the Purpose of Which Is to Protect Them, Property in the Hands of the Reorganized Corporation Will Be Subject to the Debts of the Old Company

Under a plan for reorganization agreed to between and among stockholders, and secured creditors of an insolvent corporation, such plan is carried out pursuant to which the property of the insolvent corporation is sold at foreclosure judicial sale and by other means transferred to the new corporate formation, and under this plan the stockholders of the old corporation retain their interest and rights in the property by virtue of being issued to them stock in the new organization and otherwise taken care of, such proceeding, though had through a court, is a fraud on the rights of unsecured creditors; and the new corporate organization may be held liable for the unsecured obligations of the old.[102]

§ 191. Transfer by Means of an Assignment For Benefit of Creditors' Property May Be Reached in Hands of Reorganized Corporation

Where the stockholders of an existing corporation and as part of the scheme to defraud creditors, make an assignment to its general manager for the purported benefit of creditors, and such assignee thereafter holds a pretended sale of the property of the corporation by secretly buying it in pursuance of a scheme with other stockholders to cheat and defraud creditors, and a new corporation is thereafter organized and

[101] Jones vs. Arkansas Mechanical & Agriculture Co., 38 Ark. 17.

[102] Central of Georgia Railway Co. vs. Paul, 93 Fed. 878; 35 C. C. A. 639; Blue Ridge Electric Co. vs. American Bank Note Co., 230 Fed. 911; reversed, however, on other grounds, 150 C. C. A. 509; 237 Fed. 755.

the property transferred to it such new corporate organization will be held liable for the debts of the old under such circumstances notwithstanding the purported proceedings of an assignment for the benefit of creditors.[103] However, this is nothing more or less than the court holding both corporations are the same—that is to say the court brushes aside the corporate entities of the transferor company of the transferee body politic, and treats the two as one because they both respond to the same moving spirit.

§ 192. Reorganized Corporation Must Provide For Payment of All Debts on Equal Basis Even Though a Judicial Sale Is Had

In order for a reorganized corporation to escape liabilities and satisfy the demands of the law such reorganized corporation must provide for the payment of all of the debts and obligations of its predecessor or the property it has received from the original company will be subjected to the satisfaction of the claims of creditors of such original company in the hands of the reorganized corporation and so, where a corporation provides for the liquidation of a portion of the debts of the original company, but makes no provision for the payment of claims arising from the tortious act of the old company and the fact that a transfer is effected from the old company to the new by a judicial proceeding, will not in any way operate to the detriment of the right of such claimant.[104] The general rule seems to be well settled that in transactions by corporations, that the transferee company will be responsible for the debts and liabilities of the *quondam* corporation if there is no consideration for the sale, or if it is not in good faith but for the purpose of defeating the creditors of the former corporation, or where there has been a merger or consolidation of the corporations, or where the purchasing corporation

[103] Blanc vs. Paymaster Mining Co., 95 Cal. 524; 29 A. S. R. 149; 30 Pac. 765.

[104] Mountain States Power Co. vs. Jordan Lbr. Co., 293 Fed. 502; 286 Fed. 217; 264 U. S. 582; 44 S. Ct. 332; 68 L. Ed. 860.

took over from the stockholders all of the stock of the selling corporation or where the transaction amounts to a mere reincorporation or reorganization of such former corporation and this is true even though the metamorphosis of the property from one corporate entity to another is effected by the means of a purported judicial sale.[105] It is generally true that where the reorganized corporation makes an equitable offer of settlement with all creditors and claimants of its predecessor, that it will take the property of such predecessor freed of the claims, but this may not be done under all circumstances and in many cases the offer of stock or securities falls short of the equitable requirement necessary to relieve the transferee corporation of responsibility.[106] The rule that no scheme of reorganization, whether by means of judicial proceedings or otherwise, which contemplates the transfer to the original stockholders of the stock in a new corporation unburdened by the old debts will be upheld, is so firmly established and is operative with such vigor and efficacy that it is now invulnerable to any assailment that may be made upon it. No plan whereby the stockholders may, by manipulation of the corporate entity retain their interest in the property of a former corporate organization will be allowed to stand, and it is wholly immaterial what means are resorted to in the efforts of such stockholders to effect such change of corporate form.[107] The courts in order to reach property which is thus attempted to be juggled from one corporate entity to another by a sort of jural legerdemain simply disregard the corporate entity, for in contemplation of law the share of stock in a corporation represents the property thereof, and so where part of the stock of the old corporation is put in as a part

[105] Mt. States Power Co. vs. Jordan Lbr. Co., supra; Valley Bank vs. Malcolm, 23 Ariz. 395; 204 Pac. 207; Guaranty State Bank vs. Hidalgo County Bank, 245 S. W. 1039; Wabash Railway Co. vs. Marshall, 195 N. W. 134; 224 Mich. 593.

[106] Wabash Railway Co. vs. Marshall, supra; Mt. States Power Co. vs. Jordan Lbr. Co., supra.

[107] Male vs. Atchison, Topeka, & Santa Fe Railway Co., 230 N. Y. 158; 129 N. E. 458; 15 A. L. R. 1098; 179 App. Div. 87; 166 N. Y. S. 593.

of the reorganized plan or consideration, it is equivalent of the transfer to the new corporation of a part of the tangible property of the old corporation, which creditors are entitled to have applied to the payment of their debts.[108] Sometimes the courts predicate their decision upon the ground of a fraud.[109] But it would seem that the simpler proceeding for the courts to resort to would be merely to disregard the corporate entity and deal with the actual beneficial owner of the corporate property, through and by virtue of stock ownership.

§ 193. No Defense on Part of Reorganized Corporation to Contend There Was No Equity in the Property Received by It

It seems that it would not suffice as a defense for the reorganized or receiving corporation to contend that there was no equity in property that it has received that could be reached by the creditors and claimants of the transferor corporation.[110] Some courts have reached the result that it is no defense on the part of the reorganized corporation to contend that there was no equity in the property that it had received from the old corporation for the reason that the property was encumbered to its full value and that the plan of reorganization had taken care of the encumbrances but by application of the principle that the courts will disregard the corporate entity where a proper case is presented and therefore hold that under such plan of reorganization and purchase of property at a foreclosure sale was merely the mortgagor purchasing from himself and that a mortgagor cannot acquire rights

[108] Sebree vs. Cassville & W. R. Co., 212 S. W. Mo. 11.

[109] Montgomery Web vs. Dienelt, 133 Pa. 585; 19 A. S. R. 663; 19 Atl. 428; Carstens & Earles vs. Hofius, 44 Wash. 456; 87 Pac. 631; Hibernia Ins. Co. vs. St. L. & New Orleans Transfer Co., 4 McCrary 432; 13 Fed. 516; Blair vs. St. L. H. & K. R. Co., 22 Fed. 36; 24 Fed. 148; see sec. 153, supra.

[110] Central Improvement Co. vs. Cambria Steel Co., 127 C. C. A. 184; 201 Fed. 811; 210 Fed. 696; 240 U. S. 166; 60 L. Ed. 579; 36 S. Ct. 334.

superior to those of his creditors by purchasing at his own sale and this is true though the selling is effected by means of judicial proceedings and without perpetration of fraud on the part of the reorganized corporation.[111]

§ 194. Reorganized Corporation by Bondholders, Purchase at Foreclosure Sale Liable For Indebtedness Incurred While Trustee Is in Charge

It seems clear enough that a reorganized corporation by the bondholders who acquire the property at a foreclosure sale, paying no consideration therefor, but merely taking by virtue of being bondholders, such reorganized corporation will be liable for indebtedness incurred in the name of the old corporation prior to the foreclosure while the trustee for the bondholders is in possession of the property and business, the indebtedness being for materials and supplies which were used for the purpose of preserving the property. The courts in such case predicate their decision upon the ground that it would be a fraud upon the rights of the particular creditors who had furnished supplies for the purpose of keeping and preserving the corporate property and therefore preserves and protects the securities of bondholders, to permit the same persons, when the corporate entity is brushed aside, to incur the indebtedness to avoid liability therefor simply by hiding behind the newly formed corporation, or the courts in some cases have predicated liability on the ground that the creation of the new corporation and its taking over and succession to the property of the old corporation, was in fact not a purchase under the circumstances but simply a change in capacity in which the same parties conducted the business and owned the corporation.[112] So it is likewise held that where a corporation

[111] Sweeney vs. Heap O'Brien Mining Co., 194 Mo. App. 140; 186 S. W 739; Northern Pacific Railway Co. vs. Boyd, 228 U. S. 482; 33 S. Ct. 554; 57 L. Ed. 931; Boyd vs. Northern Pacific Railway Co., 170 Fed. 779; 177 Fed. 804; 101 C. C. A. 18; see secs. 153, 192, supra.

[112] Spadra-Clarksville Coal Co. vs. Nicholson, 93 Kan. 638; 145 Pac. 571; 1916D A. C. 652.

has forfeited its charter for the nonpayment of license taxes and property is vested in statutory trustees and during the time that such trustees are holding and operating the property a liability is incurred and the trustees thereafter transfer the property to themselves and then to a corporation formed and owned by them, paying for such transfer by them to the newly formed corporation, with stock in the new corporation in the same proportion as their holdings, they being stockholders in the old corporation; the objects of the new and the old corporation being the same; such new corporation amounting to merely a continuance of the old and will be held liable upon obligations incurred during the time that there was a hiatus in the continuity of the corporate entity and the property was in the hands of the statutory trustees. It is immaterial that this liability arose from a personal injury to an employee. It is likewise immaterial that the transfers were made in accordance with and pursuant to *ex parte* court orders.[11β]

§ 195. Where a Corporation Pays to the Creditors an Amount Equal or in Excess of a Reasonable Value of the Assets Received From a Former Corporation It Is Not Liable in Addition Thereto

While, of course, it must be conceded, if a new corporation gets possession of the assets of an old corporation for which it pays nothing or from which the old corporation derives no benefit then the new corporate organization would be held responsible for the debts of the old, and as some courts contend, at least to the extent of the value of the assets received. It is this situation that impels courts to hold a corporation obtaining assets from a predecessor liable for the debts thereof. So where the new company is manifestly organized, not in order to pay the debts of the old but, with a hope on the part of the stockholders of the new corporation to recoupe their losses at the expense of creditors, the staying

[11β] Jones vs. Francis, 70 Wash. 676; 127 Pac. 307.

hand of the court will intervene to prevent a successful conclusion of such a scheme, but where the new corporate entity pays to the creditors of the company it succeeds the full value or in excess of the full value of the assets that such new corporate organization receives, then the clearest principles of justice would dictate that such new corporation should not be called upon to make further or additional payments.[114] However, we have already discussed the extent of the liability of the new corporate organization,[115] but if the new corporation is held to be merely a continuation of the old, operating as a different entity, under a separate charter or corporate franchise, then it is indeed difficult to see upon what theory its liability may be limited to the amount of the assets received, for if it is the same corporation with a changed front that incurred the liability, the matter of the possession of assets is immaterial. Courts will not refuse to give judgment because forsooth the judgment debtor is not able to respond to execution thereon. Some courts hold that where the succeeding corporation pays a mortgage for the full amount of the property it is not further liable. Some courts hold and perhaps a majority subscribe to the doctrine that general creditors are not defrauded and are without remedy where the corporation transfers to its successor all of its property where such property is encumbered for its full value or in excess of its full value and that such transferee discharges the mortgage.[116] However, there exists a very strong and able dissent to this proposition and it is thought that the dissent is based upon better dialectics.[117] Reorganized churches are not responsible or liable for debts of old where the reorganization is

[114] Evans vs. Unity Investment Co., 196 S. W. 49.

[115] See sec. 184, supra.

[116] Clarke Woodward Drug Co. vs. Hot Lake Sanatorium, 88 Ore. 284; 169 Pac. 796; Justice vs. Catlettsburg Timber Co., 168 Ky. 665; 182 S. W. 831; Warfield vs. Marshall County Canning Co., 72 Iowa 666; 2 A. S. R. 263; 34 N. W. 467. See, however, sec. 193, supra.

[117] Sweeney vs. Heap O'Brien Mining Company, 194 Mo. App. 140; 186 S. W. 739; Central Improvement Co. vs. Cambria Steel Co., 127 C. C. A. 184; 210 Fed. 696; 240 U. S. 166; 60 L. Ed. 579; 36 S. Ct. 334; 201 Fed. 811.

composed of old and new members and bought the property at foreclosure sale. In the absence of the establishment of fraud or bad faith it has been held that a creditor of a religious corporation has no right to enforce his claim against such religious corporation's successor or the property of such successor, which formerly belonged to such reorganized corporation, as the property of the original corporation has been sold on mortgage foreclosure, the original corporation being legally dissolved and a new corporate organization is brought into existence, composed of members of the old, together with new ones and the property is bought at such foreclosure sale. It is immaterial that the new corporation, after it has so acquired the property, proceeds to carry on the work of the original corporation at its location and maintains the same general relationship as the old one did to the religious denomination.[118] It must be conceded, however, that the case cited in the footnote of this section is indeed of doubtful soundness, and it is highly improbable that it announces a correct rule of law.[119]

§ 196. New Corporation May Be Formed by Stockholders and Bondholders For the Purpose of Buying in Property of a Corporation at Judicial Sale

The stockholders, bondholders, and secured creditors of a corporation may combine for the purpose of buying in the

[118] Allen vs. North Des Moines Methodist Epicopal Church, 127 Iowa 96; 69 L. R. A. 255; 109 A. S. R. 366; 102 N. W. 808; 4 A. C. 257.

[119] Central of Georgia Railway Co. vs. Paul, 35 C. C. A. 639; 93 Fed. 878; Good vs. Ferguson, etc., Co., 107 Ark. 118; 153 S. W. 1107; 1915A A. C. 544; 112 Ark. 260; 165 S. W. 628; Blanc vs. Paymaster Mining Co., 95 Cal. 524; 29 A. S. R. 149; 30 Pac. 765; Koch vs. Speedwell Motor Car Co., 24 Cal. App. 123; 140 Pac. 600; Seymour vs. Boise Railway Co., 24 Idaho 7; 132 Pac. 427; Taylor Co. vs. Gulf Land & Lbr. Co., 119 La. 426; 44 Southern 187; Austin vs. Tecumseh National Bank, 49 Neb. 412; 35 L. R. A. 444; 59 A. S. R. 543; 68 N. W. 628; Douglas Printing Co. vs. Over, 69 Neb. 320; 95 N. W. 656; Friedenwald vs. Asheville Tobacco & Cigarette Co., 117 N. C. 544; 23 S. E. 490; Long vs. Fisher Typewriting Co., 1 Tenn. Ch. App. 668; Male Trustees vs. Atchison T. & S. F. R. Co., 230 N. Y. 158; 129 N. E. 458; 15 A. L. R. 1098; 179 App. Div. 87; 166 N. Y. S. 593; Skirving Operating Co. vs. Southwestern Elec. Co., 174 Pac. 1069; 15 A. L. R. 1104; 71 Okla. 25.

property of such corporation at judicial sale and in the furtherance of a plan of so buying the property a new corporation may be organized for that purpose and if the sale and the proceedings are free from fraud, such corporation will take the property bought at such judicial sale, free from the claims of creditors.[120] It would seem that even stockholders might organize a corporation to buy in at a judicial sale, but clearly such transaction, where the stockholders organize a corporation for the purpose of buying in at a judicial sale the property of their corporation, would be closely scrutinized and it would have to be clearly free from fraud, collusion, or perhaps suspicion.[121]

§ 197. It Is Held That in Case There Is a Reorganization Scheme Which Permits All Creditors to Come in and Share Alike and Is Approved by the Court, Such Reorganization Will Be Sustained

It seems well settled that where there is a reorganization scheme under the orders of the court and all creditors are permitted to come in and share alike that such scheme will be sustained and that creditors refusing to share therein, do so at their peril and in order to sustain a reorganization scheme, it is not necessary that it be proposed to pay the creditors in cash as it will be sustained upon any other equitable basis and it being held that the same may be sustained, though

[120] Sebree vs. Cassville & W. R. Co., 212 S. W. (Mo.) 11; Tex. State Fair & D. Exhibition Association vs. Caruthers, 8 Tex. Civ. App. 474, 29 S. W. 48; Sullivan vs. Portland & K. R. Co., 94 U. S. 806; 24 L. Ed. 324; Aff. Fed. Case No. 13596; Hoard vs. Chesapeake & Ohio Railway Co., 123 U. S. 222; 31 L. Ed. 130; 8 S. Ct. 74; Wiggins Ferry Co. vs. Ohio & M. R. Co., 142 U. S. 396; 35 L. Ed. 1055; 12 S. Ct. 188; Warren Co. vs. Black Coal Co., 85 W. Va. 684; 102 S. E. 672; 15 A. L. R. 1083; National Foundry and Pipe Works vs. Oconto City Water Supply Co., 105 Wis. 48; 81 N. W. 125; 183 U. S. 216; 22 S. Ct. 111; 46 L. Ed. 157; Hukle vs. Atchison T. & S. F. R. Co., 71 Kan. 251; 80 Pac. 603; 6 A. C. 83; Moyer vs. Fort Wayne C. & L. R. Co., 132 Ind. 88; 31 N. E. 567; Equitable Trust Co. vs. United Box, Board & Paper Co., 220 Fed. 714; see sec. 198, infra.

[121] Warren vs. Black Coal Co., supra; Wabash Railway Co. vs. Iowa & S. W. Railway Co., 200 Iowa 384; 202 N. W. 595.

the offer of payment was in stock.[122] The rule underlying these holdings is no doubt grounded upon the maxim that equality is equity.

§ 198. It Has Been Held That a Director of a Corporation May Not Become a Purchaser of Its Property at a Sale Thereof

It has been held that the directors of a corporation are not competent to become purchasers of its property at a sale and a sale to such directors cannot, if questioned by the corporation, be upheld, where the directors at the time the sale was contemplated and made, actively encouraged and participated in all matters tending to the completion of the sale and were in possession of all of the books and records of the company and conversant with all of the facts and circumstances surrounding it. In reaching this conclusion, the court proceeded upon the theory that trustees cannot purchase at their own sale, either directly or indirectly, and if a purchase were so made by trustees at their own sale, it will be set aside on proper application of the interested parties and that this doctrine applies with equal force to directors of a corporation as in other cases. Purchase by persons acting in a fiduciary capacity, which imposes upon them the obligation of obtaining the best terms for the vendor is not permitted by law.[123] It is apparent that if the corporation complains at the action of its directors purchasing at a sale of its own property that the sale will be set aside and if the creditors may be placed in the shoes of the corporation itself, then there would be a serious question arise as to the soundness of the doctrine that is announced by some cases,[124] that the directors or stockholders of a corpo-

[122] Northern Pacific Railway Co. vs. Boyd, 228 U. S. 482; 57 L. Ed. 931; 33 S. Ct. 554; 170 Fed. 779; 177 Fed. 804; 101 C. C. A. 18; Penn. Transportation Company's Appeal, 101 Pa. 576; Wheeler vs. Acme Harvesting Machine Co., 175 Ill. App. 69; see secs. 153, 192, supra.

[123] Hoffman Steam Coal Co. vs. Cumberland Coal and Iron Co., 16 Md. 456; 77 A. D. 311.

[124] Wabash Railway Co. vs. Iowa & S. W. Railway Co., 200 Iowa 384; 202 N. W. 595; see sec. 196, supra.

ration may organize a corporation to buy in the property at a judicial sale, then, by the simple method of applying the principle that the corporate entity in a proper case will be disregarded, it is readily seen that the case is present where the directors are buying the property of the corporation at a sale, that is, of course, if the directors participated in bringing about the sale.

§ 199. Corporation Having Absorbed Former Corporation and Assumed Supervision of the Execution of a Contract with Such Former Corporation Will Be Held Liable Upon Such Contract

Where the successor of a corporation, which preceeding corporation had made a contract with the plaintiff in an action which succeeding corporation was largely controlled by the same stockholders and officered by the same persons as the contracting corporation, and had assumed the supervision and control of the execution of the contract on the part of the plaintiff and in the action filed a counter claim for damages upon a supposed breach of such contract, such succeeding corporation cannot be treated as an innocent purchaser but under such facts is regarded as having absorbed its predecessor and presumptively assumed its liability by the act of taking over its assets.[125] Where an old corporation is legally dissolved shortly after its successor took over its property and before a suit is brought against the old organization and such old organization is barren of assets, the new corporation will be liable upon such obligations of the old where it has taken over all of the assets and assumed all of the known and disclosed liabilities of such old corporation and to the end to avoid the working of an injustice and circumlocution, a direct proceeding may be brought against the new corporate organization.[126] The principle operating in such cases is that since the corpo-

[125] Kentucky Beaver Collieries vs. Mellon & Smith, 200 Ky. 198; 254 S. W. 421.

[126] Riegel vs. Planters State Bank, 100 Okla. 42; 227 Pac. 105; see secs. 131, 132, 133, 145, supra, 222, 499, infra.

ration took over all of the property of the old leaving nothing to pay the amount due the holders of claims against such old corporation, and since it took the assets not as a creditor but as owner, it is clear enough that it should follow in the interest of justice that it must pay the debts of the old company, at least to the extent of the amount of assets received by it.[127]

§ 200. Where One Corporation Leases Its Assets to Another and the Lessee Assigns Such Lease to a Third Corporation, Such Assignee of the Lease Will Be Held Liable For Mortgaged Indebtedness Against Such Assets

It has been held that where one corporation leases all of its assets to another with the agreement and upon the understanding that the moneys due the lessor under such lease shall be paid upon a mortgage indebtedness, that such lessee corporation thereafter assigns such lease to a third corporation; that such third corporation may be required to respond for a decree rendered against the lessee corporation under an accounting of the net earnings and such assignee corporation will be held liable on the decree under a rule to show cause, even though it was not made a party to the proceeding prior to judgment where it has taken charge of the litigation and has defended the action against the lessee corporation.[128]

§ 201. Where a Corporation Transfers All of Its Property to Another in Consideration of Issuance of Stock to Its Stockholders and Assumption of Its Debts, the Receiving Corporation Will Be Held Liable For the Debts by Virtue of Such Agreement

A transfer by a corporation of all of its property to another corporation, the consideration of which being an assump-

[127] Brum vs. Merchants Mutual Insurance Co., 16 Fed. 140; 4 Woods 156; Riegel vs. Planters State Bank, supra; see sec. 184, supra.

[128] Louisville & Nashville Railway Co. vs. Schmidt, 177 U. S. 230; 20 S. Ct. 620; 44 L. Ed. 747; 104 Ky. 599; 47 S. W. 583; 14 Ky. St. 810.

tion by the receiving corporation of the debts of the original company and in addition thereto the issuance of stock of the receiving corporation to the transferring corporation and which agreement is carried out in so far as the issuance and delivery of said stock is concerned, but such stock is delivered to the stockholders of the original company instead of to it, and thus placing it within their power as they see fit to divide the stock among themselves instead of applying to the satisfaction of debts, will render the receiving corporation liable to creditors of the transferor corporation. The court, however, predicated such liability upon the ground of fraud.[129] But such a transaction, it is submitted, might take place and be entirely free of fraud in fact if not fraud in law. The same equitable end could be attained by brushing aside the corporate fiction, and the facts warrant such judgment on the part of the court. So, too, the same result could be obtained by holding it a merger, or consolidation. However, in the final analysis liability in cases of merger or consolidation rests upon the ignoring of corporate entities.

§ 202. Where An Insolvent Bank Had Offered a Composition With Its Creditors and Then a New Organization Takes Over the Business of the Bank to Pay the Composition, the New Organization Is Liable For All the Debts of the Bank, There Being No Change in Franchise

Where a bank is insolvent and has offered a composition with its creditors, a majority of the creditors having agreed thereto, it then transferred all of its assets, business, franchise, and all of its property to another organization, which succeeding organization continued the business under the same grant of powers and in the same place of business and used the seal of its predecessor, such succeeding organization is liable for all of the debts of the insolvent bank, there being

[129] Couse vs. Columbia Powder Mfg. Co., 33 Atl. (N. J.) 297.

merely a change in membership and not a new corporation organized.[130] It is readily understood that where there is a change in membership only of the corporation that that could not possibly affect the liability of such corporation upon contracts and obligations. It is equally true that where a corporation is but a continuation of another under a different technical entity, that such succeeding corporation will as readily be held liable upon the obligations of its predecessor as in the case where there is merely a change in membership, so where one corporation is merely a reorganization or continuation of another the former is liable upon the contract of the latter. That is, to say, where the circumstances are such as to warrant the conclusion that the former is not in substance and in fact a separate and distinct corporation but merely a continuation of the latter and therefore, in law, is the same jural personality.[131]

§ 203. Liability Generally on Merger

It may be stated generally that where one corporation goes entirely out of existence by being annexed to and merged into another corporation, if no arrangements are made as to liabilities of the corporation that ceases to exist, the subsisting corporation will be entitled to all of the property and as a corollary of this proposition will be answerable for all of the liabilities. In other words, the receiving corporation takes the property into its hands and when the benefits are thus acquired, the burdens attendant thereon are assumed. Touching the business of the old companies and the rights of the creditors of each corporation that go to make up the merged corporation, the consolidated or merged company is but a continuance of the old under a new name. And this is true whether a new corporation succeeds one or more corporations. The new corporate organization, by virtue of such merger, inherits the

[130] Island City Savings Bank vs. Schtleben, 67 Tex. 420; 3 S. W. 733.
[131] Meeks vs. Arkansas Light & Power Co., 147 Ark. 232; 227 S. W. 405.

property and obligations alike of the old corporation and therefore, if the new company refuses to carry out the obligations of the old, the obligee of such old can maintain an action therefore, directly against the new corporate organization.[132] The merged or consolidated corporation is so far regarded as the old under a new name, that where the merger or consolidation is effected *pendente lite*, that it is not even necessary to issue a summons bringing in the merged or consolidated corporation but it suffices to merely amend the pleadings by inserting the name of the new corporation formation.[133] There appears no logical ground why this would not be equally true when a partnership is organized into a corporation, or an individual organizes himself into a body politic. So it would seem that when a partnership is continued in corporate form, or an individual converts his business into a jural personality, that it is only necessary to amend the proceedings and insert the corporate name, and proceed against it without the issuance of summons. The ground upon which successorship of liability is based, is that the old company has parted with all of its property constituting the only funds to which its creditors can look for the payment of their claims, receiving nothing in return that is available for that purpose and therefore the new corporation is deemed to have taken the assets, not by clear title that would pass to a purchaser in good faith but charged with a virtual lien for the protection of claimants whose security has otherwise been lost through the transaction in which it has participated, and of which it is the beneficiary and so it has been held that it follows that the liabilities of the successor company is measured not by the total amount of property it has received, but by the value of the portion thereof to which creditors of

[132] Lincoln Safe Deposit Company vs. Continental Life Insurance Co., 213 Mo. App. 561; 249 S. W. 677; Black vs. St. Louis & S. F. Railroad, 110 Mo. App. 198; 85 S. W. 96; Kinion vs. K. C. F. S. & M. Railroad, 39 Mo. App. 382; Eans vs. Exchange Bank, 79 Mo. 182; John Hancock Mutual Life Ins. Co. vs. Worchester N. & R. R. Co., 149 Mass. 214; 21 N. E. 364; see sec. 142, n. 37, supra.

[133] Kinion vs. Kansas City F. S. & M. R. Co., supra; see sec. 523, infra.

the old company had a right to look for the payment of their demands.[134]

§ 204. The Illegality or Lack of Legislative Authority For Merger No Defense to Liabilities of Predecessor

A consolidation or merger agreed upon and actually put into operation, the illegality of the arrangement or the lack of legislative authority sanctioning such merger or consolidation will not be permitted to be set up by the defendant company as a defense against liability to the creditors of the merging or consolidating corporations. It is encumbent upon those who seek to assert rights against the merged or consolidated corporation to allege the fact of such merger or consolidation having taken place and to point to the fact that the merged or consolidated corporation took over the assets of the old corporations and are using the same in its business and when this state of facts is made to appear, liability is fixed upon the merged or consolidated corporation without a further showing. In other words it is unnecessary to show fraud or bad faith in the transaction.[135]

§ 205. The Rule of Liability of Successor Corporation on Consolidation or Merger Will Be Enforced in Admiralty

The rule that fixes liability upon a consolidated or merged corporation for the obligations of the constitutent corporations, will be as readily applied in a court of admiralty as in any other court and so where one corporation is obligated, combined with another that has no obligations and the two

[134] Jackson vs. Knights & Ladies of the Orient, 101 Kan. 383; 167 Pac. 1046; see sec 184, supra.

[135] Collins vs. Chicago S. P. & Fed. L. Railway Co., 14 Wis. 533; Jackson Consol. Traction Co. vs. Jackson Circuit Judge, 155 Mich. 522; 119 N. W. 915; Gueringer vs. St. L. B. & M. Railway Co., 23 S. W. (2d) Tex. 704; Rev. 11 S. W. (2d) 809; see also sec. 146, 157, supra.

thus united form a third, such consolidated or merged corporation will be liable for the debts and obligations of the constituent companies. In other words, an admiralty court will as readily disregard and brush aside the corporate entity, as other courts.[136]

§ 206. Where a Corporation Ceases to Do Business and Its Stockholders, With One Other Person Organize a New Corporation, Take Its Assets, the New Corporation Is Liable For the Debts of the Old

Where a corporation ceases to do business and its stockholders, with at least one other person, form a new corporation with a different name under the laws of a different state and such new corporation takes over all of the assets of the old, except its books, but does not assume to pay the debts of the old, both corporations having the same manager, the creditors of the old have an equitable right to follow the assets of the old corporation.[137]

§ 207. Where Two Corporations Consolidate and Continue the Business Under the Name of One, Such Corporation Is Liable For Debts of the Other

Where there are two corporations and they unite and form a consolidated company which continues the business under the name of one of the corporations and where the other corporation than that which the name is used for the continuation of the business is indebted, the creditors of such corporation may recover from the consolidated company the amount of such debts, it being made to appear to the satisfaction of the court that the consolidated company received sufficient assets from the debtor corporation to liquidate the amount of the creditor's claim.[138]

[136] Young vs. The Key City, 14 Wall. 653; 20 L. Ed. 896.
[137] Ewing vs. Composite Brake Shoe Co., 169 Mass. 72; 47 N. E. 241.
[138] Harrison vs. Union Pacific Railway Co., 13 Fed. 522; 4 McCrary 264; see sec. 184, supra, for extent of liability of succeeding corporations.

§ 208. Where a Corporation Takes Over the Property of Another and Issues Stock to the Transferor Company's Stockholders For Such Assets, the Succeeding Corporation Is Liable For the Debts of the Transferor

Debts and liabilities of the corporation existing at the time of its dissolution, are not thereby *ipso facto* extinguished, but they continue to follow the assets of such corporation either in the hands of the shareholders of the debtor corporation or any one else in whose hands they may be found, except innocent purchasers for value and such value may not be the stock of another corporation issued to the stockholders of the debtor corporation in consideration of the transfer of the debtor corporation's property. So, where a corporation, which is in fact a successor of another corporation having taken over the property of the predecessor corporation and having gone on with the business of such predecessor and having issued its shares in consideration of the transfer by the predecessor to the successor, the predecessor's property, to the stockholders of the transferor corporation, such receiving corporation is liable for the debts and obligations of the transferor corporation and the question of whether or not there was an express agreement to assume and pay for them is not necessary to make it liable.[139] So, where a consolidation of two corporations takes place the fact that there is no mention as to the liablilities of the constituent company is not a matter for consideration as the consolidated company will be held liable whether or not there is an agreement to assume the debts and liabilities of the consolidating companies. The principle that operates in such case and that controls to fix the liability of the receiving corporation of the property for the constituent companies is simply that in a case where justice demands, corporate entities will be overridden, and the individuals composing them or owning their stock will be dealt with as such or that a number of corporate entities may for the proper administration of justice be treated as a single

[139] Arlington Hotel Co. vs. Rector, 124 Ark. 90; 186 S. W. 622.

body politic; so in dealing with a merged or consolidated corporation for the purpose of answering for the liabilities of the constituent companies it is treated the same as each of its constituents and will be treated as such constituent continuing in a different form or under another name.[140] The rule is not altered that it is not necessary to mention the indebtedness of the constituent company in order to hold liable the consolidated or merged corporation whether consolidation takes place under statutes or otherwise.[141]

§ 209. Where Partnership and a Corporation Combine to Form a New Corporation Such New Corporation Will Be Liable For the Contracts of the Constituent Corporation and the Partnership

It seems that in the application of the principle holding a consolidated corporation liable for the obligations and liabilities for its constituent companies, that the same rule applies where one of the constituent interests is a partnership instead of a corporation, so, where a corporation agrees with a partnership to form a new corporation and at the same time agrees with an individual to employ that individual when the

[140] Houston & T. C. R. R. Co. vs. Shirley, 54 Tex. 125; Meyer vs. Johnston, 53 Ala. 237; Wolff vs. Shreveport Gas, Electric Light & Power Co., 138 La. 743; 1916D L. R. A. 1138; 70 Southern 789; Morrison vs. American Snuff Co., 79 Miss. 330; 89 A. S. R. 598; 30 Southern 723; Quinn vs. American Bankers Assurance Co., 183 Mo. App. 8; 165 S. W. 823; Sharples Co. vs. Harding Creamery Co., 78 Neb. 795; 11 L. R. A. N. S. 863; 111 N. W. 783; Memphis Water Co. vs. Magens, 15 Lea (Tenn.) 37; Langhorne vs. Richmond R. Co., 91 Va. 369; 22 S. E. 159. Sometimes the cases, while proceeding upon theory of assumption of liabilities by implication, reach same result: Louisville N. A. & C. R. Co. vs. Boney, 117 Ind. 501; 3 L. R. A. 435; 20 N. E. 432; Berry vs. Kansas City Ft. S. & M. R. Co., 52 Kan. 774; 39 A. S. R. 381; 36 Pac. 724; Texas Seed & Floral Co. vs. Chicago Set & Seed Co., 187 S. W. Tex. 747.) However, the more logical course to pursue to reach the desired result is that sustained by the majority of the modern cases, that the corporate forms will be brushed aside and the corporations treated as one—in other words, the law refuses to allow one corporation to function under the guise of another. The underlying principle is that by parading in the integuments of a different entity does not make it so as a matter of fact.

[141] Texas Floral & Seed Co. vs. Chicago Set and Seed Co., supra.

new corporation is formed, that such new corporation will be held liable to such employee. It seems immaterial whether the agreement was made with the constituent partnership or corporation.[142]

§ 210. Where a Public Service Corporation Is Possibly Liable in a Number of Personal Injury Actions and Thereafter Conveys Its Property to Another Corporation, Either the Original or New Company May Be Sued in Such Personal Injury Actions

Where a gas and electric light and power company has an explosion, inflicting injuries for which it is liable in damage, makes a conveyance *omnium bonorum* to another which purports to assume a number of its obligations, but not the obligations incident to the continuance of business as is imposed by its franchise, receiving merely a nominal consideration, then such new corporation or the original company, either or both will be held liable to the personal injury claimants and either or both may be sued therefor. The facts in such case warrant the conclusion that the new corporate organization is merely a continuation or reorganization of the old. So where one corporation conveys all of its property, both corporeal and incorporeal to another under such circumstances, which has the earmarks of a transaction by the persons dealing with themselves—in other words—if it is sort of Dr. Jekyll dealing with Mr. Hyde, and the two corporations are sued upon a claim, either upon contract or in tort, which claim was in existence at the time of the incorporation, of the succeeding company, the corporations have the burden of proof to show that the conveyance was *bona fide* and for an adequate consideration and that such conclusion will be strengthened where the transferor corporation is organized under the domestic state and the receiving corporation is organized under the laws of another state. The principle

[142] Girard vs. Case Bros. Cutlery Co., 225 Pa. 327; 74 Atl. 201.

applicable in such case casting the burden upon the corporations to explain the transaction is the familiar rule that the corporations possess the information and that it is inaccessable to the claimant unless obtained from the corporations, and therefore the corporation will be required to make proof of facts in their possession and readily producible by them.[143]

§ 211. Extent of Liability of Merged Corporation on Contracts of Predecessor Corporations

When a merger takes place, the merged or succeeding corporation is liable upon contracts of the constituent corporations to the same extent that the constituent corporations themselves were liable thereon.[144] There is but one sound theory upon which the courts can possibly reach a result of this sort and that is the court necessarily disregards the corporate entity of the two corporations and especially of the receiving corporation and hold it liable as a mere reincarnation, or continuance of the former existing corporation.

§ 212. Where a New Corporation Is Permitted to Absorb the Assets of the Old and Do Business in Its Name, the Old Will Be Responsible For the Debts of the New

We have been dealing largely with the questions of the liability of a succeeding corporation—that is where an existing corporation had been merged or consolidated with another, or a newly created corporation, but the reverse of this question has likewise been presented to the courts and so where a new corporation absorbs all of the assets of an old existing corporation, and continues to do business in the name of the old, the old is liable for the obligations so contracted by the new

[143] Wolff vs. Shreveport Gas, Electric Light & Power Co., 138 La. 743; 1916D L. R. A. 1138; 70 Southern 789; Penn. Ry. Co. vs. Anoka Ntl. Bank, 108 Fed. 482; see sec. 373, infra.

[144] Atlanta B. & A. Ry. Co. vs. Atlantic Coast Line Ry. Co., 138 Ga. 353; 75 S. E. 468; see sec. 184, supra.

corporation. The liability, however, is predicated upon the principle of agency but liability might have been bottomed upon the theory that the court would override the corporate forms and deal with the individuals carrying on the business through and by means of the corporate instrumentalities.[145]

§ 213. Where an Individual Owns a Controlling Interest in a Corporation and Contracts With the Other Stockholders Thereof to Exchange Their Stock For Stock in Another Corporation, the Succeeding Corporation Would Be Liable For the Debts of the Old

Where an individual controls the stock of a corporation and such individual entered into a contract, contracting with the remaining stockholders to take up their stock and issue in lieu thereof the stock of another corporation, after the conveyance by the former corporation of all its property and franchises to such other corporation, the transferee corporation under such circumstances is liable for the existing debts and contractual obligations of the transferor corporation and when this liability is asserted against the receiving corporation it will not be permitted to say that it is not liable because the transferring corporation was insolvent at the time of the conveyance.[146]

§ 214. Where One Corporation Takes Over Only a Part of the Assets of Another, the Rule Holding Liability Under a Merger or Consolidation Is Inapplicable

The rule seems to be pretty well settled that where one corporation takes over only a part of the assets of another, that the rule holding the receiving corporation liable as on a con-

[145] Davis Provision Co. vs. Fowler Bros., 20 App. Div. 626; 47 N. Y. Supp. 205; 163 N. Y. 580; 57 N. E. 1108.

[146] Camden Interstate Ry. Co. vs. Lee, 27 Ky. L. R. 75; 84 S. W. 332; Howell vs. Lansing Suburban Traction Co., 146 Mich. 450; 109 N. W. 846; see sec. 193, supra.

solidation or merger will not be applied;[147] so where one corporation transfers its assets to a copartnership which, subsequent to such transfer, retransfers them to a second corporation the rule is applicable.[148] No doubt the rule of these cases is predicated upon the idea that it is a sale and not a merger or consolidation but it is difficult to harmonize these cases with the trust-fund doctrine. It is also difficult to harmonize these cases with that line of decisions that holds the receiving corporation liable, to the extent of the property it has received, to the creditors of the transferring corporation. It would seem that the rule of these cases holding that the receipt of a part of the assets of a corporation will not make such receiving corporation liable, invites a safe means of a commission and concealment of fraud, for under this rule the transferring corporation could dispose of substantially all of its property and the receiving corporation escape liability under the theory of these cases, and yet for all practical purposes there would be an actual merger or consolidation. It also would seem of considerable importance to inquire whether the part of the assets of the transferring corporation was paid for in stock of the receiving corporation and the stock issued to the stockholders of the transferring corporation and if that situation appeared, it is submitted that the holdings of the court of appeals of Illinois and the Georgia court are unsound. The whole situation could easily be cleared up, however, if the simple rule that in a proper case the court would override and brush aside the corporate entity and deal with the individuals were applied in such cases. If it appears that the facts warrant it, and the stockholders of the two corporations are substantially the same, and one has received assets from the other, there would appear to be no reason for holding that the receiving corporation was not liable to the creditors of the transferring corporation. Some cases predicate

[147] Deshelter vs. American Spring Water Supply Co., 182 Ill. App. 403; Austin Co. vs. Smith Co., 138 Ga. 651; 75 S. E. 1048; 1913E A. C. 1042.

[148] Deshelter vs. American Spring Water Supply Co., 182 Ill. App. 403.

liability upon the theory that the transaction is out of the ordinary course of business and that the very circumstances of the case imply full knowledge on the part of the receiving corporation of all the facts necessary to charge the property in its hands with the debts of the selling corporation.[149] It would seem that this rule would apply with equal force where a corporation transfers a portion of its assets not in the ordinary course of business. So it has also been held that where a portion of the stockholders of one corporation organize another and that such former corporation may legally sell a part of its property to the new corporation and that the separate corporate entities will keep separate the liabilities of such corporations and that neither corporation will be liable on the obligations of the other.[150]

It is respectfully submitted that the court announces a rule in this case that is hard to sustain and that it is not a rule that could be appealed to as a safe guide in determination of the question between separate corporate entities but is rather inclined to adhere to the archaic position that the corporate fiction must be sustained, and that influenced the courts for so long and led to the many decisions that lack the elements of justice.

§ 215. Where a Number of Stockholders Agree to Transfer Their Assets to a New Corporation in Exchange For Stock to Be Issued by the New to the Stockholders of the Old, Such Stockholders May Compel Issuance

Where several stockholders, under agreement, transfer the whole of the corporate property, business, and assets to a new corporate organization, which new corporation accepted same subject to and burdened with an agreement between the members of the original corporation that payment for the transfer should be made by the issuance of stock of the new corpo-

[149] Jennings Neff & Co. vs. Crystal Ice Co., 128 Tenn. 231; 47 L. R. A. N. S. 1058; 159 S. W. 1088; see secs. 152, 184, supra.
[150] Goodwin vs. Bobcaw Lbr. Co., 109 La. 1050; 34 Southern 74.

ration to the several original incorporators respectively in exchange for the old stock held by each, and under such circumstances an original stockholder has a cause of action against, and may sue the new corporation to compel it to issue to him the number of shares conceded to be his proportionate part and the fact that the new corporation had already issued to the stockholder's company the amount of stock that was to be allotted among its stockholders, including the claimant, would be no defense to such action.[151]

§ 216. Where a Merger, Absorption, or Consolidation Takes Place and the Succeeding Corporation Assumes Liability For Contractual Obligations, But No Mention Is Made of Tortious Liability, the Succeeding Corporation Will Be Liable Therefor

Where a consolidation, merger, or absorption takes place, and the succeeding corporation agrees to assume and liquidate all contractual liabilities, but under the arrangement no mention is made as to the satisfaction of claims arising *ex delicto*, notwithstanding this fact, the succeeding corporation will be required to stand responsible for such tortious liabilities.[152] In other words, it may be generally stated that on a consolidation, merger, or absorption, the succeeding corporation is liable for both the contractual obligations and tortious liabilities including responsibility for negligence, of the constituent companies and there is no priority of right in such cases, the claimants of both sorts standing on an equal footing before the courts.[153] The contrary, however, has been

[151] Anthony vs. American Glucose Co., 146 N. Y. 407; 41 N. E. 23; 66 Hun. 634; 21 N. Y. S. 667; 49 N. Y. St. R. 857.

[152] Coggin vs. Central R. Co., 62 Ga. 685; 35 A. R. 132; Tomkins vs. Augusta Southern Ry. Co., 102 Ga. 436; 30 S. E. 992; Louisville & Nashville Ry. Co. vs. Biddell, 112 Ky. 494; 66 S. W. 34; 23 Ky. L. R. 1702.

[153] Palmer vs. Chi. & A. R. Ry. Co., 142 Mo. App. 633; 121 S. W. 1087; Green vs. Mich. United Rys. Co., 159 Mich. 58; 123 N. W. 607; Swing vs. Empire Lbr. Co., 105 Minn. 356; 117 N. W. 467; Columbus Chicago & I. C. Ry. Co. vs. Powell Adm'r, 40 Ind. 37; Indianapolis C. & L. R. Ry. Co. vs. Jones, 29 Ind. 465; 95 A. D. 654; Cleve-

it has been held assumption of "other indebtedness" was sufficient to hold the succeeding corporation liable for a tortious liability of its predecessor.[161] Of course, under such a contractual provision, creditors holding ordinary debts will be protected.[162]

§ 220. Where An Old Corporation Is Succeeded By a New, It Taking All of the Assets and Composed Largely of Members of the Former, Successor Liable For Negligence or Torts

A corporation which succeeds to all of the business and takes over all of the assets of a former company, and which new succeeding corporation was largely composed of the same membership as the old, the new corporation will be required to respond in damages for the negligent acts or torts of its predecessor.[163]

§ 221. New Corporation Composed of Same Stockholders Continuing Same Business, It Will Be Held Liable For Obligations of Old

Where a new corporation continues the business of the old and it is made to appear that the new corporation organized

Coal Co., 66 S. E. 1073; 26 L. R. A. N. S. 1101; 66 W. Va. 696; St. L. & S. F. Railway Co. vs. Marker, 41 Ark. 542; Smith vs. Los Angeles & P. R. Co., 98 Cal. 210; 33 Pac. 53; Louisville E. & St. L. Consol. Railway Co. vs. Summers, 131 Ind. 241; 30 N. E. 873; Columbus C. & I. C. R. Co. vs. Powell, 40 Ind. 37; Louisville E. & St. L. Consol. Ry. Co. vs. Utz, 133 Ind. 265; 32 N. E. 881; Geiger vs. Sanitary Farm Dairies, 146 Minn. 235; 178 N. W. 501; K. C. Leavenworth Railway Co. vs. Langley, 70 Kan. 453; 78 Pac. 858; Chesapeake O. & R. Co. vs. McLean, 12 Ky. L. R. 989; Forbes vs. Thorpe, 209 Mass. 570; 95 N. E. 955; Campbell vs. Pittsburg & W. Ry. Co., 137 Pa. 574; 20 Atl. 949; Hinrichs vs. Mississippi Valley Trust Co., 139 C. C. A. 371; 223 Fed. 995. But it seems that a provision to assume current liabilities is not broad enough to embrace tortious liability; Hawkins vs. Central of Georgia Railway Co., 119 Ga. 159; 46 S. E. 82; Chesapeake O. & S. W. R. Co. vs. Griest, 85 Ky. 619; 4 S. W. 323; 9 Ky. L. R. 177; see sec. 216, supra.

[161] Louisville & Nashville R. Co. vs. Biddell, supra.

[162] Baker vs. D. Appleton Co., 107 App. Div. 358; 95 N. Y. S. 125; 187 N. Y. 548; 80 N. E. 1104.

[163] McWilliams vs. City of New York, 134 Fed. 1015.

is a corporation of the same or substantially the same stockholders, as the old, such new corporation will be required to respond for the liabilities of the old to the same extent and as fully as if the new corporate organization had not been brought into existence.[164] So where the new corporation takes over the business of the old without any substantial change in the personnel composing the two, it is sufficient to fix liability upon the new corporate organization.[165]

§ 222. Where a New Corporation Is in Reality Organized Out of An Old, the New Corporation Will Be Liable For the Obligations of the Old and May Be Sued Directly Therefor

Where the new corporation is organized out of an old or is in its essence but a continuation of the activities and interests of the old, which retains simply its franchise as a corporation but for all other purposes becomes practically extinct as an active entity, the new corporation is liable upon the obligations of the old and a direct recovery is allowable therefor. To bring about this situation it is only necessary that where it can be seen in advance that a judgment against the old would necessitate further proceedings against the new to secure satisfaction of that judgment, this useless multiplicity of suits and circuity of action will be obviated by permitting direct proceedings against the new corporation.[166] So where a plan for

[164] Stanford Hotel Co. vs. M. Schwind Co., 180 Cal. 348; 181 Pac. 780; Art Society of Pittsburgh vs. Leader Publishing Co., 60 Pa. Super. Ct. 548; Friedenwall Co. vs. Asheville Tobacco & Cigarette Co., 117 N. C. 544; 23 S. E. 490; see sec. 216, supra.

[165] Parsons Mfg. Co. vs. Hamilton Ice Mfg. Co., 78 N. J. L. 309; 73 Atl. 254; see sec. 184.

[166] Okmulgee Window Glass Co. vs. Frink, 171 C. C. A. 195; 260 Fed. 159; 251 U. S. 563; 64 L. Ed. 415; 40 S. Ct. 342; Central Improvement Co. vs. Cambria Steel Co., 210 Fed. 696; 127 C. C. A. 184; 120 C. C. A. 121; 240 U. S. 166; 60 L. Ed. 579; 36 S. Ct. 334; 201 Fed. 811; Howe vs. Robinson, 20 Fla. 352; Morrison vs. American Snuff Co., 79 Miss. 330; 30 Southern 723; 89 A. S. R. 598; Central of Georgia Railway Co. vs. Paul, 93 Fed. 878; 35 C. C. A. 639; Harrison vs. Union Pacific Railway Co., 13 Fed. 522; 4 McCrary 264. See secs. 145, supra, 499, infra.

organization, yet both corporations may, for many purposes, continue as such separate and distinct legal entities.[173] This position is readily understood when resort is had to the simple principle that the courts will in a proper case, disregard corporate entities and override corporate forms to deal with the substantial interests of the parties composing the corporate organizations.

§ 226. New Corporation Is Generally Liable When It Takes Over the Assets of the Old and Pays in Stock or Mortgage

It may be stated generally, as a sound proposition, that one of the controlling elements in fixing liability upon a new corporate organization for the obligations of the old is the fact that the new company pays to the old, or its stockholders, in stock of the new.[174] There is no difference in the application of the principle in cases where the new corporation pays for the assets of the old by a mortgage on the property transferred from the old corporation to the new.[175]

§ 227. New Corporation Formed by Stockholders and Taking a Lease of Substantially All of the Property of Old, Liable For Obligations

Where a new corporation is formed by a majority of the stockholders of an existing corporation and the new corporation is to engage in the same business as the old and the stockholders of the old so forming the new are likewise stockholders and directors of the new and the new corporation

California Petroleum & Asphalt Co., 122 Cal. 373; 41 Pac. 1087; 109 Cal. 304; 55 Pac. 155; 81 Pac. 1070; 147 Cal. 363; Strahm vs. Fraser, 32 Cal. App. 447; 163 Pac. 680.

[173] North Tex. National Bank vs. Thompson, 23 S. W. (2d) Tex. 494; see secs. 181, 182, supra.

[174] Carstens & Earles vs. Hofius, 87 Pac. 631; 44 Wash. 456.

[175] Fort Payne Bank vs. Ala. Sanitarium, 103 Ala. 358; 15 Southern 618; see secs. 144; 145, 156, 157, 174, supra.

takes a lease of substantially all of the property of the old corporate organization, such new corporation will be held liable for the debts, obligations, and liabilities of its lessor.[176] It seems that the principle operating to bring about the resulting liability of the new corporate organization is that a consolidation may be effected by means of a lease as readily as by the process of a purported sale.[177] After all, in all of the cases where liability is fastened upon the new corporate organization, the judgment of the courts so holding could be readily based upon the principle that in a proper case the courts will override corporate entities to deal with the real owners—the stockholders. The conclusion that the court goes behind the corporate fiction, is inescapable, when it determines liability by virtue of the stockholders in two corporations being the same.

§ 228. Two Corporations Controlled by Practically the Same Stockholders, One Surrendering a Lease to the Other, Lessor May Be Liable For Obligations of Lessee

We have already seen that by leasing all of its property to another, the successor in interest may be held liable for the obligations of the lessor and it has also been held that where the lessee surrenders the lease to the lessor and that the two corporations are composed of practically the same stockholders, that in such a case the lessor may be held liable upon the debts and liabilities of the lessee.[178] This is but another application of the doctrine that the courts are not limited by the supposed imaginary barrier of corporate entities. It is simply a disregarding of the two corporate entities and dealing with the stockholders in their individual capacity instead of the corporate formations is so far as the lease is concerned.[179]

[176] Santa Fe Electric Co. vs. Hitchcock, 9 N. Mex. 156; 50 Pac. 332.
[177] Santa Fe Electric Co. vs. Hitchcock, 9 N. Mex. 156; 50 Pac. 332.
[178] Barrie vs. United Railway Co., 138 Mo. App. 557; 119 S. W. 1020.
[179] See sec. 223, supra.

§ 229. The Corporate Entity Will Not Be Disregarded to Prevent a Forfeiture of a Lease Where the Lessee Has Held Out the Corporation As a Separate Entity

It has been held that the corporate entity will not be disregarded in a case where practically, if not the sole owner of the corporation has represented it to be a separate entity and has made application to the corporation commissioner for a permit to issue stock representing that the corporation was composed of three stockholders where the lease provided against the assignment without the lessors consent and such assignment having taken place to such corporation, the court will refuse to disregard the corporate entity and will cancel the lease. The general rule seems to be that in so far as the adjudicated cases are concerned that where the tenant or lessee is an individual or partnership, and it is converted into a corporation that such works a breach of covenants against assignment or subletting.[180] But it would seem that these adjudications are not sustained by the dialectics of the situation. If the lessee forms a corporation without fraudulent designs but yet the corporation is in substance and fact but the *alter ego* of the tenant it would hardly seem equitable to visit such innocent conduct with the harsh result of a forfeiture of his tenancy. If the tenant merely assumed to do business under a fictitious or trade name, it cannot be contended this would warrant a forfeiture. A one-man corporation, in substance, is no different.

§ 230. A Lessee Corporation May Not Organize a New Corporation to Maintain a Supposed Cause of Action Against the Lessor

Where a corporation has a lease, it will not be permitted to organize itself into a new corporation for the purpose of

[180] Weintraub vs. Weingart, 277 Pac. 752; 98 Cal. App. 690; Emery vs. Hill, 67 N. H. 330; 30 Atl. 266; Harris vs. Campbell, 187 S. W. (Tex.) 365. It is a sound rule that where an individual is in substance a corporation, that such corporation will be accorded all rights and privileges granted to individuals. See sec. 235, infra.

maintaining a suit that the original corporation could not maintain. In other words, where this is attempted and it is sought to bring suit by reason of the terms of the lease, the two corporations will be treated as identical and no relief granted to one that could not be granted to the other.[181]

§ 231. It May Be Said to Be Generally True That Where One Corporation Gives a Long Lease to Another. This Amounts to Consolidation

The law seems to be well settled that where one corporation gives a long lease on all of its property to another, that this will amount in law to a consolidation or a merger of the two corporations, with all of the incidents attendant upon such relationship, generally, resulting in liability on the part of the lessee corporation for the obligations and liabilities of the lessor company.[182]

§ 232. A Sublessee Is Liable for Obligations of Lessee

Where a corporation leased the property of another corporation and agreed to pay sufficient from the earnings of the property and other properties operated by the lessee corporation, to pay off a mortgage indebtedness against the lessor corporation's property, the lessee corporation subsequently transferred all of its property, including its right in the lease, to another corporation, the sublessee corporation will be held liable upon the obligations assumed by the lessee in the same

[181] New York & Brooklyn Ferry Co. vs. Mayor, etc., of N. Y., 146 N. Y. 145; 40 N. E. 785; 83 Hun. 610; 31 N. Y. S. 1131; 64 N. Y. S. St. R. 878. The situation in this section discussed is analogous to the question of organizing a corporation to confer or defeat jurisdiction of courts. See secs. 308, 309, infra.

[182] Chicago Milwaukee & St. Paul vs. Third National Bank, 134 U. S. 276; 33 L. Ed. 900; 10 S. Ct. 550; 26 Fed. 820; Black vs. St. Louis & San Fransisco Railway Co., 110 Mo. App. 198; 85 S. W. 96; Santa Fe Electric Co. vs. Hitchcock, 9 N. Mex. 156; 50 Pac. 332; Missouri Pacific Ry. Co. vs. Owens; White & W. Civ. Cas. Ct. App. 384; see, however, sec. 340, infra.

manner and to the same extent as in other cases of merger and consolidation.[183]

§ 233. If Succeeding Corporation Is Composed of Different Stockholders It Is Not Liable

Where a corporation is formed with different stockholders, it cannot be held liable at the suit of creditors on obligations of its predecessor, provided it pays full value therefor. But on the other hand, if such new corporate organization is composed of the stockholders of the old and has received assets and paid for the same in stock or has not paid full value, then in that case it will be liable therefor at the instance of the creditors of the old corporation.[184] There are many circumstances, too numerous to state, collate or collect in a single section, under which succeeding corporations have been held liable at the suit of creditors of predecessor and general rules often are not sufficiently comprehensive as to embrace all of the conditions under which the successor corporation will be held liable. However, where it appears that the officers or stockholders of a corporation form another corporation and transfer the goodwill, business and assets of the old corporation to the new without the payment of the debts of the old, the property in the hands of the new corporate organization will be subjected to the payment of the debts of the old corporation the same as if no transfer had taken place.[185] And so, where a newly organized corporation succeeds to the business, property, and assets of an established corporation without giving the old corporation any means of discharging its obligations to its creditors, and the circumstances of the transfer are sufficient to raise an inference that the new corporation is a mere continuance or reorganization of the former

[183] Schmidt vs. Louisville C. & L. Railway Co., 99 Ky. 143; 35 S. W. 135; 36 S. W. 168; 13 Ky. L. R. 65; 177 U. S. 230; 20 S. Ct. 620; 44 L. Ed. 747.

[184] Donnally vs. Hearndon, 41 W. Va. 519; 23 S. E. 646; see secs. 144, 156, 157, 174, 226, supra.

[185] Loughlin vs. U. S. School Furniture Co., 118 Ill. App. 36.

with substantially the same stockholders, the new corporation is responsible for the debts of the former corporate organization.[186] However, it has been held by the Supreme Court of the State of Idaho that where one corporation buys the stock of another and assumes the payment of certain debts and the transaction is free from fraud, the purchasing corporation cannot be held liable for the obligations not enumerated in those assumed.[187] But, it cannot be said that this holding is sustained by either the weight of authority or sound reason and the court in a later case, without overruling the case cited in the footnote, receded from the position above referred to.[188]

[186] Alberger Condenser Co. vs. United Water, Gas & Electric Co., 87 Kan. 843; 126 Pac. 1087; W. F. Taylor Co. vs. Gulf Land & Lbr. Co., 119 Louisiana 426; 44 Southern 187.

[187] Anderson vs. War Eagle Consolidated Mining Co., 8 Idaho 789; 72 Pac. 671.

[188] Seymour vs. Boise Railway Co., 24 Idaho 7; 132 Pac. 427. See, however, Moore vs. Boise Land & Orchard Co., 31 Idaho 390; 173 Pac. 117. But it is quite apparent as observed by the Supreme Court of Kansas that Anderson vs. War Eagle Consolidated Mining Co. is somewhat out of harmony with the great current and trend of authority on this question. Altoona vs. Richardson Gas & Oil Co., 81 Kan. 717; 106 Pac. 1025; 26 L. R. A. N. S. 651; 79 Kan. 466; 21 L. R. A. N. S. 214; 100 Pac. 50.

CHAPTER X

RIGHTS AND LIABILITIES OF AN INDIVIDUAL SUBSTANTIALLY OWNING A CORPORATION

CONTENTS

Section

234. Individual may not escape liability by incorporating and placing his property in corporation's name.

235. Where an individual owns all of the stock of a corporation, the corporation will be granted all of the rights under the laws that the individual might enjoy.

236. Doctrine that the rule is different where an individual incorporates himself than where a corporation reorganizes itself.

237. Where a corporation is a mere shadow of its owner, its property may be taken in satisfaction of its owner's debts including bank deposits in the name of the corporation.

238. Sole stockholder not allowed to recover from former stockholders for corporate property transferred to them for their stock.

§ 234. Individual May Not Escape Liability by Incorporating and Placing His Property in Corporation's Name

It is the modern rule sustained by ample authority that an individual cannot escape liability for his contracts, obligations, or wrongful acts by incorporating himself and placing his property in the name of a corporation wholly owned by himself. In such case, the courts will not permit themselves to be blinded or deceived by mere forms of law, but regardless of fiction, deal with circumstances of any transaction involved as if the corporate agency did not exist, and as justice of the case may require, and so, when it is made to appear that the corporation is a mere *alter ego* of its owner, the obligees will be justified in pursuing the corporation in the same manner as if they were pursuing its owner individ-

ually.[1] The courts in reaching this conclusion proceed upon the theory that where there is a mere transformation, the substantial parties remaining the same, and the property is transferred by its owner to himself in the corporate form, then the act does not constitute a sale by one and a purchase by the other. It is simply a change in the manner and form of carrying on the same business, by the same parties, and so brushing aside the fiction of legal entities it is seen that no change takes place and that in looking to the corporate formation for a responsibility for the obligations of the individual, the claimant merely looks to the same party, possessed of the same property and rights that created the liabilities in the first instance and to constitute the transaction as to creditors and claimants as to the individual incorporating himself into a corporation as a purchase, tends to operate a fraud upon the rights of creditors. In other words, when an individual creates himself into a corporation he merely changes front—changes his coat, but the substance remains the same.[2] The rule constituting a corporation and its owner to be one and the same—in other words brushing aside the corporate entity and dealing with the individual owner, as if the corporation did not exist—is by no means confined to the prayer of creditors and contracting parties dealing with the individual that composed the corporation. But the rule will be applied in any case where equity and good conscience require to the end that a miscarriage of justice may not be allowed to take place. It is simply the proposition that in the last analysis the stockholders are the equitable owners of the corporate property and when the mere form of fiction is brushed aside the individuals who own the stock of the corporation remain. The liability of the corporation is not affected by the fact that the party seeking to hold the body

[1] Chicago, Milwaukee & St. Paul Railway Co. vs. Minneapolis C. & C. Ass'n, 247 U. S. 490; 38 S. Ct. 553; 134 Minn. 169; 158 N. W. 817, 62 L. Ed. 1229; Keating vs. Hammerstein, 209 N. Y. Supp. 769; 125 Misc. 334.

[2] Andres vs. Morgan, 62 Ohio State 236; 78 A. S. R. 712; 56 N. E. 875.

politic was an employee of the individual converting his business into a corporation form and aided therein, and that upon the corporation being organized, acted as a director thereof. Under such circumstances the form is immaterial, effect being given to the substance.[3]

So where the difference between a corporation and its owner is reduced to merely a matter of names, then the entity will be disregarded and both treated as one.[4]

§ 235. Where An Individual Owns All of the Stock of a Corporation, the Corporation Will Be Granted All of the Rights Under the Laws That the Individual Might Enjoy

Where an individual owns all of the stock of a corporation, the state, in dealing with that corporation, will treat it in the same manner as if it were dealing with the individual directly. So where the laws provide that no corporation except domestic ones may be permitted to build railroads within the state, such law will not prevent a foreign corporation from building a railroad therein where all of the stock of such corporation is owned by a single individual, the corporate entity will be disregarded and treated as a dummy.[5]

§ 236. Doctrine That the Rule Is Different Where an Individual Incorporates Himself Than Where a Corporation Reorganizes Itself

One of the earliest and well considered cases upon the subject of limiting and disregarding the corporate entity unfortunately fell into the error of announcing that the rule applicable whereby a corporation that has reincorporated itself or in other words, where a merger or consolidation had taken place, was to be distinguished from a case where an individ-

[3] Davis vs. Fanny Briggs Carr, Inc., 288 Pac. (Cal.) 710.
[4] Supra, n. 3.
[5] Boston & Texas Corp. vs. Guarantee Life Insurance Co., 233 S. W. (Tex. App.) 1022; see, however, sec. 420, infra.

ual incorporates himself and transfers his business to such incorporation.[6] At least one other case is found where the court followed the lead thus announced,[7] and adverted to, but not followed by one other court.[8] But the great weight of authority doubtless is that there is no difference in principle where a corporation reorganizes itself into another corporation or where an individual or partnership reorganizes himself or themselves into a corporation.[9] We have already seen that this holding probably resulted from a confusion on the part of the courts of the doctrine under consideration with the trust-fund doctrine.[10]

§ 237. Where a Corporation Is a Mere Shadow of Its Owner, Its Property May Be Taken in Satisfaction of Its Owner's Debts Including Bank Deposits in the Name of the Corporation

The abstract idea that the corporate entity shall never be allowed to bar out and prevent the real and obvious truth and so where a corporation is a mere colorable one—a shadow organized and maintained by its owner as a cloak or an alias under which to conduct his own business—such owner and the corporation will be treated as identical and where the cor-

[6] Hibernia Insurance Co. vs. St. Louis & New Orleans Transportation Co., 13 Fed. 516; 4 McCrary 432.

[7] National Union Bank of Maryland vs. Hollingsworth, 135 N. C. 556; 47 S. E. 618.

[8] Collinsville National Bank vs. Esau, 176 Pac. 514; 74 Okla. 45.

[9] Ziemer vs. Bretting Mfg. Co., 147 Wis. 252; 133 N. W. 139; 142 Wis. 224; 125 N. W. 318; 1912D A. C. 1275; Hawkins vs. Bryan 128 Okla. 27; 261 Pac. 167; Bosanich vs. Chicago N. S. & M. R. Co., 173 Wis. 280; 181 N. W. 297; Curtis Jones & Co. vs. Smelter National Bank, 43 Colo. 391; 96 Pac. 172; Bremans Savings Bank vs. Branch Crook Co., 104 Mo. 425; 16 S. W. 209; Star Brewing Co. vs. Flynn, 158 N. E. 891; 261 Mass. 426; in re Berkowitz, 173 Fed. 1012; Roberts vs. W. H. Hughes Co., 86 Vt. 76; 83 Atl. 807; Kellogg vs. Douglas County Bank, 58 Kan. 43; 62 A. S. R. 596; 48 Pac. 587; First National Bank vs. Trebein Co., 59 Ohio State 316; 52 N. E. 834; Forbes vs. Thorpe, 209 Mass. 570; 95 N. E. 955; Terhune vs. Skinner, Terhune vs. Hackensack, 45 N. J. Eq. 344; 19 Atl. 377; Bennett vs. Minott, 28 Ore. 339; 44 Pac. 288; 39 Pac. 997; Blumenthal vs. Schneider, 186 Wis. 588; 203 N. W. 393.

[10] See sec. 42, supra.

poration has a deposit in a bank and the owner of such corporation is likewise indebted to the bank, the bank may be at liberty to apply the corporate deposit to the satisfaction of its owner's obligations. In such case, the owner of the corporation will not be permitted to hide behind the corporate entity and maintain an action against the bank for the deposit and thereby mulct the bank in damages besides evading the payment of his just obligations.[11]

§ 238. Sole Stockholder Not Allowed to Recover From Former Stockholders For Corporate Property Transferred to Them For Their Stock

Where a stockholder, seeking to obtain all of the stock of the corporation, transfers property of the corporation to stockholders in satisfaction of their stock, which stock is in turn transferred to such sole stockholder, he cannot thereafter, either in his own name or in the corporate name, bring suit against the stockholders who have thus received the corporate property upon the ground of an improper diversion of the corporate property to its stockholders. To do this would be to allow such sole stockholder to take advantage of his own wrong, and in so doing, the court will treat such sole stockholder and the corporation as identical with it, to prevent the working of an injustice.[12]

[11] Hanson Sheep Co. vs. Farmers & Traders State Bank, 53 Mont. 324; 163 Pac. 1151; Seymour vs. Spring Forest Cemetery Ass'n, 144 N. Y. 333; 39 N. E. 365; 26 L. R. A. 859; 64 Hun. 632; 19 N. Y. S. 94; 45 N. Y. St. R. 520; Barnes vs. Smith, 48 Mont. 309; 137 Pac. 541; see sec. 70, supra, 248, infra.

[12] Stonybrook Lbr. Co. vs. Blackman, 286 Pa. 305; 133 Atl. 556; see secs. 70, 237, supra, 248, infra.

CHAPTER XI

LIABILITY FOR PERSONAL INJURY WHERE TWO CORPORATIONS ARE THE SAME

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244. Some courts adhere to the old doctrine that the corporate entities will not be disregarded to allow recovery for personal injury.

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§ 239. Where Two Corporations Have the Same Stockholders and Officers and Largely Are the Same, Both Liable for Personal Injury to Employee of Either

In giving a further application of the principle of disregarding corporate entity and broadening the rule that the courts will in proper cases, treat different corporations as identical, and intimately connected with the subject discussed in the immediate preceeding sections, that a corporation and its owner may be regarded as the same, it is now

well established that where two corporations have the same officers and are largely the same that they both will be liable for personal injury sustained by an employee of either.[1] These holdings are doubtless forced upon the courts by reason of the fact that a contracting corporation would undertake construction of railroads, buildings, and the like and then immediately sublet the principal portion of the work to a corporation created and officered by the stockholders and officers of the contracting concern and by this simple subterfuge would seek to hinder claims for personal injuries if not entirely escape liability. It seems that Chicago Economic Fuel Co. vs. Myers,[2] was the first case of this class to ignore corporate fiction of separate entity and hold both corporations equally liable for personal injuries sustained by an employee of such purported subcontracting company.[3]

§ 240. Where a Partnership Organizes a Corporation and Sublets Construction Work Thereto, Partnership Liable for Personal Injuries

At first the courts merely applied the rule that where a contracting company sublets construction work to a corporation, a work of its creation, that both corporations would be held liable for personal injuries to the employees of either, as discussed in the last preceding section. But in the course of time, the courts were confronted with the same situation where the contracting concern was a partnership and had

[1] Chicago Economic Fuel Co. vs. Myers, 168 Ill. 139; 48 N. E. 66; Traction Co. vs. O'Conner, 149 Ill. App. 598; Holbrook Cabot & Rollins Corp. vs. Perkins, 147 Fed. 166; 77 C. C. A. 462; Nelson vs. American Cement Plaster Co., 84 Kan. 797; 115 Pac. 578; James McNeil & Bro. Co. vs. Crucuiable Steel Co., 207 Pa. 493; 56 Atl. 1067; Consol. Coal Corp. vs. Sneiger, 179 Ill. 370; 53 N. E. 733; 79 Ill. App. 456; Towles & Co. vs. Miles, 131 Tenn. 79; 173 S. W. 439; Chesapeake Stone Co. vs. Holbrook, 168 Ky. 128; 181 S. W. 953; 1916D L. R. A. 311.

[2] 168 Ill. 139; 48 N. E. 66; 64 Ill. App. 270.

[3] 65 L. R. A. 507; Towels & Co. vs. Miles, supra; see secs. 240, supra, 258, infra; Jefferson Co. Burial Soc. vs. Cotton, 133 So. (Ala.) 256.

created a body politic out of such partnership and sublet the construction work thereto. It was but an easy matter by analogy of reason and by giving greater elasticity to a sound principle of law, well grounded in reason and in the interest of justice, to apply the same rule in the case where the corporation was organized by a partnership, as in case where a corporation is organized by another corporation, and so it is now the law that if a partnership having a contract for construction work creates a corporation and sublets the construction work thereto, that the partnership will be liable for the personal injuries sustained by the employees of its subcontracting corporation.[4] Of course, there is no good reason why the liability in such cases should be restricted to personal injuries or other torts but the liability follows when it flows from a contractual obligation. Manifestly, there could be no difference in the application of the principle under discussion, where the corporation is organized by an individual, a partnership, or another corporation holding a contract for construction work.[5]

§ 241. Where a Corporation Is Organized by Joint Owners, Though Not Partners, and Their Business Transferred to It For Stock, Corporation Liable For Personal Injury

Where joint owners of a manufacturing plant, having acquired such ownership by reason of the debts of its sole owner, and such joint owners form a corporation and transfer to such corporation all of the property of such joint ownership, for shares of stock and such corporation takes over the plant, continues the business as theretofore, using the same books of account, under the same name and in the same place of business,

[4] Towels & Co. vs. Miles, supra; see sec. 258, infra; Stark Elec. Co. vs. McGinty Contr. Co., 238 Fed. 657.

[5] Ziemer vs. Bretting Mfg. Co., 147 Wis. 252; 133 N. W. 139; 1912D A. C. 1275; 142 Wis. 224; 125 N. W. 318; see sec. 245.

it will be held as a matter of law, to assume the liabilities of such owners for personal injuries to an employee in the business, although the injury giving rise to such claim by such employee occurred prior to the incorporation of the concern.[6]

§ 242. A Parent Corporation Will Be Held Liable For the Tort of Its Subsidiary

Also intimately associated with the application of the principle discussed in a preceeding section,[7] comes the question of when a parent corporation may be held liable for the tort or negligence resulting in personal injury of employee of such subsidiary and it is now the rule that where a corporation holds stock in another not for the purpose of participation in the affairs of the other in the nominal and usual manner, but for the purpose of controlling it so that the subsidiary company may be used as a mere agency or instrumentality for the stockholding company, such stockholding company will be required to respond in damages for injuries due to the negligence of the subsidiary and the mere fact that the accident is caused by negligence solely, of the employee of subsidiary corporation will not absolve the dominant corporation of liability.[8]

§ 243. The Rule Holding Parent For Torts of Its Subsidiary, Same As the Rule Holding Corporations Organizing Another Corporation to Evade Liability

The principle holding a parent corporation liable for the commission of torts by its subsidiary, is but a different application of the principle that operates to fix liability upon con-

[6] Ziemer vs. Bretting Mfg. Co., 147 Wis. 252; 133 N. W. 139; 1912D A. C. 1275; 142 Wis. 224; 125 N. W. 318; see sec. 276, 288, infra.

[7] Sec. 240, supra.

[8] Ross vs. Pa. Railway Co., 146 Atl. 37; 7 N. J. Misc. 469; 138 Atl. 383; 148 Atl. 741; Oriental Investment Co. vs. Barclay, 25 Tex. Civ. App. 543; 64 S. W. 80.

struction corporations, partnerships, or individuals, having a contract for construction of railroads and like, and organize a corporation and purport to sublet the construction to such corporation. It is in the last analysis an attempt to evade liability by the interposition of the fictional jural personality which the courts generally disapprove.[9]

§ 244. Some Courts Adhere to the Old Doctrine That the Corporate Entities Will Not Be Disregarded to Allow Recovery For Personal Injury

Some courts are slow to take the step of progress and therefore they refuse to follow the lead of modern authority and hold an owner of a corporation, whether that owner be an individual, partnership, or another corporation, liable for personal injuries resulting from the negligence of the owned corporation. Apparently, the Supreme Court of Maryland—contrary to its general disposition to brush aside corporate forms—adheres to this archaic doctrine that the owner of a corporation will not be responsible for its negligence under any circumstances.[10] Apparently in line with Maryland is New York, beginning with Weiner vs. Hearst[11] and then going to the extreme that even where a corporation is but a cover created to escape personal liability, it is not sufficient to render the controlling stockholders liable for the acts of the corporation.[12] And the court of last resort in New York adheres to this obsolete position whether the stockholders be an individual, partnership, or another corporation, and it seems that it is of little consequence in that jurisdiction, the purpose for which the corporation is created and maintained. The fetish

[9] See sec. 240, supra.

[10] Bethlehem Steel Co. vs. Raymond Concrete Pile Co., 118 Atl. 279; 141 Md. 67. It is not easy to harmonize this holding of the Maryland Court when it is remembered how it has taken the lead in discarding the corporate fiction in the interest of justice. See secs. 84, 85, supra.

[11] 177 N. Y. 63, 69 N. E. 221.

[12] Elenkrieg vs. Siebrecht, 228 N. Y. 254; 144 N. E. 519; 34 A. L. R. 502; Rev. 206 App. Div. 736; 200 N. Y. S. 307.

of a corporate entity is still worshipped in the State of New York.[13]

§ 245. The Principal or Sole Stockholder of a Corporation Is Liable For an Award of Industrial Accident Board

Where the principal stockholder of a corporation owned all of the property that the corporation used, and the corporation owned no property and where a forfeiture of its charter took place for the nonpayment of license tax, and such stockholder thereafter reorganized the business into a new corporation, will make such stockholder individually liable for an award of the industrial accident board of the state, allowing compensation for a personal injury of an employee of the corporation. But the application of the doctrine that such stockholder is liable for an award of compensation is not confined to cases where the corporation is without assets, but the rule that such stockholder and the corporation are in law one applies.[14]

[13] Berkey vs. Third Avenue Railway Co., 244 N. Y. 84; 155 N. E. 58; Rev. 217, App. Div. 504; 217 N. Y. S. 156. See, however, same case in 155 N. E. 914; 244 N. Y. 602 where the court subscribes to the doctrine that "a parent corporation, operating legally or illegally, the business of a subsidiary assumes its liabilities or those growing out of what is done." When this is conceded, then it is harder still to understand why the plaintiff is not entitled to a recovery in this case.

[14] Hawkins vs. Bryan, 128 Okla. 27; 261 Pac. 167; Dixie Mining & Mfg. Co. vs. Williams, 128 So. (Ala.) 799. In the last cited case it appeared an individual conducted his business in a corporate name, he owning the body politic—and he was it. The evidence showed that others than such owner subscribed for stock sufficient to comply with law and get a charter. This showing was sufficient to move the court to ignore the corporate form and hold such owner for an award for compensation.

CHAPTER XII

RIGHTS AND LIABILITIES OF INDIVIDUAL MANAGING HIS PROPERTY THROUGH CORPORATE AGENCY

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Section

246. Where an individual manages property through corporate agency, entity disregarded.
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248. Where an individual creates a corporation and transfers his property to it, the corporation is liable for his debts.
249. Where a debtor organizes a corporation to hinder and delay creditors, the corporation will be liable for his debts.
250. Where a corporation, through its officers and stockholders, buys property on credit, the property may not be transferred to another corporation of the stockholder's organization.
251. Where a sole trader organizes a corporation and continues to manage the business, the corporation presumed to have assumed liability.
252. On bankruptcy of owner of corporation, property in the name of the corporation will be administered.
253. Where two persons are the sole owners of a corporation, they are not hampered by control by the action of dummy directors.
254. Where the owners of a corporation buy property and pay for it with corporate checks, the corporation may not recover.
255. Where a contract is made in the name of the principal stockholder and president of the corporation, it is bound thereon.
256. Where the owner of a corporation sells his stock to another upon representation that the corporation is not indebted, he may not enforce claim against it.
257. Where a party gives a check in a purported corporate name, which is thereafter organized, the signer of the check may not recover against the bank for paying the same.
258. Where parties organize a corporation under such circumstances as to warrant findings that it was organized to evade contracts, corporators personally liable.

259. Corporation will be liable upon note given in the name of exclusive owner.

260. A corporation, the stock of which is owned by an individual, is the assignee of the contract of that individual and on rescission must restore full consideration.

261. Corporate entity disregarded to prevent defense of *ultra vires*.

262. So where all of the stockholders and all members of the board of directors of a corporation act together and enter into a contract in reality in the interest of the corporation, the corporate entity will be disregarded and their acts held binding on it.

263. Where two corporations have interlocking directors and are owned by the same stockholders, the corporate entities will be disregarded and defense of *ultra vires* denied.

264. Sole stockholder may pledge credit of debt-free corporation for stockholder's obligations.

265. Individual engaged in business organizes two corporations, one becomes bankrupt, both will be administered.

266. Where a merchant incorporates himself and sells stock to another and the corporation thereafter goes bankrupt, individual creditors of such merchant share in proceeds.

267. Corporate entity will be ignored to prevent the recovery upon a commission contract.

268. Where an individual owns two corporations organized under the laws of different states, identical in name, said corporations will both be held liable along with their owners for goods sold to either or being uncertain as to which of said corporations the goods were in fact sold.

269. Debtor and creditor may not organize corporation and put debtor's property in its name so as to be subjected to creditor's claim to the exclusion of other creditors.

§ 246. Where an Individual Manages Property Through Corporate Agency, Entity Disregarded

Where an individual manages his property through and by means of a corporate agency, under such circumstances, the court will refuse to recognize the fiction of a separate corporate existence and will treat the act of the owner as the act of the corporation and will treat the act of the corporation as the act of its owner. There is essentially no difference in such cases when the sole stockholder is a corporation. But, some

cases are indeed difficult to harmonize with neoteric adjudications.[1] One of such cases comes from Wisconsin and is the case of Bosanich vs. Chicago N. S. & M. R. R. Company.[2] It is indeed difficult to reconcile it with the pronouncement of the general principle and while the court recognizes the principle announced in this section, it attempts to distinguish a case therefrom that is not possible to distinguish. In the Bosanich case, it appears that a street railway company was organized in 1896, as a Wisconsin corporation, at which time it obtained a franchise from Milwaukee for the operation of a street railway over Milwaukee's streets. In 1908 the franchise was so amended as to permit its successors or assigns to operate over its tracks. The defendant corporation in the Bosanich case was organized under the laws of Illinois in the year 1916 and operated an interurban railroad from Chicago to Milwaukee. In the city of Milwaukee proper, it operated over the tracks of the Chicago Milwaukee Electric Railway Company, by arrangements with that company and pursuant to authority granted by the amendment in 1908. Each of the corporations had an authorized capital stock which was oustanding of $100,000.00. The stock was held by the same parties and the entire stock of the railway company was pledged as security for first mortgage bonds of the Chicago North Shore and Milwaukee Railroad Company. Both corporations used the same office and had substantially the same officers. However, the funds were kept separate and were deposited to separate bank accounts and were paid out for operation of the particular corporate entity that created the same. The moneys of the

[1] Milbrath vs. State, 138 Wis. 354; 120 N. W. 252; 131 A. S. R. 1012; Haynes vs. Kenosha Electric Railway Co., 139 Wis. 227; 119 N. W. 568; 121 N. W. 124; Wolf Company vs. Kutch, 147 Wis. 209; 132 N. W. 981; Dibbert vs. Metropolitan Investment Company, 158 Wis. 69; 147 N. W. 3; 148 N. W. 1095; 1915D L. R. A. 305; 1916E A. C. 924; Fernekes vs. Nugent Sanatorium, 158 Wis. 671; 149 N. W. 393; Bosanich vs. Chicago N. S. & M. Railway Co., 173 Wis. 280; 181 N. W. 297; Lipman vs. Manger, 185 Wis. 63; 200 N. W. 663; Wichita Falls & N. W. Railway Co. vs. Pucket, 53 Okla. 463; 157 Pac. 112; 242 U. S. 619; 37 S. Ct. 214; 61 L. Ed. 531; see sec. 70, supra.

[2] Supra.

two companies were never mingled and the interurban company paid for repairs upon the tracks it used out of its own funds. Under this state of facts, in view of modern authority it is indeed hard to reconcile the court's holding that these corporate entities were not one and the same and especially in view of the fact that the court recognized the general principle that was applicable to the facts of the case beyond controversy.

§ 247. Where the Corporation Is Mere Instrumentality of Its Owner, the Corporation Will Be Bound For Its Owner's Act and Vice Versa

It is now so well established that it has become almost aphoristic that, upon a proper showing that a corporation is but an instrumentality through which its owner or substantial owners for convenience transacts or transact his or their business, by the great weight of authority, both equity and law will look through the form to its substance and will hold such corporation bound as the owner of the corporation might be bound or conversely hold the owner bound by acts which bind his corporation.[3] And so, where an individual owns all of the stock of a corporation or substantially so, and that the corporation is in truth and in fact, but the juristic double of its owner and where fraud or injustice will likely operate to the injury of third persons, this situa-

[3] Llewellyn Iron Works vs. Abbott Kinney Co., 172 Cal. 210; 155 Pac. 986; Bank of U. S. vs. Deveaux, 5 Cranch 61; 3 L. Ed. 38; Bank of Columbia vs. Patterson's Adm'x, 7 Cranch 299; 3 L. Ed. 351; Society etc., vs. New Haven, 8 Wheat. 464; 5 L. Ed. 662; Newton Mfg. Co. vs. White, 42 Ga. 148; Brannin vs. Loving, 82 Ky. 370; 6 Ky. L. R. 328; McKinley vs. Wheeler, 130 U. S. 630; 9 S. Ct. 638; 32 L. Ed. 1048; State vs. Standard Oil Co., 49 Ohio St. 137; 30 N. E. 279; 15 L R. A. 145; 34 A. S. R. 541; Bank of England vs. Moffatt, 3 Bro. Ch. Rep. 262; Bellona Co.'s Case, 3 Bland 442; Hoffman Steam Co. vs. Cumberland Coal & Iron Co., 16 Md. 456; 77 Am. Dec. 311; Melledge vs. Boston Iron Co., 5 Cush. (Mass.) 158; 51 Am. Dec. 59; Des Moines Gas Co. vs. West, 50 Iowa 16; Swift vs. Smith et al., 65 Md. 428; 5 Atl. 534; 57 A. R. 336; Moore & Handley Hardware Co. vs. Towers Hardware Co., 87 Ala. 206;

tion suffices to dissipate the separate fictional identity of the corporation and the law will have no compunction in holding the corporation liable for the acts of its owners or *vice versa*.[4] And this rule is the same though the stock of the corporation is owned by two or more who act in conjunction with the corporate organization.[5]

§ 248. Where an Individual Creates a Corporation and Transfers His Property to It, the Corporation Is Liable For His Debts

The corporate entity will be disregarded where an individual creates a corporation and transfers his property to it and takes stock therefore. Under such circumstances the courts will hold that in looking to the corporation for the satisfaction of the individual's debts, the creditor is merely looking to the party with whom he contracted. The rule is now well established that a debtor may not, by the simple changing of fronts, or by changing his coat, shield his identity and evade the payment of his just obligations. Such juristic changes as

6 Southern 41; 13 A. S. R. 23; Pott vs. Schmucker, 84 Md. 535; 36 Atl. 592; 35 L. R. A. 392; 57 A. S. R. 415; Louisville Banking Co. vs. Eisenman, 94 Ky. 83; 14 Ky. L. R. 705; 21 S. W. 531, 1049; 19 L. R. A. 684; 42 A. S. R. 335; Jones vs. Williams, 139 Mo. 1; 39 S. W. 486; 40 S. W. 353; 37 L. R. A. 682; 61 A. S. R. 436; McElroy vs. Minn. Percheron Horse Co., 96 Wis. 317; 71 N. W. 652; Sargent vs. Palace Cafe Co., 175 Cal. 737; 167 Pac. 146; Erkenbrecher vs. Grant, 187 Cal. 7; 200 Pac. 641; Minifie vs. Rowley, 187 Cal. 481; 202 Pac. 673; Hotaling vs. Hotaling, 193 Cal. 368; 224 Pac. 455; Wenban Estate vs. Hewlett, 193 Cal. 675; 227 Pac. 723; Ellet vs. Los Altos Country Club Properties, 264 Pac. 270; 88 Cal. App. 740.

[4] Minifie vs. Rowley, supra; Commercial Security Co. vs. Modesto Drug Co., 43 Cal. App. 162; 184 Pac. 964; Porter vs. Lassen County Land Co., 127 Cal. 261; 59 Pac. 563; Swartz vs. Burr, 43 Cal. App. 442; 185 Pac. 411. Dissenting opinion of Judge Burnell, Goldwater vs. Oltman, 285 Pac. (Cal.) 734; Varni vs. Anglo American Land Co., 284 Pac. (Cal.) 520; Williamson vs. Marshall, 54 Cal. App. 24; 200 Pac. 1058; Campbell vs. Hanford, 67 Cal. App. 155; 227 Pac. 234; Zenos vs. Britten-Cook Land & Livestock Co., 242 Pac. 914; 75 Cal. App. 299; Wilkinson vs. Walker, 294 Fed. 939; see secs. 70, 237, supra.

[5] Zenos vs. Britten-Cook Land & Livestock Co., supra; McCormick Saeltzer Co. vs. Grizzly Creek Lbr. Co., 74 Cal. App. 278; 240 Pac. 32.

an individual organizing himself into a corporation will not serve to create a metamorphoses of substance.[6] So, an embarrassed debtor cannot hide behind a corporation organized by him and in such case the court will impute fraud, if necessary, to brush aside the corporate fiction.[7] Likewise a corporation formed to shield property of an insolvent debtor will be seized in the possession of the corporation.[8] In such case the court will impute fraud to the transaction as a legal basis for disregarding the corporate entity.[9]

§ 249. Where a Debtor Organizes a Corporation to Hinder and Delay Creditors, the Corporation Will Be Liable For His Debts

Where a debtor organizes a corporation for the purpose of hindering and delaying his creditors in the enforcement of their obligations against his property and transfers his property to such corporate organization of which he is the principal stockholder, the juristic fiction of corporate existence will be disregarded and the corporation will be held liable for the debts of its predecessor in interest. In such case it will not suffice to defeat the claims of creditors to show that the corporation was regularly and legally organized. It appeared that such debtor made the contract between himself and the corporation whereby he transferred his property to the corporation and took in payment thereof substantially all of the stock of the corporation. Under such circumstances the fact that the corporation is legally organized in due form is

[6] Curtis Jones Co. vs. Smelter National Bank, 43 Colo, 391; 96 Pac. 172; Breman Savings Bank vs. Branch-Crook Co., 104 Mo. 425; 16 S. W. 209; see secs. 70, 237, 246, supra.

[7] Star Brewing Co. vs. Flynn, 158 N. E. 891; 361 Mass. 426.

[8] In re Berkowitz, 173 Fed. 1012.

[9] Roberts vs. W. H. Hughes Co., 86 Vermont 76; 83 Atl. 807; Kellogg vs. Douglas County Bank, 58 Kan. 43; 62 A. S. R. 596; 48 Pac. 587; First National Bank vs. Trebein, 59 Ohio State 316; 52 N. E. 834; Forbes vs. Thorpe, 209 Mass. 570; 95 N. E. 955; Terhune vs. Skinner, Terhune vs. Hackensack Savings Bank, 45 N. J. Eq. 344; 19 Alt. 377.

immaterial and the corporate entity in such case will be disregarded in the attainment of justice.[10]

§ 250. Where a Corporation, Through Its Officers and Stockholders, Buys Property on Credit, the Property May Not Be Transferred to Another Corporation of the Stockholder's Organization

The stockholders of a corporation, in the name of which property has been purchased on a credit, will not be permitted to form a new corporation in which their interests are the same as in the old, and no new consideration appearing in the transaction and such stockholders transfer the property in which their interests are the same as in the old, to the new corporation, such transfer will not suffice to escape liability to the original sellers and creditors. In other words, the law will not sanction a transaction where it appears that the new corporation under such circumstances *quoad* the property of the old—stood in the shoes of the old.[11]

§ 251. Where a Sole Trader Organizes a Corporation and Continues to Manage the Business, the Corporation Presumed to Have Assumed Liability

Where a sole trader organizes a corporation and transfers his business, as a sole trader, to such corporation and conducts the same business at the same place, and substantially the same name and under substantially the same ownership as a matter of equitable justice, therefore, under such circumstances, the inference is that the corporation has assumed the liability of such sole trader.[12]

[10] Chicago & G. T. Ry. Co. vs. Miller, 51 N. W. 981; 91 Mich. 166; Des Moines Gas Co. vs. West, 50 Iowa 16; Booth vs. Bunce, 33 N. Y. 139; 88 A. D. 372; Bennett vs. Minott, 28 Ore. 339; 44 Pac. 288; 39 Pac. 997; Hanson Sheep Co. vs. Farmers & Traders State Bank, 53 Mont. 324; 163 Pac. 1151.

[11] Hancock vs. Holbrook, 40 La. Ann. 53; 3 Southern 351.

[12] Blumenthal vs. Schneider, 186 Wis. 588; 203 N. W. 393; Pratt vs.

§ 252. On Bankruptcy of Owner of Corporation, Property in the Name of the Corporation Will Be Administered

Where a bankrupt has caused a corporation to be organized as a vehicle through which to transact his business and conceal assets from and to hinder, delay, and defraud his creditors, and after it is organized uses said corporation for that purpose, the bankrupt being the sole owner of the corporation, upon adjudication of the owner of the corporation as a bankrupt, the assets of the corporation will be administered without regard as to whose name in which those assets may stand. Real estate standing in the name of the corporation will be administered and applied to the satisfaction of debts in as full and ample a manner as if the corporation did not exist.[13]

§ 253. Where Two Persons Are the Sole Owners of a Corporation, They Are Not Hampered by Control by the Action of Dummy Directors

Where two parties are the sole corporate owners of a corporation, they are not hampered or limited or controlled by a board of directors which must necessarily be dummies, but as to each other they are substantially partners and it seems their act will be construed as that of the corporation.[14]

Oshkosh Match Co., 89 Wis. 406; 62 N. W. 84; Ziemer vs. Bretting Mfg. Co., 147 Wis. 252; 133 N. W. 139; 142 Wis. 224; 125 N. W. 318; 1912D A. C. 1275.

Contra, in re Lothair Hardware Co., 18 Fed. (2d) 975. Undoubtedly in re Lothair is a sporadic case running counter to the great drift of modern authority.

[13] Isaacson vs. Union Trust Co., 273 Pac. 119; 275 Pac. 529; 286 Pac. 1017; 95 Cal. App. 633.

[14] Carney vs. Penn. Realty Co., 174 App. Div. 86; 159 N. Y. Supp. 273; First National Bank vs. G. V. B. Mining Co., 89 Fed. 439; Goss & Co. vs. Goss, 147 App. Div. 698; 132 N. Y. S. 76; 207 N. Y. 742; 101 N. E. 1099.

§ 254. Where the Owners of a Corporation Buy Property and Pay For It With Corporate Checks, the Corporation May Not Recover

Where the president and owner of a corporation buys real or other property and pays therefor in whole or in part with checks signed by the corporation, by himself as president, and the corporation sues to recover the amount of these checks upon the theory that the recipient of these checks had knowledge that the president was misusing corporate funds, a recovery will be denied and the court will not permit the fictional existence of the corporate entity to be used in this fashion to perpetrate a fraud.[15]

§ 255. Where a Contract Is Made in the Name of the Principal Stockholder and President of the Corporation, It Is Bound Thereon

The rule that the courts will, in a proper case, justice requiring, disregard the corporate entities and treat the parties in their individual capacity has been so far developed in modern times that it is now established by law that where a contract is made in the name of the principal stockholder and president of a corporation, which is manifestly made in the interest of the prosecution of the corporate business, will be held to be a contract of the corporation and the corporation accordingly bound thereon and which may be enforced in suit against the corporation in the same manner and to as full an extent as if it had been made with all of the formality of a corporate act.[16] In short, it may be said with assurance that the law is not scrupulously particular in discriminating between the contract of one who practically owns all of the

[15] Bresseman vs. Mosson, 127 Misc. 282; 215 N. Y. S. 766; Quaid vs. Ratkowsky, 183 App. Div. 428; 170 N. Y. S. 812; 224 N. Y. 624; 121 N. E. 887; Almirall & Co. vs. McClement, 207 App. Div. 320; 202 N. Y. S. 139; see secs. 70, 237, supra.

[16] Jones vs. Williams, 139 Mo. 1; 39 S. W. 486; 40 S. W. 353; 61 A. S. R. 436; 37 L. R. A. 682; Schuyler vs. Pantages, 54 Cal. App. 83; 201 Pac. 137.

stock of a corporation and controls its affairs as to whether he executes a contract relating to the corporate business in his individual or corporate capacity.[17] And, so also, where it appears that a contract executed on behalf of the corporation in the name of the sole stockholder, that such contract will inure to the benefit of the corporation, the corporation may enforce it against the other contracting party.[18] While the law recognizes the affairs of a corporation to be controlled by a board of directors, yet a contract entered into by the president of the corporation, who owned all of its stock and entered into it in his name, is binding on the corporation, although not authorized or sanctioned by a board of directors, as required by law, where the president is given the full charge of the corporate affairs by the directors and authorized by the by-laws of the corporation to sign all contracts or other instruments in writing on approval of the directors.[19] So, where all stockholders enter into a contract in interest of the corporate business the corporation itself may not repudiate such contractual obligation.[20]

§ 256. Where the Owner of a Corporation Sells His Stock to Another Upon Representation That the Corporation Is Not Indebted, He May Not Enforce Claim Against It

Where an owner of the stock in a corporation induces another to purchase the stockholder's holdings in the corporation upon the representation that the corporation is not indebted, such selling stockholder may not thereafter assert any claim of indebtedness against the corporation, the law be-

[17] Swartz vs. Burr, 43 Cal. App. 442; 185 Pac. 411; McCormick Saeltzer Co. vs. Grizzly Creek Lbr. Co., 240 Pac. 32; 74 Cal. App. 278; see sec. 70, supra.

[18] Kentucky Coal Lands Co. vs. Mineral Development Co., 295 Fed. 255; 259 Fed. 118; 285 Fed. 1021.

[19] Edwards vs. Plains Light & Water Co., 49 Mont. 533; 143 Pac. 962

[20] Breslin vs. Fries Breslin Co., 70 N. J. L. 274; 58 Atl. 313; Swift vs. Smith, 65 Md. 428; 5 Atl. 534; 57 A. R. 336; Stokes vs. Detrick, 75 Md. 256; 23 Atl. 846; Cantor vs. Baltimore Overall Co., 121 Md. 65; 87 Atl. 1115; Wootton Land & Fuel Co. vs. Ownbey, 265 Fed. 91; Minch vs. Minch, 115 Atl. (Md.) 702; see sec. 85, supra.

ing that the corporate entity will be disregarded and that the vendor of the stock will be estopped from making any claim against the corporate entity.[21]

§ 257. Where a Party Gives a Check in a Purported Corporate Name, Which Is Thereafter Organized, the Signer of the Check May Not Recover Against the Bank for Paying the Same

Where a party dealing with a purported corporation but in fact which has not any legal existence as a corporation, issues a check to such purported corporation, the drawer of such check may not recover from the bank upon the ground that the money was improperly deducted by the bank from the drawer's account. Such endorsement in the purported corporation's name does not amount to a forgery, in the meantime the purported corporation having been organized into a corporation *de jure*.[22]

§ 258. Where Parties Organize a Corporation Under Such Circumstances As to Warrant Findings That It Was Organized to Evade Contracts, Corporators Personally Liable

Where it appears that certain parties organized a corporation and turned over to it land which they had bought for a lumber plant and that such parties took all of the shares of the stock of the corporation except three, which were issued one to each of three persons, but were never delivered or paid for, the law requiring that there should be at least five stockholders, this state of facts will justify a conclusion that the corporation was organized for the purpose of evading com-

[21] Given vs. Times Republican Printing Co., 106 Fed. 253; 114 Fed. 92; 52 C. C. A. 40; 189 U. S. 513; 23 S. Ct. 851; 47 L. Ed. 924; Aurora Daily News Co. vs. Frazier, 157 Ill. App. 456; see also Jones vs. Bolles, 9 Wall 364; 19 L. Ed. 734. Generally if corporation is estopped stockholders are likewise estopped, and vice versa; see sec. 323, infra.

[22] Alent vs. Bank of United States, 131 Misc. 370; 226 N. Y. S. 653.

pliance with contracts but by which they had made the other contracting parties sole selling agents for lumber or products to be manufactured by them and such contract providing for a continuance as long as defendants or their successors trading under any name should manufacture lumber. This is simply an application of the doctrine that the courts will go behind a corporate front and ascertain the real parties in interest; finding them so, they will deal with them and the corporate entity will be entirely put aside or disregarded.[23]

§ 259. Corporation Will Be Liable Upon Note Given in the Name of Exclusive Owner

Where it appears that a corporation is used as a medium through which and by which an individual conducts his business, the corporation will be held to all intents and purposes, both in name and fact, the same as its owner and any duty or obligation devolving upon its owner will devolve upon the corporation and *vice versa*, and so a note executed by the owner in his name may be collected from the corporation and *vice versa*.[24]

§ 260. A Corporation, the Stock of Which Is Owned by an Individual, Is the Assignee of the Contract of That Individual and on Rescission Must Restore Full Consideration

A corporation which is owned entirely by an individual, except two qualifying shares, is the assignee of a contract of sale and such stockholder being the original vendor and the corporation rescinds the contract of sale, the corporate entity will be disregarded or overridden and it will be required to restore the full consideration paid by the vendee in the contract. This is another application of the doctrine that in

[23] Hagy vs. Maguire, 147 Pa. 187; 23 Atl. 806; see secs. 239, 240.
[24] National Bank of Commerce vs. James Pingree Co., 62 Utah 259; 218 Pac. 552; see secs. 70, 255, supra.

order to prevent a miscarriage of justice the courts will ignore the difference between the corporate entity and its stockholders.[25]

§ 261. Corporate Entity Disregarded to Prevent Defense of Ultra Vires

Where an individual owns all of the stock of a corporation, except two qualifying shares and they are beneficially owned by him and it is his practice to pay his individual indebtedness with corporate funds and such stockholder enters into a contract employing another on behalf of said corporation, although the act of employment is done in his name and not that of the corporation, the corporation cannot successfully defend an action based upon the contract of employment on the ground that the action of the stockholder was *ultra vires*. It is an easy matter to understand how the court reached this conclusion, when the corporate entity is brushed aside.[26]

§ 262. So Where All of the Stockholders and All Members of the Board of Directors of a Corporation Act Together and Enter Into a Contract in Reality in the Interest of the Corporation, the Corporate Entity Will Be Disregarded and Their Acts Held Binding on It

Notwithstanding the fact that the directors did not act in the technical capacity of their directorship, such contract will be held binding on the corporation; the absence of previous directorate authorization is immaterial.[27] So, where all of the stockholders unite for the purpose of borrowing

[25] Mills vs. Richman Co., 63 Cal. App. 594; 219 Pac. 465.

[26] Rafter vs. Richard K. Fox Publishing Co., 206 App. Div. 389; 201 N. Y. S. 401; 238 N. Y. 567; 144 N. E. 894; see secs. 70, 255, supra.

[27] Holland Land & Loan Co. vs. Holland, 274 S. W. (Mo.) 951; 298 S. W. 39; Union National Bank vs. Shoemaker, 68 Mo. App. 592; Union National Bank vs. State National Bank, 155 Mo. 95; 55 S. W. 989; 78 A. S. R. 560; Grafeman Dairy Co. vs. Northwestern Bank, 290 Mo. 311; 235 S. W. 435.

money to be used without the scope of its corporate powers, such act will be held to be that of the corporation and it may not interpose the defense raising the question of the lack of its corporate authority. In such cases the court simply takes the position that when the corporate entity is brushed aside, the law will not forget that the stockholders are the real and substantial beneficiaries of the defense, interposed by or on behalf of such corporation, and if in law, equity, and good conscience, the stockholders would have no standing in court, if the corporate entity is dissipated, then every sense of justice would seem to dictate and the soundest principles of law would require that the corporation should not be permitted to recover.[28]

§ 263. Where Two Corporations Have Interlocking Directors and Are Owned by the Same Stockholders, the Corporate Entities Will Be Disregarded and Defense of Ultra Vires Denied

Where two corporations are owned by the same parties and they have interlocking directors, it apparently will call for an application of the principle that corporate entities will be overridden in the interest of justice and the two corporations treated as one and the same. So, where a bank owned by the same stockholders as another corporation and the two corporations have interlocked directors and such other corporation goes upon a bond to secure a deposit made in the bank by a municipality, the corporation signing as a surety on such bond will not be permitted to plead *ultra vires,* but the two corporations will be treated as the same and such surety corporation held liable to the depositor—the municipality.[29]

[28] Taylor Feed Pen Co. vs. Taylor National Bank, 181 S. W. (Tex.) 534; see, however, 177 S. W. 176; 215 S. W. 850; see secs. 255, supra 323, 323a, infra.

[29] Power Co. vs. Evans Bros. Land & Livestock Co., 252 Pac. 182; 43 Idaho 158; Power County vs. Evans Bros. Land & Livestock Co., 252 Pac. 185; 43 Idaho 171; City of American Falls vs. Evans Bros. Land & Livestock Co., 252 Pac. 185; 43 Idaho 172; Independent

§ 264. Sole Stockholder May Pledge Credit of Debt-free Corporation For Stockholder's Obligations

Where a private business corporation is free from debt and is reduced to one or two stockholders who purchased the interest of others, such stockholders have the equitable ownership of the corporate property and being thus possessed equitably of corporate property, the stockholders may mortgage it to secure their individual obligations and such encumbrance subjects the interest thus mortgaged to the debt secured thereby as against the demands of succeeding encumbrances or purchasers, and is superior to another mortgage given by the corporation itself on the same property thereafter.[30] In such case the defense of *ultra vires* will not avail.[31] So where the president of a corporation, who in fact owns it, gives the corporate obligation for his own personal debts, which obligation is worthless, the president so giving the corporate obligation will remain liable therefor and he may not resort to a plea of the statute of frauds.[32]

§ 265. Individual Engaged in Business Organizes Two Corporations, One Becomes Bankrupt, Both Will Be Administered

Where an individual is engaged in business and he creates two corporations, one of which to transact the business and the other to hold the real estate pertaining to such business, upon a bankruptcy of either of said corporations, the affairs of the other will be drawn into bankruptcy proceedings and

School District No. 1 vs. Evans Bros. Land & Livestock Co., 252 Pac. 185; 43 Idaho 173. In these cases cited in this note the court pursued a course of great circuity to ultimately reach the goal that these two corporations would be treated as one. If the court in fact ever came to such conclusion, but manifestly the principle that the courts will, in a proper case, treat two or more corporations as a single entity in the interest of justice, was given application.

[30] First National Bank vs. Winchester, 119 Ala. 168; 72 A. S. R. 904; 24 Southern 351; Donovan vs. Purtell, 216 Ill. 629; 75 N. E. 334, 1 L. R. A. N. S. 176; 119 Ill. App. 116.

[31] First National Bank vs. Winchester, supra.

[32] Donovan vs. Purtell, supra; see secs. 70, 84, supra, 336, infra.

the corporate entity disregarded and the whole business administered in one and the same case.[33] The court illustrated such situation similar to that of a natural person doing business in his correct name to designate himself, or contract with himself, as his own agent and regard another branch of his business conducted by himself, under a fictitious name, and to thus hold himself out to the public as two distinct persons. It will not be permitted that a debtor should so represent himself, keep for his two corporations separate books and separate bank accounts, for to do so might give him different lines of credit and could doubtless be resorted to to hinder and delay creditors in reaching his assets but when the knowledge of the true situation has once been brought to the court's attention, the court will have no difficulty in brushing aside the subterfuge of the jural personality and subject the whole of the property that in truth and good conscience belongs to the debtor for the payment of his debts.[34]

§ 266. Where a Merchant Incorporates Himself and Sells Stock to Another and the Corporation Thereafter Goes Bankrupt, Individual Creditors of Such Merchant Share in Proceeds

Where a merchant is indebted to a bank and such merchant having engaged in business for a number of years, organizes the business into a corporation and procures another to take an interest therein, it being understood that upon the payment for the stock in such corporation so organized, that a note that such merchant owed to a bank would be paid, it further appearing that the interest upon the note had been paid by the corporation out of the profits arising from the conducting of the business, upon such corporation going bankrupt, it will be held to have assumed the note of the merchant owing to the bank. It further appeared that a

[33] In re Looschen Piano Case Co., 261 Fed. 93; 259 Fed. 931; 266 Fed. 359.

[34] In re Rieger, Kapner and Altmark, 157 Fed. 609; see sec. 268, infra.

number of the obligations of the merchant had been assumed and paid by the corporation.[35]

§ 267. Corporate Entity Will Be Ignored to Prevent the Recovery Upon a Commission Contract

Where an agent undertakes to sell certain products for another and represents that it is necessary to pay a commission to a third party in order to make the sale, such agent will not be permitted to recover the commission where the supposed third party is a corporation owned by such agent. In other words, the corporate entity will be disregarded and the agent will not be permitted to collect a commission for his services and for the supposed services of his corporation.[36]

§ 268. Where an Individual Owns Two Corporations Organized Under the Laws of Different States, Identical in Name, Said Corporations Will Both Be Held Liable Along With Their Owner For Goods Sold to Either or Being Uncertain As to Which of Said Corporations the Goods Were in Fact Sold.

In modern times the very respectable Dr. Jekyll will be held liable and responsible for the conduct of a corporate Mr. Hyde and if necessary the courts will readily administer legal potions to establish the identity of Dr. Jekyll with the corporate Mr. Hyde. So where an individual is the owner of a corporation organized under the laws of one state, and another chartered under the laws of another, and a creditor cannot determine which entity is liable to him, he may hold both bodies politic and the individual owning them, in as full and ample manner as if there were but a single corporate organization and the owner of such corporations as well.[37]

[35] In re Scranton and Short, 7 Fed. (2d) 473.
[36] Garrigus Co. vs. International Agricultural Corp., 159 App. Div. 877; 144 N. Y. S. 982.
[37] Weintraub vs. Superior Court, 267 Pac. 733; 91 Cal. App. 763; see sec. 265, supra.

§ 269. Debtor and Creditor May Not Organize Corporation and Put Debtor's Property in Its Name So As to Be Subjected to Creditor's Claim to the Exclusion of Other Creditors

An insolvent debtor, to secure a particular creditor joined with the creditor and organized a corporation and conveyed his property to it. He and the creditor having control thereof, the corporation possessed no assets other than those received from the debtor and having paid for the same by its stock and notes and also having assumed the indebtedness owing to the favored creditor who joined in the organization of the corporation, a conveyance was thereafter made of the corporate property to such creditor in satisfaction of the assumed indebtedness, will be held fraudulent as to creditors.[38]

[38] Folsom vs. Detrieck Fertilizer & Chemical Co., 85 Md. 52; 36 Atl. 446.

CHAPTER XIII

DISREGARD OF CORPORATE ENTITY IN PROTECTION OF GOODWILL

CONTENTS

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272. Where individuals having valid contract restraining other parties from engaging in business, such individuals may enforce the contract, notwithstanding having transferred the business to a corporation they have formed.

§ 270. A Stockholder Buying the Stock of Others in a Corporation Together With a Stipulation For Protection of Goodwill May Enforce Such Stipulation

Where three parties own a corporation and one of them buys out the other two, that are among themselves substantially partners and there being a stipulation in the contract for the protection of the goodwill of the corporation, the stock of which is the subject matter of the deal among the parties, such purchaser will be entitled to enforce the stipulation in the contract for the protection of the goodwill and is entitled to the injunctive relief of the court and damages, in order to properly enforce and protect his rights under the contract if his rights are threatened as to the goodwill of the corporation.[1] Before the court could reach this result it

[1] Kamow vs. Simplex Cloth Cutting Machine Co., 109 Misc. 358; 179 N. Y. S. 682.

must have manifestly ignored the fiction of the corporate entity.

§ 271. An Individual Selling His Business May Not Thereafter Organize a Corporation to Engage in That Business and Thus Evade His Contract of Sale of Goodwill

An individual engaged in business and selling the same to another may not thereafter organize a corporation or cause a corporation to be organized under his control and engage in that business in violation of the seller's contract, the restriction imposed being a contract whereby an individual sells his business and goodwill and agrees not to again, within the limits of the time allowed by law and in the restrictions of territory circumscribed by law, engage in business through and by means of a corporation of which he is the principal stockholder and controlling the same.[2] So where an individual has an established business and sells out the same and agrees not to further prosecute such business but afterwards forms a corporation with other persons who knew of such contract or who were obligated by similar contracts to the same vendee, the vendor and the corporation thus organized will be restrained from engaging in that business.[3] In a few cases the courts have attempted to distinguish the principles announced in the case of Beal vs. Chase,[4] but when this attempted distinction is analyzed, it is found that the court merely adheres to the archaic position that the corporate entity will not be ignored.[5]

[1] Beal vs. Chase, 31 Mich. 490.

[2] A. Booth & Co. vs. Seibold, 37 Misc. 101; 74 N. Y. S. 776; LePage Co. vs. Russian Cement Co., 17 L. R. A. 354; 2 C. C. A. 555; 5 U. S. App. 112; 51 Fed. 941; Kramer vs. Old, 119 N. C. 1; 34 L. R. A. 389; 56 A. S. R. 650; 25 S. E. 813; Davis Improved Wrought Iron Wagon Wheel Co. vs. Davis Wrought Iron Wagon Co., 20 Fed. 699.

[3] Davis Improved Wrought Iron Wagon Wheel Co. vs. Davis Wrought Iron Wagon Co., supra.

[4] Moore & Handly Hdwe. Co. vs. Towers Hdwe. Co., 87 Ala. 206; 13 A. S. R. 23; 6 Southern 41; Hall's Safe Co. vs. Herring Hall Mar-

§ 272. Where Individuals Having Valid Contract Restraining Other Parties From Engaging in Business, Such Individuals May Enforce the Contract, Notwithstanding Having Transferred the Business to a Corporation They Have Formed

The better rule appears to be and the one in consonance with the modern trend of decisions, that where individuals having a valid contract prohibiting another from engaging in business and such individuals have formed a corporation and transferred the business that such contract protects, and the contract is infringed by the other contracting party, the individuals may sue to enforce the terms of said contract in the interest of such corporation.[6] However, this position is by no means without dissent, for on the other hand Maryland, Alabama, Wisconsin and Pennsylvania hold that the corporation only may sue to enforce the contract in such case and that the stockholders of the corporation, who where the contracting parties therein cannot maintain such a suit after having created and transferred the business to such corporation even though it is owned by them.[7] It is indeed a little singular that the two courts that have gone the farthest in some respects in dissipating the corporate entity have assumed so technical a stand as not to allow the party to the contract, who is a stockholder of the corporation, and who is at the time the real beneficiary under the contract, to assert the rights given by such contract. The Supreme Court of Alabama has declared that where a private business corporation is reduced to two stockholders and the corporation is free from debts, that the stockholders are equitable owners of the corporation

Van Safe Co., 76 C. C. A. 495; 146 Fed. 37; 28 S. Ct. 350; 52 L. Ed. 616; 14 L. R. A. N. S. 1182; 203 U. S. 591; 27 S. Ct. 780; 51 L. Ed. 331; 208 U. S. 554.

[6] Ragsdale vs. Nagel, 106 Cal. 332; 39 Pac. 628; Dunlop vs. Gregory, 10 N. Y. 241; 61 Am. Dec. 746; McCausland vs. Hall, 23 Ont. App. Rep. 738.

[7] Knowles vs. Jones, 182 Ala. 187; 62 Southern 514; Palmer vs. Toms, 96 Wis. 367; 71 N. W. 654; Gompers vs. Rochester, 56 Pa. 194; Anderson vs. Truitt, 148 Atl. (Md.) 223.

property and may go to the extent of mortgaging it for the payment of the stockholder's individual debts.[8] The Alabama court in taking this position followed the lead of Maryland in a case where the Maryland court had held that the only stockholder of a corporation might deed the property of the corporation away.[9] If the stockholders are under some circumstances to be regarded as the equitable owners of the corporate property, it is a little difficult to understand how it could be that those same equitable owners may not seek the injunctive aid in a court of equity to protect their title, but after all, law is not an exact science and the personnel of courts changes from time to time and thus many inconsistencies creep into the law, and are thereby explained.

[8] First National Bank vs. Winchester, 119 Ala. 168; 72 A. S. R. 904; 24 Southern 351.

[9] Swift vs. Smith, 5 Atl. 534; 65 Md. 428; 5 A. R. 336; see secs. 84, 85, supra.

CHAPTER XIV

A CORPORATION ORGANIZED OUT OF PARTNERSHIP, LIABILITY FOR DEBTS AT COMMON LAW

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§ 273. The Rule at Common Law Is That a Partnership Organized Into a Corporation, Is Liable For the Partnership's Debts

It is a rule of common law that a corporation which succeeds to the business of a partnership or a corporation organized for the purpose of continuing the business of such

partnership and takes over the assets thereof, by so doing *ipso facto* assumes the debts and liabilities of the partnership.[1] This is especially true where the corporation pays for the assets in stock, and the position of the liability of the corporation is strengthened by the fact that it has no other assets after its organization other than those acquired from the partnership.[2] Upon this subject it seems that the common law does not prevail in Georgia and there a corporation succeeding to the interest of a partnership is not liable for the debts of the corporation's predecessor.[3] However, where the question arises in the federal courts in Georgia they will follow the common law instead of the peculiar local rule prevailing in that state.[4] It should be noted that the mere transfer of the partnership assets, no other facts appearing such as that the corporation was organized for the purpose of continuing the business of the partnership, or that the partnership organizes itself into the corporation, or that the corporation paid for the assets in stock to the partners, and the like,

[1] Shield vs. Smith, 221 N. W. 87; 53 S. D. 477; in re W. J. Marshall Co., 3 Fed. (2d) 192; Cook Stock & Stockholders 3, sec. 671; Beach Private Corporation 360; Eans Adm'rs vs. Exchange Bank of Jefferson City, 79 Mo. 182; 2 Cook on Corporations 4th Ed. 673; Austin vs. Tecumseh National Bank, 49 Neb. 412; 68 N. W. 628; 35 L. R. A. 144; 59 A. S. R. 543; Reed Bros. vs. First National Bank, 46 Neb. 168; 64 N. W. 701; Baker Furniture Co. vs. Hall, 76 Neb. 88; 107 N. W. 117; 111 N. W. 129; 113 N. W. 267; Sanger vs. Upton, 91 U. S. 56; 23 L. Ed. 220; Chicago M. & St. P. Railway Co. vs. Third National Bank, 134 U. S. 276; 10 S. Ct. 550; 33 L. Ed. 900; Grenell vs. Detroit Gas Co., 112 Mich. 70; 70 N. W. 413; DuVivier & Co. vs. Gallice, 149 Fed. 118; 80 C. C. A. 556; Booth vs. Bunce, 33 N. Y. 139; 88 Am. Dec. 372; Andres vs. Morgan, 62 Ohio St. Rep. 236; 56 N. E. 875; 78 A. S. R. 712; Metcalf vs. Arnold, 110 Ala. 180; 20 Southern 301; 55 A. S. R. 24; Acorn Lumber Co. vs. Friedlander Box Co., 240 Ill. App. 425; in re A. G. Crosby Co., 199 Fed. 344; Haslett vs. Wotherspoon, 20 S. C. Eq. (1 Strobh) 209; Tex. Loan Agency vs. Hunter, 13 Tex. Civ. App. 402; 35 S. W. 399; Williams vs. Colby, 24 A. R. 793; 53 Hun. 637; 3d Silvernail 337; 6 N. Y. S. 459.

[2] Shield vs. Smith, 221 N. W. 87; 53 S. D. 437;

[3] Culberson vs. Ala. Construction Co., 127 Ga. 599; 56 S. E. 765; 9 L. R. A. N. S. 411; 9 A. C. 507; Greenberg Miller Co. vs. Everett Shoe Co., 138 Ga. 729; 75 S. E. 1120; Bludwine Bottling Co. vs. Crown Cork & Seal Co., 14 Ga. App. 285; 80 S. E. 853; Georgia Co. vs. Castleberry, 43 Ga. 187; see secs. 140, 141, supra.

[4] In re W. J. Marshall Co., 3 Fed. (2d) 192.

will not suffice to hold the corporation liable on the partnership obligations.[5]

§ 274. Partnership Organizing Itself Into a Corporation Priority of Payment by Partnership Creditors and Corporate Creditors

The members of a partnership organizing a corporation and transferring the business to the corporation, taking stock therefor, such transaction will be deemed fraudulent as to existing creditors and in such case the question of priority of payment arises: that is, whether the partnership creditors are entitled to a priority of payment over the corporate creditors or vice versa. Some cases go upon the theory that the creditors all stand equally as to the assests of the corporation that had succeeded the partnership.[6] While on the other hand other cases hold that the corporate creditors are entitled to full payment before the partnership creditors may share in the assets at all.[7] However, if the corporate entity, in such case, is disregarded and the corporation and the former partnership are treated as one and the same, then manifestly the holdings allowing the corporate creditors a priority is untenable and cannot be sustained. The whole matter resolves itself into a question of whether or not the court will disregard and override the juristic personality brought into existence when the corporation is created and it must be upon that theory, in many cases that the corporation is held liable for the partnership debts, when it is conceded that this is the basic principle underlying the corporation's liability, then any reason for granting a priority to corporate creditors must

[5] Smith vs. Bowker-Torrey Co., 207 Fed. 967; Lawrence vs. Nyberg Automobile Works, 162 Ill. App. 348; Hart Pioneer Nurseries Co. vs. Coryell, 8 Kan. App. 496; 55 Pac. 514; Schufeldt vs. Smith, 139 Mo. 367; 40 S. W. 887; Paxton vs. Bacon Mill & Mining Co., 2 Nev. 257; 3 Morrison Mining Rep. 512.

[6] Booth vs. Bunce, 33 N. Y. 139; 88 Am. Dec. 372.

[7] Thorpe vs. Pennock Merc. Co., 99 Minn. 22; 108 N. W. 940; 9 A. C. 229; Lamkin vs. Baldwin & Lamkin Mfg. Co., 72 Conn. 57; 43 Atl. 593-1042; 44 L. R. A. 786.

disappear. Holdings have been predicated upon the theory that the corporate entity would be overridden and the corporation and the partnership would be treated as the identical concern.[8]

§ 275. Where a Partnership Is Organized Into a Corporation, It Is Liable For the Debts of the Partnership Whether Expressly Assumed or Not

It may be hardly necessary to mention that where a partnership is organized into a corporation, or in other words, where the partnership is merely changed from the partnership form to body politic, that the corporation will be liable for the partnership debts whether they are expressly assumed or not.[9] However, some of the cases essay to make a distinction between cases where others join in the organization of a partnership into a corporation and where only the partners are parties participating therein.[10] It is thought, however, that this supposed distinction is perhaps too technical as it would seem equitable and just to apply the rule where the interests were substantially the same, and manifestly it was not the intent and purpose of the law that the rule could be defeated by associating a stranger into the partnership interest with only a negligible amount of the capital stock of the newly formed corporation.

§ 276. Where a Joint Adventure Is Organized Into a Corporation, the Corporation Will Be Held Liable For the Joint Adventurer's Debts

Where a joint adventure is brought into existence by the participating parties therein for the continuance of a certain

[8] Andres vs. Morgan, 62 Ohio State 236; 78 A. S. R. 712; 56 N. E. 875.

[9] Andres vs. Morgan, 62 Ohio State 236; 78 A. S. R. 712; 56 N. E. 875; DuVivier vs. Gallice, 149 Fed. 118; 80 C. C. A. 556.

[10] Paxton vs. Bacon Mill & Mining Co., 2 Nev. 257; 3 Morrison Mining Rep. 512; see sec. 236, supra.

line of business and they thereafter organize the joint adventure into a corporation, the same rule will be applied as in the case of a partnership being organized into a corporation and the corporation will be held responsible for the obligations of the joint adventure. In other words, where the facts warrant it and the corporation has succeeded a joint adventure, the court will brush aside the corporate form and consider the parties in their individual capacity.[11]

§ 277. Where an Insolvent Partnership or Jointly Owned Business Is Formed Into a Corporation, the Corporation Will Be Presumed to Have Assumed the Indebtedness

It is thought that the weight of authority may be said to hold that where copartners or joint owners of an insolvent going business, transform themselves into a corporation to which the joint property is transferred in exchange for shares of stock, there may be a presumption indulged that the corporation assumed the liabilities of the partnership or joint owners of the business.[12] The minority view is that there must be an express assumption by the corporation of such liability before it can be held.[13] There is a line of cases that occupies what may commonly be denominated middle ground and these hold to the view that the assumption of liability may be express or implied and that in many cases the mere fact of having received the assets of the partnership or other busi-

[11] Modlin vs. Licht, 224 App. Div. 614; 231 N. Y. S. 265; see sec. 241, 274, 275, supra, 288, infra.

[12] Ziemer vs. Bretting Mfg. Co., 147 Wis. 252; 133 N. W. 139; 142 Wis. 224; 125 N. W. 318; 1912D A. C. 1275; DuVivier vs. Gallice, 149 Fed. 118; 80 C. C. A. 556; Modern Dairy vs. Blanke, etc., Supply Co., 116 S. W. 153; Haslett vs. Wotherspoon, I Strobh Eq. 209; 20 S. C. Eq. 209; Andres vs. Morgan, 62 Ohio State 236; 56 N. E. 875; 78 A. S. R. 712; Texas Loan Agency vs. Hunter, 13 Tex. Civ. App. 402; 35 S. W. 399; York Manufacturing Co. vs. Brewster, 174 Fed. 566; 98 C. C. A. 348.

[13] Hart Pioneer Nurseries vs. Coryell, 8 Kans. App. 496; 55 Pac. 514; Austin vs. Tecumseh National Bank, 49 Neb. 412; 68 N. W. 628, 59 A. S. R. 543; 35 L. R. A. 444; Ziemer vs. Bretting Mfg. Co., supra.

ness and giving in payment stock and continuing the business, will raise an implication of assumption of the liability of the business thus received by the corporation.[14]

§ 278. An Insolvent Partnership Organizing Itself Into a Corporation, the Corporation Is Liable For the Obligations of Its Predecessor.

The rule is pretty well settled that where a partnership engaged in business in straightened and failing circumstances, is incorporated into a body politic and the assets and business of the partnership are transferred, conveyed or otherwise put in the corporation's name and they are appropriated to the corporate objects and purposes, all of which may fairly be said to result in a continuation of the former business, the corporation will be presumed to be liable for the obligations and liabilities of the partnership.[15]

§ 279. Presumption of Liability, Whether Rebuttable or Conclusive

There is some dissent among the cases as to whether the presumption attaching to a corporation having succeeded a partnership, and continued the same business of the partnership, having been formed by the members of the partnership subsequent to the incurring of the debt and having taken all of the property of the partnership, paying therefor in stock, is conclusively presumed to be liable for debts of the partnership. The weight of authority is undoubtedly that such presumption is of the dignity of conclusiveness.[16] It seems,

[14] Pratt vs. Oshkosh Match Co., 89 Wis. 406; 62 N. W. 84; Hall vs. Herter Bros., 83 Hun. 19; 31 N. Y. S. 692; 90 Hun. 280; 35 N. Y. S. 769; 157 N. Y. 694; 51 N. E. 1091; 64 N. Y. S. R. 378; 70 N. Y. S. R. 273; Ziemer vs. Bretting Mfg. Co., supra.

[15] Reed Bros. vs. First National Bank, 46 Neb. 168; 64 N. W. 701; Cunningham vs. Spencer, 111 Okla. 217; 239 Pac. 444; Modern Dairy vs. Blanke, etc., Supply Co., 116 S. W. Tex. 153; Leckie vs. Bennett, 160 Mo. App. 145; 141 S. W. 706.

[16] Reed Bros. vs. First National Bank, 46 Neb. 168; 64 N. W. 701; Campbell vs. Farmers & Merchants Bank, 49 Neb. 143; 68 N. W.

however, that a number of cases incline to the position that such presumption is of no greater force than going to make a *prima facie* case.[17] Of course, in such case, if the principle of law that when the facts and circumstances go to establish that the corporation is merely the continuation of the partnership is applicable, then there manifestly can be no further reason urged why the liability of the corporation should not be conclusively presumed, for if it is merely the form that has changed and the substance remains the same, then there can be no reason advanced why the mere change of form should in any degree alter the liability of the particular individuals that have incurred the liability. It is thought that the doctrine that the corporate entity would be disregarded by the court has been nurtured and fostered by the trust-fund doctrine and if this position be sound, and that the doctrine of the disregarding of the corporate entity in a proper case may draw upon the trust-fund doctrine for further aid, then certainly it would appear that a corporation having received the assets of the partnership would be held to have assumed the liability therewith and when this is made to appear it would seem that liability should conclusively follow.

§ 280. A Partnership That Has Received a Fraudulent Conveyance and Organizes Itself Into a Corporation, the Fraudulent Conveyance May Be Set Aside As Against the Corporation and the Corporation Held For the Full Value of the Property Received by Such Conveyance

Where a debtor transfers his property to a partnership in fraud of the rights of his creditors and such partnership is

344; Brum vs. Merchants Mutual Ins. Co., 16 Fed. 140; 4 Woods 156; Slatterey vs. St. L. & N. O. Transportation Co., 91 Mo. 217; 4 S. W. 79; 60 A. R. 245; Hibernia Ins. Co. vs. St. Louis & New Orleans Transportation Co., 13 Fed. 516; 4 McCrary 442; Leckie vs. Bennett, 160 Mo. App. 145; 141 S. W. 706.

[17] Modern Dairy vs. Blanke, etc., Supply Co., 116 S. W. (Tex.) 153; Cunningham vs. Spencer, 111 Okla. 217; 239 Pac. 444.

thereafter transformed into a corporation and the property transferred to the corporation and the debtor who has so transferred his property in fraud of his creditors is, in four months after such transfer, adjudged a bankrupt, the trustee in bankruptcy may set aside such fraudulent conveyances as against the corporation and hold the corporation for the full value of the property that its predecessor partnership received from such debtor.[18] This is an application of the doctrine that the courts will override and entirely dissipate a corporate entity if such juristic fictional creation is interposed to prevent the court from administering full justice.

§ 281. Where a Corporation Succeeds a Partnership and Is Composed of the Members Thereof and Takes Negotiable Securities Payable to the Partnership, It Cannot Be an Innocent Purchaser For Value

Where a partnership organizes itself into a corporation composed largely of the same parties as those who were members of the partnership, and in the transaction negotiable instruments are endorsed to such corporation by the partnership, the corporation cannot maintain the position that it is an innocent purchaser for value in due course of trade of such securities. The same defenses and offsets that might be interposed and set up against the partnership will be available as against its successor, the corporation.[19]

§ 282. Three Parties Forming a Partnership and Agreeing to Thereafter Incorporate and Hold the Interest in the Corporation in the Same Proportion As the Partnership Will Be Subject to the Same Proportionate Liabilities

Where three parties form a partnership and agree to there-

[18] Holloway and McRaney vs. Brame, 83 Miss. 335; 36 Southern 1.
[19] McElwee Mfg. Co. vs. Trowbridge, 62 Hun. 471; 17 N. Y. S. 3; 43 N. Y. S. 238; see sec. 98, supra.

after convert the same into a corporation at the time of forming a partnership, and which was thereafter transformed into a corporation, such corporation would have the power to assess the stock, the stockholders owning in the corporation in the same proportion as their interest in the partnership upon the same basis as the partnership interests were, to liquidate the partnership indebtedness.[20] This is but a further illustration that where the facts warrant it, the courts will override a corporate entity and deal with the individuals composing that corporation in as full and as ample a manner as if the entity did not obtrude itself in the case at all.

§ 283. Corporation Having Taken Over the Assets of Partnership and Expressly Assumed Liabilities, Substituting Its Note For That of the Partnership, Such Note Is Supported by Sufficient Consideration

Where a corporation takes over and succeeds to the assets and business of a partnership and contractually assumes the liabilities of such partnership and thereafter renews the note of the partnership given for the partnership's obligation and signs the same in place of such partnership, such renewal note is supported by a sufficient consideration and the corporation will not be permitted to interpose the defense of lack of consideration or the defense of *ultra vires*.[21]

§ 284. Where a Partnership Is Engaged in the Loan Business and Has Charged Usury and Is Organized Into a Corporation, the Corporation Will Be Liable For Such Usurious Conduct

A partnership engaged in the loan business and in the course of the practice of its business violates the law

[20] Hennessy vs. Griggs, 44 N. W. 1010; 1 N. D. 52; see secs. 296, 297, infra.

[21] Johnson vs. Johnson Bros., 108 Me. 272; 80 Atl. 741; 1913A A. C. 1303; Baldwin vs. Devereux School, 154 Atl. (Pa.) 21.

against usury and is subject to an action by reason thereof, and thereafter transforms itself into a corporation, which corporation is composed of substantially the same members as composed the partnership, such corporation will be held liable for the usurious conduct of its predecessor partnership.[22] This case is easily sustained by an application of the doctrine that where a partnership and a corporation are in truth and in fact one, that they will be so regarded and so held before the courts and that the corporate entity will not be permitted to be injected into the case for the purpose of shielding the partnership, having merely changed the form under which they transact their business, the substance remaining the same.

§ 285. Where a Partnership and Another Enter Into an Agreement Providing For Sharing of the Fruits of the Agreement 90% to Partnership and 10% to the Individual, and Partnership Is Thereafter Organized Into a Corporation, It Will Be Liable Upon Such Agreement

An individual and a partnership entered into a contract, by the terms of which the partnership was to be formed into a corporation and then develop certain properties, that the individual was to have 10% of the gains for thus developing the property by rendering certain services therein. Then the partnership was organized into a corporation and the members of the partnership controlling its affairs were its officers and the substantial owners of the corporation. Under such circumstances the corporation, being the beneficiary of such contract, will be held to have taken the profits *cum onere*, the liabilities attendant upon the reaping of the fruits of the contract and will be held liable to such individual for his 10% of the profits arising by operation under the

[22] Texas Loan Agency vs. Hunter, 13 Tex. Civ. App. 402; 35 S. W. 399.

contract.[23] The case cited in the footnote simply holds that a corporation may be bound by a contract that is made in its behalf before it is brought into existence. This conclusion can only be reached by overriding the corporate entity, and that is what the court did.

§ 286. A Corporation Organized Out of a Partnership Is Subject to Estoppel That Is Operative As Against the Partnership

Where a corporation is the successor of a copartnership, the members of the partnership owning a controlling interest in the corporation and such partnership was subject to estoppel, the corporation succeeding to its interest will likewise be subjected to the estoppel that was effective and operative against the copartnership. In other words, the copartnership could not by the simple process of transforming itself into a corporate entity, obviate the effect of the estoppel that would have operated against it clearly had its form remained that of a partnership.[24] Undoubtedly, the principle announced by the case cited in the footnote of this section would find application and would be given operation to the same extent where a corporation had succeeded another corporation by consolidation, reorganization, merger, and the like, as in the case where the predecessor in interest was a partnership, and no reason is perceived why this principle would not operate in the case where an individual had organized himself into a corporation and such individual was subject to an estoppel, that the estoppel would likewise operate against the corporation he created. In short, the doctrine of estoppel may not be stayed by the interposition of the corporate fiction, where it would properly operate as to the individual that is behind that corporate fiction and controlling the same.

[23] New England Oil Refining Co. vs. Wiltsee, 3 Fed. (2d) 424.
[24] Dudlo Mfg. Co. vs. Varley Duplex Magnet Co., 253 Fed. 745; 165 C. C. A. 339; see secs. 323, 392, infra.

§ 287. A Partnership Acting As Agent For a Mortgage Concern Which Partnership Is Organized Into a Corporation, the Corporation Cannot Recover For Services Which Under the Contract the Partnership Had Rendered to the Principal Gratitiously

Where a partnership had a contract with and was acting as agent for a mortgage concern, which concern was engaged in the business of making farm loans, and such partnership made an agreement with the mortgage concern to collect such loans without charge, the partnership was organized into a corporation and the corporation was composed and officered by the members of the partnership; the corporation succeeded to the business of the partnership and the succeeding corporation assumed the balance due from the partnership to the mortgage concern on an account, existing at that time, and the corporation continued the business during the remainder of the contractual period; without a further or different agreement, it collected money, foreclosed numerous mortgages, for all of which it made no charge as the partnership had theretofore done. Under such circumstances the corporation will not be permitted to make charges for services in addition to those that were charged for by the partnership under the agreement.[25] It is true that the court predicated its decision in the case cited in the footnote largely upon estoppel, but it is equally true that by giving expression to the principle that the courts will disregard corporate entity, when the facts warrant it and justice requires it, others would have reached the same conclusion as this court did upon the basis of estoppel.

§ 288. Massachusetts Trust, Joint Stock Company, or Association Converted Into a Corporation, the Corporation Is Liable For the Association's Obligations

A voluntary association engaged in the business of life in-

[25] No. Am. Loan & Trust Co. vs. Colonial Trust & Mortgage Co., 53 Fed. 796; 76 Fed. 623; 26 C. C. A. 88.

surance was, through and by the efforts of its controlling directors, converted into a corporation but without any appreciable change taking place in the manner and conduct of the business, there being nothing to show that it had abandoned its voluntary character and assumed the form of a jural personality; the officers, members, names, seal, by-laws, and constitution were all appropriated by the corporation and used in the further prosecution of the business; all of the funds, books, records, and other assets were likewise taken over by the corporation; under these facts the corporation will be held liable for the obligations of the association. When the corporation was called upon to respond as being liable for the obligations of the association, the corporation essayed to escape liability by reason of it having not been in existence at the time the liability arose. This position was held untenable by the court as contrary to equity, fair dealing and good conscience and was not a defense that might be sustained unless the strict rules of law clearly allowed it.[26]

It may be stated as a general proposition that a Massachusetts or common-law trust or an association that is by its members converted into a corporation and then the corporation takes all of the property of such association and continues the prosecution of the business thereafter, that such corporation will be liable for the debts and obligations of its predecessor.[27]

§ 289. Member of a Partnership and a Creditor Thereof Organizing the Partnership Into a Corporation, It Will Be Liable For the Debts of the Partnership

Where a partnership is engaged in business and has approximately assets of one-third of the full value of its aggre-

[26] Chicago City Railway Employees Mutual Aid Ass'n vs. Hogan, 124 Ill. App. 447.

[27] Haslett vs. Wotherspoon, 1 Strobh Eq. 209; 20 Sc. Eq. 209; Thorn vs. Volunteer St. Gregory Hospital, 59 Misc. Rep. 442; 110 N. Y. S. 931; Cattle Raisers Loan Co. vs. Sutton; 271 S. W. (Tex.) 233; see secs. 241, 276, supra.

gate indebtedness, a member of the partnership combining with one of the creditors of such partnership and organizing the business into a corporation, to which the assets of the corporation are transferred, the creditor and the member of the partnership resorted to the subterfuge of giving to such creditor a check for the amount of the creditor's account and which creditor, in lieu thereof and at the same time, gave to the corporation his check for the same amount in the liquidation of a half interest in the corporation; under such circumstances the corporation will be held responsible to creditors for their claims. In addition to the fact that the courts will in such cases override the corporate entity and will deal with the individuals as such—considering substance and ignoring form—such transaction amounts to a fraud upon the other non-participating creditors.[28]

§ 290. Where a Husband and Wife Are Engaged in Business and Transform the Business Into a Corporation, Such Corporation Will Be Liable For the Former Obligations of the Business

Where incorporators of legal entity are themselves an *alter ego* of the corporation and are the sole owners of the capital stock and exclusive managers and directors of the policies of the corporation—in other words where they are the corporation—and having been thus converted into such corporation from a partnership, or in a case where a husband and wife are conducting the business and they are substantially the corporation, that showing will be sufficient to call for a disregarding of the corporate entity and treating such parties as partners and holding such parties and the corporation all alike liable for the obligations of the business.[29] It may be stated generally that a corporation may not be formed for the purpose of perpetrating a fraud or other illegal act under the

[28] Colorado Trade and Transfer Co. vs. Acres Commission Co., 18 Colo. App. 253; 70 Pac. 954.

[29] Rice vs. Sanger Bros., 27 Ariz. 15; 229 Pac. 397.

guise of the fiction that a corporation is a legal entity separate and distinct from its members, and when this is attempted, the separate existence of corporation will be disregarded by the courts and the acts of the real parties dealt with as though no corporation had been attempted to be created.

§ 291. Where Practically the Sole Owner of a Corporation Makes a Contract With Another Party That the Other Party Shall Receive a Percentage of the Profits Arising From a Corporate Enterprise in Excess of 6% on Capital Stock, Such Other Party Being an Employee, This Arrangement Amounts to a Partnership Between the Corporation or Its Principal Stockholder and Such Employee

A corporation that is practically a one-man corporation and the principal stockholder makes an agreement with an employee that for the employee's efforts in the prosecution of the corporate business, the employee shall receive a certain percent of the profits in excess of 6% of the coporate stock, such arrangement creates a quasi partnership between the stockholder and the employee and neither the corporation nor its stockholder may escape the liability created by such contract. The stockholder will not be permitted to interpose through and by means of his *alter ego*, the corporation, a defense of *ultra vires*.[80]

§ 292. A Partnership Owning Substantially All of the Stock in a Corporation, the Corporation and Partnership Will Be Treated As One

A partnership engaged in business and in the course of the conduct of its business, acquired substantially all of the stock of a corporation, of which the partners were officers and directors and managed the business of the corporation.

[80] Gamer Paper Co. vs. Tuscany, 264 S. W. (Tex.) 132; see secs. 285, supra, 297, 298, infra.

Under such circumstances the corporation will be treated merely as an agency of the partnership and upon adjudication in bankruptcy of the partnership, the trustee will be entitled to receive the properties of the corporation and administer the same in the partnership bankruptcy. The fiction of legal corporate entity will not be allowed to be applied in such a manner as to work fraud upon the rights of the partnership creditors, or hinder or delay them in the collection of their claims. Neither can the fictional corporate concept be interposed to defeat the manifest intent of the bankruptcy act.[31]

§ 293. In Order to Hold a Corporation Created Out of a Partnership, Something More Must Appear Than Receiving a Portion of the Partnership Assets

It will not suffice to hold a corporation supposed to have been organized out of a partnership to merely show that it received some assets from the partnership. Something more than that must appear.[32] So in a case where it appeared that a corporation was organized with substantially the same name as that of the partnership and the only other evidence being introduced to give rise to the presumption of assumption on the part of the corporation of the liability of the partnership was the introduction of a deed to certain real property in another state, which deed purported to convey all of the partnership property. No evidence was adduced showing the transfer of any personal property whatever. It did appear, however, that the corporation was substantially owned by the partnership members and totally owned by the members of such partnership and their families.[33] It is thought, however, that the court proceeded upon an erroneous hypothesis, for if it is made to appear that the corporation is for all practical purposes a mere continuance of the partner-

[31] In re Rieger, Kapner & Altmark, 157 Fed. 609; see sec. 265, supra.
[32] Swing vs. Taylor & Crate, 68 W. Va. 621; 70 S. E. 373; see secs. 159, 184, supra; Campbell vs. Farmers & Merchants Bank, 49 Neb. 143; 68 N. W. 344.
[33] Swing vs. Taylor & Crate, supra.

ship and sufficient facts are brought to the attention of the court as to move it to disregard the fictional creation of the corporation, then it would seem immaterial whether it received all of the property of the partnership or only a portion. If the partnership is in fact the corporation then there is no more reason for allowing the partnership to escape liability in its corporate form than there would be to free a man for his obligations if he should resort to legal proceedings to change his name, the obligations having been created prior to the change, or to deny recovery against a married woman who had contracted in her maiden name prior to marriage. It seems hard for some courts to break the gyves that have been inherited from other times, that were unfounded in reason and cannot be justified on principle. Many cases may be found that are excellent examples of the courts continuing to travel the "calf path."[34]

[34] For Calf Path Poem see Judge Scott's dissenting opinion, Van Kleeck vs. Ramer, 62 Colo. 4; 156 Pac. 1108.

CHAPTER XV

SIMILARITY BETWEEN CORPORATION AND PARTNERSHIP AND STOCKHOLDERS AS PARTNERS INTER SE

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§ 294. Corporation Likened Unto a Partnership

A corporation is somewhat like a partnership, if it were possible, to do the business of a partnership wholly through agents were the copartners empowered to appoint the agents but not liable for their acts. It cannot be gainsaid that the power to manage the corporate affairs resides in the directorate who are agents of this corporation, but these agents are appointed by the stockholders and in modern times frequently the stockholders override the agency.[1] The original idea that brought forth the corporate entity was to invite a combination of capital to properly handle gigantic enterprises that were too huge for the undertaking of a single individual and in order to combine and amass idle capital in the process of such enterprises, it was necessary to vouchsafe to the contributor of that capital a freedom from obligations of the corporation. There may have been many investors who would readily hazard the loss of their initial investment and yet who would hesitate to do that and besides assume liability for a large amount of obligations for the corporation, as is true in the case of partnerships. This is especially true where the stockholder has but little voice in the management of the affairs of the company. The corporate idea grew rapidly until in time the courts refused to look behind the fictional personality in the form of the corporate entity even though there was but a single stockholder behind it. This was a misapprehension of the original corporate theory and is one that has in innumerable cases lent itself to the perpetration of fraud and has led to unjust results, but in modern times the courts more

[1] Stokes vs. Continental Trust Co., 99 App. Div. 377; 91 N. Y. S. 239; 186 N. Y. 285; 78 N. E. 1090; 12 L. R. A. N. S. 969; 9 A. C. 738; see sec. 253, supra.

and more liken corporations unto partnerships and fix liability where it properly belongs, deny and refuse to be hampered by the corporate entity theory that was never anything but a fiction from the remotest times. According to the great weight of modern authority, untechnically speaking, ownership of stock in a corporation creates the relationship of a partnership among the stockholders. That is to say that when the substance of the situation is regarded and the technical form is ignored, the stockholders and their relationship *inter se*, are very similar to that of partners.[2] Indeed there is much authority for the proposition that, under our law a partnership or joint stock company is just as distinct and palpable an entity in the idea of the law, as distinguished from the individuals composing it as a corporation.[3] When this much is assumed, that is the separateness of the partnership from its members, the line of demarcation between the corporation and the partnership becomes indeed shadowy and hazy, if not entirely obliterated. It seems in bankruptcy proceedings the entity of a partnership is recognized to as full an extent as the corporateness of the body politic.[4]

§ 295. Corporation Organized Out of a Solvent Partnership Which Corporation Thereafter Became Insolvent, Holder of a Corporate Note For Firm Debt Entitled to Share in the Distribution of the Corporate Assets

Where a corporation is organized to take over and continue the business of a partnership—in other words, is or-

[2] Barrett vs. King, 181 Mass. 476; 63 N. E. 934; Merchants National Bank vs. Wehrman, 202 U. S. 295; 50 L. Ed. 1036; 26 S. Ct. 613; Rev. 69 Ohio St. 160; 68 N. E. 1004; Bauernschmidt vs. Bauernschmidt, 101 Md. 148; 60 Atl. 437; see also sec. 6, supra.

[3] Some Judicial Myths, 22 Har. Law Rev. 393, 394, 396. The Firm as a legal person, 57 Cent. L. J. 343. The separate estates of nonbankrupt partners, 20 Har. Law Rev. 589. Dissenting opinion of Justice Brandeis in Eisner vs. Macomber, 252 U. S. 189; 40 S. Ct. 189; 64 L. Ed. 521; 9 A. L. R. 1570.

[4] In re Sugar Valley Gin Co., 292 Fed. 508; 4 Am. Bankr. Rep. N. S. 140; Titus vs. Maxwell, 281 Fed. 433; 49 Am. Bankr. Rep. 156; see also Black on Bankruptcy (4th Ed.) 204.

ganized out of the partnership and in the transaction—the corporation acquires the partnership assets and assumes itself liable and at the time of such assumption the partnership was solvent and the corporation continued to be in a state of solvency for some time thereafter but ultimately being adjudged a bankrupt, the holder of the note executed by the corporation for a partnership debt prior to the organization of the corporation will not be debarred from sharing in the distribution of the corporate assets in a bankruptcy court.[5]

§ 296. A Partnership Composed of Two Members Organizing a Corporation Holding Company, the Partners Being the Stockholders, As to Each Other and the Corporate Interest, the Partners Will Be Treated As Such

A partnership composed of two members organizing a corporation for the purpose of holding certain interests, the partners being the stockholders thereof as between themselves and in dealing with the corporate affairs, the partners in so far as the corporate entity is concerned will be treated as partners.[6] This is but another illustration of the doctrine that where the facts require it, in the interest of justice, the courts will override and ignore the corporate entity of a corporation and deal with the individuals as they are.

§ 297. The Modern Rule Is, and the One That Is Supported by the Greater Weight of Authority, That Corporators and Stockholders Inter Se May Be Treated As Partners

While not technically speaking but yet substantially and for the purpose of furthering the ends of justice, stockholders *inter se* will be treated as partners.[7] On the other hand it is

[5] In re A. G. Crosby Co., 199 Fed. 344.
[6] Monmouth Investment Co. vs. Means, 151 Fed. 159; 80 C. C. A. 527.
[7] Shorb vs. Beaudry, 56 Cal. 446; Chater vs. S. F. & S. R. Co., 19 Cal.

generally true that public policy will not permit a copartnership to do business in the guise of a corporation nor allow the partners to be incorporated as to the rest of the world while as between or among themselves the enterprise is conducted in the corporate form but is in fact a joint venture. Aside and apart from what has been stated, the rule is that where the vendor and vendee of a mine agreed that the vendee should convey the mine to a corporation to be formed and that the vendor should receive a part of the stock of such corporation in payment of the price of the mine, the corporation was formed and the conveyance was made but the stock was not issued, they will be treated substantially as *partners. In such cases where it appears that the corporation* was formed as a mere agency for the more convenient carrying out of the agreement between the parties, it will be held likewise to create a partnership relation between the stockholders.[8] An agreement made by persons interested in contemplation of incorporation, where the interest of others are not affected, control the conduct of the corporate affairs and the corporate fiction may be ignored, if necessary, for the purpose of treating the stockholders as partners and enforce the contractual relationship between or among them. The same rule prevails where one of the partners is guilty of fraud or bad faith in organization of the partnership into a corporation, and under such circumstances the partnership agreement continues to be in force and measures the rights of the partners in the corporation.[9] It perhaps may be stated as a general rule that among stockholders, when there are no creditors, equity and good conscience demanding it, they will

219; Cornell vs. Corbin, 64 Cal. 197; 30 Pac. 629; Hunt vs. Davis, 135 Cal. 31; 66 Pac. 957.

[8] Cornell vs. Corbin, supra; Sun River Stock & Land Co. vs. Montana Trust & Savings Bank, 262 Pac. 1039; 81 Mont. 222; Seitz vs. Michel, 148 Minn. 80; 181 N. W. 102; 12 A. L. R. 1060. The doctrine of the cases, Sun River Stock & Land Co. vs. Montana Trust & Savings Bank, supra; and Seitz vs. Michel, supra, is derived from Jackson vs. Hooper, infra, n. 11. Occasion is taken to critically analyze that case in sec. 298, *infra*.

[9] Scott vs. Prescott, 69 Mont. 540; 223 Pac. 490. See sec. 449, *infra*; Conover vs. Smith, 256 Pac. 835, 83 Cal. App. 227.

be treated as partners.[10] It seems that the doctrine discussed in this section first found sanction at the hands of the Supreme Court of California and it might well be denominated the "California doctrine" so as to distinguish it from the rule followed in some other states and particularly New Jersey. It must be conceded from a candid and impartial investigation of the subject that the California doctrine that stockholders of a corporation, in the absence of the interest of creditors or other third parties, will be treated substantially as partners is more in consonance with the modern rule, that the corporate entity will never be permitted to bar out the truth, to hold the stockholders of a corporation as partners between or among themselves, is but another application of the now familiar rule that the corporate entity will be disregarded in the interest of justice.

§ 298. In Some States the Courts Will Not Override Corporate Entity and Deal With the Stockholders As Partners Even Among Themselves and in the Absence of Creditors

The courts of some states do not feel themselves equal to the occasion that is necessary to take a forward step and override the corporate entity even though the corporation is com-

[10] Kamow vs. Simplex Cloth Cutting Machine Co., 109 Misc. Rep. 358; 179 N. Y. S. 682; Oscarson vs. Norton, 39 Fed. (2d) 610; Goss vs. Goss, 147 App. Div. 698; 132 N. Y. S. 76; 207 N. Y. 742; 101 N. E. 1099; Carney vs. Penn. Realty Co., 174 App. Div. 86; 159 N. Y. S. 273; Davis Improved Wrought Iron Wagon Wheel Company vs. Davis Wrought Iron Wagon Company, 20 Fed. 699; Boothe vs. Summit Coal Mining Co., 55 Wash. 167; 19 A. C. 1255; 104 Pac. 207; Commercial Security Co. vs. Modesto Drug Co., 184 Pac. 964; 43 Cal. App. 162; see sec. 282, supra; Tomkins vs. Miller Tomkins Co., 207 App. Div. 819; 201 N. Y. S. 392; Thomashefsky vs. Edelstein, 192 App. Div. 368; 182 N. Y. S. 707; in re Auditore's Adm'rs, 223 App. Div. 654; 229 N. Y. S. 414; 215 App. Div. 277; 213 N. Y. S. 463; Cleveland Cliffs Iron Co. vs. Artic Iron Co., 261 Fed. 15; 171 C. C. A. 611; 248 U. S. 178; 39 S. Ct. 91; 63 L. Ed. 198; 251 U. S. 558; 40 S. Ct. 179; 64 L. Ed. 413; Gallagher vs. Perot, 112 Misc. Rept. 717; 183 N. Y. S. 257; 200 App. Div. 867; 191 N. Y. S. 926.

posed of but two persons and they are substantially partners in the business.[11] The doctrine discussed in this text was advanced by the courts of the State of New Jersey and might properly be called the "New Jersey doctrine," but it is thought to be a doctrine that can never claim the privilege of longevity. It is so manifestly unsound that it is surprising that it should have found application, sanction and approval in any court beyond the borders of the state of its origin.

§ 299. California Doctrine Applied, Stockholders Treated As Partners

The California courts have so far developed the doctrine that in proper cases the courts will disregard the corporate entity and especially in the consideration of stockholders as partners, that it has been held that where a corporation is owned by two individuals, that one of them making a contract manifestly in the furtherance of the corporate business and enterprise, but not in harmony with the by-laws of the corporation, yet the corporation is bound thereby.[12]

§ 300. Where the Stockholders of a Corporation Were Largely the Same Family and It Was a Sort of a Family Affair, the Stockholders Will Be Treated As Partners

Where the stock of a corporation is largely owned within a family and there is an agreement as to distribution of dividends, earnings and profits, and stockholders will be treated

[11] Jackson vs. Hooper, 76 N. J. Eq. 592; 75 Atl. 568; 27 L. R. A. N. S. 658; Einstein vs. Rosenfeld, 38 N. J. Eq. 309; Nannizzi vs. Caprile, 43 Cal. App. 498; 185 Pac. 673. It should be said, however, that the last case does not in fact hold contrary to the California rule but there is merely some language employed that possibly indicates a leaning in that direction on the part of the court but this case was decided by the court of appeals and does not appear to have been sanctioned and approved by the Supreme Court. Boag vs. Thompson, 208 App. Div. 132; 203 N. Y. S. 395; Berger vs. Eichler, 211 App. Div. 479; 207 N. Y. S. 147. The court in the last cited case takes the position that where the relationship existing as that of a corporation, a partnership relation cannot exist. It seems that this doctrine is wholly untenable. Sun River Stock & Land

substantially as partners and the agreement enforced, even though there might be some stock outstanding in another.[13]

§ 301. Two Persons Owning a Corporation May Agree Between Themselves As to Salary

Where two persons own and are substantially a corporation they may agree between themselves without formal corporate action or without having any corporate meeting, as to the salaries that each shall draw from the business and such action on the part of the owners is binding upon the corporation.[14]

§ 302. Corporate Entity Disregarded, Recovery Allowed on Contract of Employment Where a Partnership Owns Three Corporations

The rule that the court will in a proper case disregard the corporate entity and deal with the individuals composing the juristic personality has found application in a case where a partnership owns three corporations and one of them had entered into a contract of employment, the corporate entity and partnership are treated as the same.[15]

§ 303. Surviving Partner May Not Execute Lease and Bills of Sale to Partnership Property to a Corporation That Is His Alter Ego

In application of the principle that the courts will disregard

Co. vs. Montana Trust & Savings Bank, 81 Mont. 222; 262 Pac. 1039. In this case the court went out of its way to cling to the archaic position that a corporate entity might stalk through the halls of justice and all who should sight it or hear its footsteps should flee. Seitz vs. Michel, 148 Minn. 80; 181 N. W. 102; 12 A. L. R. 1060.

[13] Commercial Security Company vs. Modesto Drug Co., 184 Pac. 964; 43 Cal. App. 162.

[14] Groh vs. Groh, 80 App. Div. 85; 80 N. Y. S. 438; but see 177 N. Y. 8; 68 N. E. 992; see however, sec. 80, supra.

[15] Hyman vs. Karl Stern Co., 47 Cal. App. 605; 191 Pac. 47; 61 Cal. App. 672; 215 Pac. 913.

[15] Offeman vs. Robertson Cole Studios, 80 Cal. App. 1; 251 Pac. 830.

corporate form when justice requires them to do so, to look to the substance and not to the shadow of a corporate organization, the court will, at the instance of receiver of a partnership appointed after the death of one of two partners, cancel a bill of sale and lease of the partnership property executed by such surviving partner to a corporation, which corporation was virtually the surviving partner in a corporate form. The corporation stock was practically all owned by him and was dominated and controlled by the surviving partner.[16]

§ 304. Corporation Organized Out of a Partnership, Liable on a Lumber Contract Entered Into by Partners, Even Though Others Interested in Corporation

A partnership entered into a contract for the purchase of lumber and which partnership by a concurrence of the acts of the partners was converted into a corporation after the entering into of the lumber contract, the corporation is nevertheless bound on such contract, the corporation having taken over the partnership assets and paid therefore principally in stock.[17] The rule seems to be recognized that when a partnership is converted into a body politic that it will be held liable upon the contracts of the former partnership, and it likewise acquires all rights of such partnership, and for it to succeed to contractual rights of such partnership, no conveyances or assignments of such contracts are necessary to vest the corporation with rights thereunder, but the converting of such partnership *ipso facto* confers on it the rights arising under partnership contracts.[18]

[16] Mosher vs. Lee, 261 Pac. 35; 32 Ariz. 560; 29 Ariz. 267; 240 Pac. 1027; contra, National Union Bank of Maryland vs. Hollingsworth, 47 S. E. 618; 135 N. C. 556. However, the National Union Bank of Maryland vs. Hollingsworth, upon a careful analysis is so manifestly illogically constructed that it is hardly needless to say that it maintained a contrary opposition in the light of modern adjudications dealing with corporate entities and kindred subjects.

[17] Pratt vs. Oshkosh Match Co., 89 Wis. 406; 62 N. W. 84.

[18] Fisher vs. Berg, 290 Pac. 985; Pratt vs. Oshkosh Match Co., supra.

§ 305. Partners Enter Into a Contract to Pay Royalties Upon Patented Article Thereafter Incorporated, Such Corporation Will Be Liable Upon Such Contract and Plea of Statute of Frauds Will Not Avail

A partnership having entered into a contract to pay royalties upon patented articles to be manufactured by such partnership and, under such agreement, obtained issuance of patent to the partnership; thereafter the partnership, under the same name and composed of the same persons as the partnership, was converted or transformed into a corporate entity and the corporate entity was sued upon such partnership contract and a recovery was allowed.[19]

§ 306. It Seems in New Jersey the Courts Are Reluctant to Discard the Corporate Entity Theory and Adopt the Modern Doctrine

In New Jersey where a member of a firm agreed if a party would take stock of a certain amount in a corporation that the partnership was then being organized into, that the corporation would employ such stockholder and the corporation being thereafter formed, the stockholder complied with his part of the agreement entered into by a member of the firm and on its behalf, but the corporation refused to employ him, the court held that the interposition of the defense of the corporate entity was sufficient to defeat recovery.[20] It is difficult to see upon what theory, in view of the well defined doctrine generally prevailing in modern times, that where a partnership organizes itself into a corporation, the corporation will be bound for the contractual obligations, that the court held that the corporation was not bound upon the contract of employment. It is readily seen that the partnership

[19] Bommer vs. The American Spirel Springs Butt Hinge Mfg. Co., 81 N. Y. 468.

[20] Brautigam vs. Dean & Co., 85 N. J. Law 549; 89 Atl. 760; 86 N. J. L. 676; 92 Atl. 344. However, it should be said to the credit of the court that they did allow the stockholder to rescind his contract as upon failure of consideration.

would be bound thereby. Then, if the partnership is bound thereby and the corporation is merely the partnership in another form, certainly the decision holding the corporation not liable for the contractual obligations of the partnership cannot be said to be sound.

§ 307. Corporation Taking All the Assets of a Partnership Liable to Income Tax Owing by the Partnership and Property Subject to Lien

When a corporation takes over the entire assets of the partnership for no consideration save its own corporate stock and with no provision for the payment of partnership debts, the partnership in effect becoming incorporated, the presumption that the corporation assumed the partnership debts may be resorted to to hold it and besides where the partnership owes income tax, the assets of the partnership passing to the corporation, under such circumstances will be burdened with the income tax lien in favor of the United States Government or the government may resort to the position that the corporation has impliedly assumed the partnership's obligations.[21]

[21] In re Glover McConnell Company, 9 Fed. (2d) 683.

CHAPTER XVI

SUFFICIENT GROUNDS FOR DISREGARD OF CORPORATE ENTITY

CONTENTS

Section

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311. When one corporation owns stock in another to dominate and control it, corporate entity will be ignored.
312. One corporation wholly under control of another, separate entity will not relieve latter from liability.
313. Mere ownership of stock alone is not enough to fix liability on stockholder for corporate acts, but stock ownership together with control sufficient.
314. If corporations are practically identical, coupled with the control, warrants court in disregarding of entities.
315. Corporate entity not permitted to stand in the way of the enforcement of lien in admiralty court.
316. Where the difference between two corporations is reduced to a matter of bookkeeping, the corporate entities ignored.
317. Corporate entities ignored to allow offset between parent corporation and creditors of subsidiary.
318. Neither a corporation nor its receiver can avoid on behalf of corporation endorsement of negotiable paper by sole stockholder.
319. A corporation that is so controlled and conducted as to make it a mere agency or instrumentality of another, separate existences ignored.
320. If relations between two corporations are so interwoven and so intimate as to easily facilitate commission of fraud, entities disregarded.
321. Where the majority stockholder causes the assets to be transferred to a new corporation owned and controlled by him, such new corporation will be held liable to the minority stockholders of the old.

322. The rule that corporate entities will be disregarded in proper case is not affected by the fact whether one or more owns the stock of the corporation.

323. General rule is that if the stockholders of a corporation are estopped, the corporation will be estopped and *vice versa*.

323a. Defense good against stockholders, were they parties to the action available as against corporation.

323b. *Res adjudicata* and disregard of the corporate fiction.

324. Where a corporation is a dummy, the stockholders' acts are its acts.

325. Rule seems to be that where a corporation is a mere dummy behind which the stockholders are hidden, their liability would be measured by that of the dummy as if it were *bona fide*.

326. The ultimate determination of corporate affairs rests with stockholders.

327. All the stockholders entering into a contract manifestly for the benefit of the corporation, it will bind the corporation though not a party by name thereto.

328. Directors representing entire corporate stock may issue bonds even though they do not do it in accord with articles.

329. A corporation allowing its officers to exercise its functions, will be bound by their acts.

330. Directors owning all of the stock of a corporation, their separate action binds the corporation.

331. Manager of a corporation organizing a new corporation, and such new corporation accepting the profits of a contract with the old, the new corporation will be liable thereon.

332. One owning substantially all of the stock of a corporation, whose acts are acquiesced in by the directors, the corporation will be liable therefor.

333. Directors owning all of the stock of a corporation, are not within the rule prohibiting persons in fiduciary capacity from contracting for their benefit.

334. Directors acting in accordance with desires of stockholders, form of action immaterial in absence of creditors.

335. If by brushing aside corporate entities it appears that the substantial intent of the parties was to bind the corporation, the form of the transaction is immaterial.

336. Originally contracts could be made only in the name of the corporation, but it is now settled that a contract for corporate purposes in the name of its officers is a corporate contract.

337. Corporate entity will be disregarded to defeat the defense of *ultra vires* where stockholders knew of the act that such defenses urged against.

338. The corporate entity will not be allowed to stand in the way of showing that the corporation's property was burned by the stockholders and that such burning is a defense by insurer in an action on the policy.

339. Where the pledgee of the corporate stock burns the corporate property, the corporation may not recover the insurance thereon.

340. It seems that the mere pledging of substantially all of the assets of one corporation to another is not enough to invoke the rule of disregarding the corporate entity.

341. Corporation taking conveyance from its stockholders, who are its directors and promoters, takes such subject to equities against the grantors.

342. Corporate entity disregarded to prevent recovery on gambling transaction.

343. Where a corporation is formed in the contemplation of the carrying out of an agreement, the corporate entity will be ignored.

§ 308. A Corporation May Not Be Organized For the Purpose of Conferring Jurisdiction Upon the Courts of the United States

Perhaps the earliest case in this country dealing with the question of when the courts would go behind the fiction of corporate entities and discover the real parties in interest is the Bank of the United States vs. Deveaux.[1] In that case it was determined that the capacity of a corporation to sue in federal court depended upon the citizenship of its members, but that position has long been abandoned in the federal courts in so far as jurisdictional questions are concerned.[2] But the same doctrine that the courts will regard the individuals composing the corporation, and not be bound by the bare existence of the corporate entity, has been applied in recent years to determine the question of diversity of citizenship and the resultant effect of such determination as to whether or not the federal courts had jurisdiction and it is now gen-

[1] 5 Cranch 61; 3 L. Ed. 38.

[2] National Park Bank vs. Nichols, 4 Biss 315; Fed. Cas. 10048; Marshall vs. Baltimore & Ohio Railroad Co., 16 How. 314; 14 L. Ed. 953; see sec. 40, supra.

erally laid down as a doctrine prevailing in the federal courts that a corporation organized for the purpose of conferring jurisdiction upon the federal courts, its entity will be ignored and the parties litigant treated in their individual capacity. So where a corporation existing under the laws of California reincorporated under the laws of Nevada for the purpose of making it possible to have adjudicated a question by the federal tribunal in California, relief by the court will be denied for the lack of diversity of citizenship where the stockholders of such corporation all reside in the state of California.[3] It is a little difficult to harmonize Miller & Lux vs. East Side Canal & Irrigation Company,[4] and other cases in line therewith, with the position of the court in the case of Black & White Taxi Cab & Transfer Co.,[5] where it appears that a corporation was organized expressly for the purpose of conferring jurisdiction upon the federal court and the court, apparently without overruling or even distinguishing between that case and Miller & Lux vs. East Side Canal & Irrigation Company, and other cases in accord with it, held that it might be done. It is respectfully submitted, however, that the position of the court in Black & White Taxi Cab & Transfer Co. vs. Brown and Yellow Taxi Cab & Transfer Co., is unsound and that the better rule sustained by more logical reason is found in Miller & Lux vs. East Side Canal & Irrigation Company and other holdings of like import and to definitely adopt the doctrine laid down by the court in Black &White Taxi Cab & Transfer vs. Brown & Yellow Taxi Cab & Transfer Company would be a step in retrogression.

[3] Miller & Lux Co. vs. East Side Canal Irrigation Co., 29 S. Ct. 111; 211 U. S. 293; 53 L. Ed. 189; Lehigh Mining & Manufacturing Co. vs. J. J. Kelly, 160 U. S. 327; 16 S. Ct. 307; 40 L. Ed. 444; Southern Realty Investment Co. vs. Walker, 211 U. S. 603; 29 S. Ct. 211; 53 L. Ed. 346; Phoenix Buttes Gold Mining Co. vs. Winstead, 226 Fed. 856; Williams vs. Nottawa, 104 U. S. 209; 26 L. Ed. 719; Mound City vs. Castleman, 177 Fed. 510; Morris vs. Gilmer, 129 U. S. 315; 32 L. Ed. 690; 9 S. Ct. 289.

[4] 211 U. S. 293; 53 L. Ed. 189.

[5] 276 U. S. 518; 72 L. Ed. 681; 15 Fed. (2d) 509; 48 S. Ct. 404; 57 A. L. R. 426; 71 L. Ed. 842. Of course where one corporation merely owns stock in another, they will not be treated as one for jurisdictional purposes; Toledo vs. Toledo R. & L. Co., 259 Fed. 456.

§ 309. Federal Jurisdiction Cannot Be Defeated by Parties Organizing Themselves Into a Corporation

We have seen in the section last preceeding that the federal jurisdiction cannot be created or the right to enter federal courts obtained by the simple procedure of changing a corporate organization from the laws of one jurisdiction to that of another. Likewise, it may be stated as a general proposition that neither may federal jurisdiction be defeated by organization of a corporation. The constitutional privilege which a citizen of one state has to sue the citizen of another state in the federal courts may not be taken away by the erection of the latter into a corporation, by the laws of the state in which they live and in such case the corporation itself may be sued in the same manner as its organizer could have been sued, had it not been created.[6]

§ 310. It Has Been Held That Corporate Entity Not Disregarded to Authorize Service on Parent Corporation by Serving Subsidiary

It has been held, however, that the corporate entity will not be disregarded so as to treat a parent and subsidiary corporation as one in a case involving whether the parent corporation is present in the state so as to render it amenable to the jurisdiction of the state court.[7] The Supreme Court of the United States has likewise held that where a corporation owns a subsidiary and sells its goods to such subsidiary and does not otherwise do business in the state that such state of facts is not sufficient to authorize service of summons or other process on such subsidiary and thereby hold the parent corporation to judgment. But, however, the Supreme Court in so holding was careful to observe that while service of process on its subsidiary will not warrant the holding of the par-

[6] Marshall vs. Baltimore & Ohio Railway Co., 16 How. 314; 14 L. Ed. 953.

[7] LaVerre vs. International Paper Co., 37 Fed. (2d) 141.

ent corporation to respond to a judgment, that this question ought not to be confused with that class of cases where it is sought to hold the parent corporation liable for an act of such subsidiary; that the question pertaining to the service of process is a matter decided by the principles of adjective law, while the question of liability of the parent for the acts of such subsidiary is determined by substantive law.[8] It has likewise been held that where a foreign corporation owning a controlling interest in a domestic corporation is not sufficient to warrant service of process on the foreign corporation on the ground that it is doing business in the domicile of the domestic corporation, where the corporate entities are kept up and are kept separate and distinct.[9]

§ 311. When One Corporation Owns Stock in Another to Dominate and Control It, Corporate Entity Will Be Ignored

It is well settled law that while as a general proposition corporate entities are separate and distinct, nevertheless, when one corporation owns stock in another and so dominates and controls it as to make it a simple instrumentality or adjunct to it, the courts will look beyond the legal fiction of distinct corporate existence in the interest of justice, and so where stock ownership is resorted to, not for the purpose of participating in the affairs of the corporation in the customary and usual manner of stockholders but for the purpose of controlling the subcorporation, so that it may be used as a mere agency or instrumentality of the owning company, the court will not permit itself to be blinded by mere corpo-

[8] Cannon Manufacturing Co. vs. Cudahy Packing Co., 267 U. S. 333; 45 S. Ct. 250; 69 L. Ed. 634; 292 Fed. 169.

[9] Peterson vs. Chicago R. I. & P. Railroad Co., 205 U. S. 364; 27 S. Ct 513; 51 L. Ed. 841; LaVerre vs. International Paper Co., 37 Fed. (2d) 141. It has been held that where subsidiary is a public utility the parent may be made a party to a proceeding seeking to enforce the subsidiary's obligation as such public utility. City of Jamestown vs. Penn. Gas Co., 263 Fed. 437. This holding could be reached only on the theory that the corporations are the same.

rate form but will, in a proper case, disregard corporate entities and treat the two corporations as one.[10] It is indeed hard to harmonize the case of Platt vs. Bradner[11] with the case of Briggs & Co. vs. Harper Clay Products Company.[12] In Briggs & Company vs. Harper Clay Products Co., the court held valid a claim of a president and general manager of the corporation for money advanced while such president and general manager was the owner of 498 shares out of 500. It is indeed hard to understand, in view of the great array of well reasoned and logically considered cases, holding the contrary, how the court reached the result it did and especially in view of the fact that some of the well considered opinions in harmony with the modern doctrine, that the corporate entity would never be permitted to work an injustice, were handed down by the same court as made the pronouncement in the case of Briggs vs. Harper Clay Products Company.

§ 312. One Corporation Wholly Under Control of Another, Separate Entity Will Not Relieve Latter from Liability

It is familiar that courts of law and equity will not allow a corporate fiction to destroy the rights of creditors where an element of fraud, either in fact or raised by implication of

[10] Platt vs. Bradner Co., 131 Wash. 573; 230 Pac. 633; Spokane Merchant Ass'n vs. Clere Clothing Co., 84 Wash. 616; 147 Pac. 414; Clere Clothing Co. vs. Union Trust & Savings Bank, 224 Fed. 363; 140 C. C. A. 49; Advance Rumley Thresher Co. vs. Geyer, 40 N. D. 18; 168 N. W. 731; in re Eilers Music House, 257 U. S. 646; 42 S. Ct. 55; 66 L. Ed. 414; 270 Fed. 915; 274 Fed. 330; Luckenbach S. S. Co. vs. W. R. Grace & Co., 267 Fed. 676; 254 U. S. 644; 41 S. Ct. 14; 65 L. Ed. 451; Hunter vs. Baker Motor Vehicle Co., 225 Fed. 1006; 238 Fed. 894; 152 C. C. A. 28; Mitchell vs. Lea Lumber Co., 43 Wash. 195; 86 Pac. 405; 9 L. R. A. N. S. 900; 10 A. C. 231; Roberts vs. Hilton Land Co., 45 Wash. 464; 88 Pac. 946; Chicago Milwaukee & St. Paul Railway Co. vs. Minneapolis Civic & Commerce Ass'n, 247 U. S. 490; 38 S. Ct. 553; 62 L. Ed. 1229; St. L. & San Francisco Railway Co. vs. Hale, 153 S. W. 411; 109 Tex. 251; 206 S. W. 75; Bond Reed Hdwe. Co. vs. Walsh, 181 S. W. 248.

[11] 131 Wash. 573; 230 Pac. 633.

[12] 272 Pac. 962; 150 Wash. 235; see also Industrial Research Corp. vs. General Motors Corp., 29 Fed. (2d) 623.

law, exists, and that form or guise will be disregarded and substance considered, for if one corporation is wholly under the control of another, the fact of its separate entity does not relieve the latter from liability for its acts. If necessary when one corporation is the owner and proprietor of the other, the latter will be regarded as a mere trade name and the real beneficiary, the owning corporation, cannot resort to the fiction of claiming in the name of the latter to defeat the rights of *bona fide* creditors.[13] So if the relationship between parties is to cover up fraud then the corporate entity will be disregarded.[14] Likewise, if a company leases all of its property to another, the stockholders in both being the same, a mechanic's lien against the lessee corporation will also be good as against the company owning the property.[15] Moreover where a corporation does business by organizing branches and the stockholders in the latter are disregarded and the parent corporation pays up the stock and manages all of the branches without regard to their corporate character, the property of the branch corporations is subject to the debts of the parent company.[16]

§ 313. Mere Ownership of Stock Alone Is Not Enough to Fix Liability of Stockholder For Corporate Acts, But Stock Ownership Together With Control Sufficient

Unquestionably the mere ownership of stock alone does not make the stockholder responsible for the obligations of the corporation, but it is equally true that where stock ownership is not resorted to for the mere matter of investment or for the purpose of participating in the affairs of the corporation as a stockholder only, such ownership of stock is

[13] Fourth National Bank vs. Portsmouth Cotton Oil Refining Co., 284 Fed. 718; in re Marcella Cotton Mills, 8 Fed. (2d) 522.

[14] Oriental Investment Co. vs. Barclay, 25 Tex. Civ. App. 543; 64 S. W. 80.

[15] Hatcher vs. United Leasing Co., 75 Fed. 368; 79 Fed. 517; 25 C. C. A. 46.

[16] Day vs. Postal Telegraph Co., 66 Md. 354; 7 Atl. 608; see secs. 110, 123, supra.

resorted to for the purpose of so manipulating and controlling a subsidiary corporation in the interest of the parent company, that such subsidiary becomes a mere agency of the parent company, then, of course, the parent company may not escape liability for the acts of the subsidiary and so where in such case, the subsidiary company incurs obligation or commits torts, the parent company will be liable for the resulting consequences of such acts.[17] Strangely enough, in view of the present state of authority and the great light thrown upon the question by the well considered opinions, courts still lapse into the former position that the corporate entity cannot be surmounted and when it is encountered in the course of an investigation, there the investigation must stop and the hand of justice must be staid. The Supreme Court of Kansas has gone on record that in the absence of fraud or other invidious and vitiating circumstances, the fact that one corporation was instrumental in the forming of another corporation and owned nearly all of the stock of the latter corporation, does not have the legal effect of making the parent corporation liable for the debts of subsidiary corporation, nor subjecting the property of the former to a lien in behalf of a creditor who claims all of the assets of the latter corporation under a trust deed.[18] The faulty reasoning underlying the position of the Kansas court is readily apparent. It wholly overlooks the element of stock ownership, coupled with control. Under the doctrine announced by the Kansas court, the parent corporation may entirely own subsidiaries, do business through them, have complete control of their policies as its business, and at the same time if the allegation of fraud or other vitiating circumstances cannot be sustained, the parent corporation cannot be held liable for the direct consequences of its own managing and conducting

[17] Gulf & S. & S. F. Railway Co. vs. City Service Co., 270 Fed. 994; 273 Fed. 946; 281 Fed. 214; Sudduth vs. Storm King Coal Co., 268 Fed. 433; Radio Craft Co. vs. Westinghouse Electric & Mfg. Co., 7 Fed. (2d) 432.

[18] Continental & Commercial Trust & Savings Bank vs. Garden City Co., 123 Kan. 659; see also 128 Kan. 942; 278 Pac. 755; 256 Pac. 983.

of its subsidiary corporation. It is encouraging, however, that such decisions in modern times are sporadic.

§ 314. If Corporations Are Practically Identical, Coupled With the Control, Warrants Court in Disregarding of Entities

It is now so well settled that it is almost unnecessary for the citation of cases, from the great wealth of authority, to show that the courts in situations where one corporation is subsidiary to and owned and controlled by another, will look through mere names, and under such circumstances the difference between the corporations is largely a matter of names, to learn the real relationship between the corporations and if this investigation results in the establishment of the fact that *they are practically the same, the court will disregard* the mere formal separation into legal entities and will treat all as one. So where a department of a bank was separately incorporated, its stock being issued to the bank and the bank fully controlling the affairs of such separate corporation, the bank carrying the account of such subsidiary on the bank's books, the bank will be liable for such other corporation although it engaged in a separate business, as that of insurance.[19]

§ 315. Corporate Entity Not Permitted to Stand in the Way of the Enforcement of Lien in Admiralty Court

The courts in admiralty, following the lead of courts of equity and concurred in by courts of law, will not permit corporate entities to stand in the way of the enforcement of a valid maritime lien in a court of admiralty. So where there is a loss of goods in which the claim for lien originates and the vessel that had it in charge was owned by a corporation and thereafter went together with another corporation and formed a third, such new corporation will be held liable for the prop-

[19] Bishop vs. U. S. 16 Fed. (2d) 410; 16 Fed. (2d) 406.

erty that it received from either of the constituent corporations, which property was subject to the lien.[20]

§ 316. Where the Difference Between Two Corporations Is Reduced to a Matter of Bookkeeping, the Corporate Entities Ignored

The Supreme Court of the United States has laid down the rule, and which has the sanction of the authorities generally, that where the difference between corporations is reduced to the mere matter of bookkeeping that such corporations cease to have separate legal entities and will, in the interest of justice, be treated as one. So where it becomes necessary for the United States government to uncover violation of the Anti-Trust Laws, to dissipate corporate entities and it appears that the difference between the corporate entities is a mere matter of bookkeeping, or that where relations between the companies involved are so intimate and interlocked that in the last analysis, the assets of one company may be considered as the assets of another, the corporate entities will not be permitted to stand in the way of the enforcement of the Anti-Trust Laws, under such circumstances.[21]

§ 317. Corporate Entities Ignored to Allow Offset Between Parent Corporation and Creditors of Subsidiary

Where a corporation is organized and controlled as a subsidiary of another and the subsidiary's affairs were so conducted as to make it practically an adjunct of the managing corporation, it would not be departing from established principles, if the book credit of the subsidiary company may

[20] Young vs. The Key City, 14 Wall 653; 20 L. Ed. 896; see secs. 114, 184, supra.

[21] Meeker & Co. vs. Lehigh Valley Railroad Co., 21 Interstate Commerce Comm. Rpts. 129; 23 Interstate Commerce Comm. Rpts. 480; 236 U. S. 412; 59 L. Ed. 644; 1915D P. U. R. 1072; 35 S. Ct. 328; 1916 B A. C. 691; 128 C. C. A. 311; 211 Fed. 785; United States of America vs. Lehigh Valley Railroad Co., 254 U. S. 255; 65 L. Ed. 253; 41 S. Ct. 104; 225 Fed. 399; see secs. 224, supra, 419, 421, infra.

be offset against a debt held by the parent corporation. To so hold could hardly be regarded as unfair to the parent, while it would be grossly unfair to the creditor of such subsidiary to compel it to pay its indebtedness in full to one of the companies and look to insolvent associate for the payment of its own account.[22]

§ 318. Neither a Corporation or Its Receiver Can Avoid on Behalf of Corporation Endorsement of Negotiable Paper by Sole Stockholder

Where the conclusion is inevitable that a stockholder owned all of the stock of and controlled a corporation, that is, that such corporation was merely his shadow, his *alter ego*, the matter of whether or not the corporation exceeded its power, or whether it was estopped to assert that it did, is supplanted by the doctrine that the stockholders of a corporation are in final analysis the equitable owners of its property, to the extent that a contract encumbering or a conveyance passing title to it, by them such conveyance or encumbrance is binding and effective for the purpose. When this view is maintained, a question of corporate power and the application of estoppel thereto are no longer involved. To apply technical rules that the corporate entity should at all times and under all conditions be maintained would be exalting form above substance and appearance above reality. This will not be done in the face of the ownership of all of the stock by a single individual when his act is called in question and especially where it appears that the corporate entity is but a cloak to shield a sole stockholder in his individual operations. To permit stockholders of corporations to unanimously make a disposition of the corporate property where no intervening rights of creditors appear and no third parties' rights are in any way involved and to afterwards repudiate their own action because

[22] Gay vs. Hudson River Electric Power Co., 187 Fed. 12; 109 C. C. A. 66. See, however, Security Savings & Trust Co. vs. Portland Flour Mills Co., 261 Pac. 432; 124 Ore. 276.

the same party had not acted through the fictional body, could serve no useful purpose and would be merely aiding in the commission of a fraud.[23] So where a corporation has become a surety on a note for another corporation, which such surety corporation largely owns, it will not be permitted to plead *ultra vires*, when sued on its contract of suretyship, there being no intervening rights of creditors of third parties.[24]

§ 319. A Corporation That Is So Controlled and Conducted As to Make It a Mere Agency or Instrumentality of Another, Separate Existences Ignored

Where a corporation is so organized and controlled and its affairs so conducted as to make it a mere instrumentality or agency or adjunct of another corporation, its separate existence as a distinct corporation will be ignored and the two corporations will be regarded in legal contemplation as a single unit. So, where a corporation exists merely as a device to evade legal obligations, the courts will disregard the entity theory and to do so the intent to defraud in the transaction is not indispensable.[25] So where it appears that the corporations and their affairs are so interlocked and interlaced as to destroy the fictional separate entities of the two corporations and render them as one and they have contracted with each other to the detriment of the public, then at the instance of the state, the contract will be treated as a nullity.[26]

[23] Boston & Texas Corp. vs. Guaranty Life Insurance Co., 233 S. W. (Tex. Civ. App.) 1022; Perkins vs. Trinity Realty Co., 69 N. J. Eq. 723; 71 Atl. 1135; 71 N. J. Eq. 304; 61 Atl. 167; First National Bank vs. Guardian Trust Co., 187 Mo. 494; 86 S. W. 109; 70 L. R. A. 79.

[24] First National Bank vs. Guardian Trust Co., supra.

[25] People vs. Mich. Bell Telephone Co., 246 Mich. 198; 224 N. W. 438; in re Muncie Pulp Co., 71 C. C. A. 530; 202 U. S. 621; 26 S. Ct. 766; 50 L. Ed. 1175; 139 Fed. 546; Interstate Telegraph Co. vs. Baltimore & Ohio Telegraph Co., 51 Fed. 49; Aff. 54 Fed. 50; 4 C. C. A. 184; Higgins vs. Cal. Petroleum & Asphalt Co., 147 Cal. 363; 81 Pac. 1070; Brundred vs. Rice, 49 Ohio St. 640; 32 N. E. 169; 34 A. S. R. 589; Donovan vs. Purtell, 216 Ill. 629; 75 N. E. 334; 1 L. R. A. N. S. 176.

[26] People vs. Mich. Telephone Co., supra; see sec. 167, supra.

§ 320. If Relations Between Two Corporations Are So Interwoven and So Intimate As to Easily Facilitate Commission of Fraud, Entities Disregarded

As a general rule, a corporation does not lose its identity when its stock or substantial part thereof is owned by another corporation,[27] and their acts are independent. Yet a different rule prevails where the screen of corporate entity is torn down by fraud or illegal acts and so too, the separate identity disappears where the charter powers and agreements between the two corporations so interweave the corporate relationship between the companies that fraud may be easily perpetrated.[28] However, it must be borne in mind that the presence of fraud in the transaction, as has been suggested in the last preceding section, is by no means an essential element of the case calling for a disregard of the corporate entities.[29] It seems, however, as suggested in this section that the authorities hold that where the corporations so intermix the relationship as to facilitate the commission of fraud it will be sufficient to disregard the corporate entity. This is in perfect harmony with the rule that it is not necessary to prove fraud in order to move the court to ignore corporate entities.

§ 321. Where the Majority Stockholder Causes the Assets to Be Transferred to a New Corporation Owned and Controlled by Him, Such New Corporation Will Be Held Liable to the Minority Stockholder of the Old

Where a majority stockholder of a corporation so manipu-

[27] Monongahela Bridge Co. vs. Pittsburg & B. Traction Co., 196 Pa. 25; 46 Atl. 99; 79 A. S. R. 685; Callery's App., 272 Pa. 255; 116 Atl. 222; Borough of Ambridge vs. Philadelphia Co., 283 Pa. 5; 129 Atl. 67; 39 A. L. R. 1064.

[28] White vs. Phoenix Iron Works Co., 283 Pa. 205; 129 Atl. 71.

[29] People vs. Michigan Bell Telephone Co., 246 Mich. 198; 224 N. W. 438; Higgins vs. California Petroleum & Asphalt Co., 147 Cal. 363; 81 Pac. 1070; Brundred vs. Rice, 49 Ohio State Rpts. 640; 32 N. E. 169; 34 A. S. R. 589; Donovan vs. Purtell, 216 Ill. 629; 75 N. E. 334; 1 L. R. A. N. S. 176; see sec. 167, supra.

lated its affairs as to transfer the assets and business of such corporation to a new corporation of his organization, which he controlled, such new corporation will be held bound to account to the minority stockholder of the old corporation for the proportion of the value of the old company's property and assets, including the goodwill that properly belonged to such minority stockholder. So where one corporation is indebted to another and the debtor corporation, by acquisition of stock of the creditor corporation, by the stockholders of the debtor corporation, obtains control of the creditor and refuses to take steps to enforce such indebtedness, a minority stockholder of the creditor corporation will be permitted to assert such rights even though there is no fraud.[30]

§ 322. The Rule That Corporate Entities Will Be Disregarded in Proper Case Is Not Affected by the Fact Whether One or More Owns the Stock of the Corporation

The rule, that in cases calling for a disregard of the corporate entity, is in no manner affected by the fact that the stock of a corporation is owned by one person or more than one. In other words, the corporate entity will be disregarded if all of the elements of a case that call for the application of the rule are present, as readily in a case where there are a number of stockholders in a corporation as where there is a single stockholder.[31]

§ 323. General Rule Is That If the Stockholders of a Corporation Are Estopped, the Corporation Will Be Estopped and Vice Versa

It may be stated as a general rule that where the stockholders have acted in such a way that the doctrine of estoppel

[30] Nave-McCord Mercantile Co. vs. Ranney, 29 Fed. (2d) 383. The court does not in so many words, in this case, put the decision upon the basis of a disregard of the corporate entities, but manifestly that

may be effectively interposed as to such stockholders, were they seeking to assert the right then the corporation of which they were stockholders, would likewise be estopped and *vice versa*. In other words, if the beneficial owners of the corporate property, by virtue of their stock ownership, have so acted that the doctrine of estoppel would be effective against them, in their attempts to assert the claim in their own names, the corporate entity will be disregarded and the estoppel allowed to operate as against them in the same manner as if the entity did not exist.[32] So where the stock of a corporation is owned by a single person and his conduct will estop him, the doctrine of estoppel, under such circumstances, will be applied and estop the corporation also. This rule has been applied to the extent that the statements and admissions of a stockholder of a corporation will be received as establishing facts from which an estoppel might arise as to the corporation itself.[33] So, too, a corporation is estopped by the conduct of its organizer and principal stockholder in the same manner as such organizer and stockholder would be estopped.[34] Likewise when the corporation is estopped the stockholder, or its sole

is what the court does in order to reach the result that it did. Just vs. Idaho Canal & Impr. Co., 16 Idaho 639; 133 A. S. R. 140; 102 Pac. 381.

[32] Security Savings & Trust Co. vs. Portland Flour Mills, 261 Pac. 132; 124 Ore. 276; Clark vs. Milsap, 197 Cal. 765; 242 Pac. 918; McCormick Saeltzer Co. vs. Grizzly Creek Lumber Co., 240 Pac. 322; 74 Cal. App. 278; Zenos vs. Britten Cook Land & Livestock Co., 242 Pac. 914; 75 Cal. App. 299.

[33] Relley vs. Campbell, 134 Cal. 175; 66 Pac. 220; Rutz vs. Obear, 15 Cal. App. 435; 115 Pac. 67; Chicago Railway Equipment Co. vs. National Hollow Brake Beam Co., 123 Ill. App. 533; but see, however, 226 Ill. App. 28; 80 N. E. 556; 239 Ill. 111; 87 N. E. 872; 141 Ill. App. 572; where the case was reversed, but manifestly the Supreme Court of Illinois was incorrect in its holding, and the court of appeals reached a sound conclusion; Breslin vs. Fries Breslin Co., 70 N. J. L. 274; 58 Atl. 313; Wootton Land & Fuel Co. vs. Ownbey, 265 Fed. 91; see sec. 286, supra, 393, infra.

[34] Relley vs. Campbell, supra; Rutz vs. Obear, supra. See also semble: Home Fire Ins. Co. vs. Barber, 67 Neb. 644; 93 N. W. 1024; 60 L. R. A. 927; 108 A. S. R. 716.

[35] Burnett Coal Mining Co. vs. Schrepferman, 133 N. E. 34; 77 Ind. App. 45.

owner, is estopped.[35] Of course, in order to work an estoppel of a corporation by reason of estoppel of its stockholders, where there are a number of such, the estoppel must be operative as to all and not just a part.

§ 323a. Defense Good Against Stockholders, Were They Parties to the Action Available As Against Corporation

Intimately associated with the principle of estoppel discussed in the next preceding section, is the position that a defense that would be good against the stockholders were they proceeding in their own name instead of that of the corporate body, the entity will be dissipated and the matter treated as if the corporate entity did not enter into the consideration at all. So where a defense might be successfully pleaded to the action if the stockholders were prosecuting it, such defense is available as against the corporation.[36] In fine the matter is one that the court simply refuses to be blinded by the corporate fiction, and brushes it aside and deals with the actual beneficiaries in the last analysis. As a result of the principles discussed in this and the preceding section it seems sound to hold that if a cause of action could not be maintained by the stockholders if corporate fiction is ignored, then the corporation stands in no better position than stockholders—the real beneficiaries in the action. So, too, it would seem to follow if a corporation cannot sustain an action, the stockholders would likewise be prevented from asserting the right of recovery.[37]

[35] Jones vs. Kentucky Glycerine Co., 11 S. W. (2d) 713; 226 Ky. 676; Fairbanks Morse & Co. vs. Coulson Stock Food Co., 151 Mo. App. 260; 131 S. W. 894; see sec. 392, infra.

[36] Home Fire Ins. Co. vs. Barber, n. 33, supra; Breslin vs. Fries Breslin Co., supra; Wootten Land & Fuel Co. vs. Ownbey, supra.

[37] Matthews vs. Headley Chocolate Co., 100 Atl. 645; 130 Md. 523; Tompkins vs. Sperry Jones & Co., 96 Md. 583; 54 Atl. 254. But where the corporation cannot defend an action at law the stockholders having equities may assert them in a court of chancery and the corporate form will be dissipated to allow this. Aurora Daily News Co. vs. Frazier, 157 Ill. App. 456.

§ 323b. Res Adjudicata and Disregard of the Corporate Fiction

The position of the stockholder is so much in privity with that of the corporation that it is readily understood that a judgment against the corporate entity operates to bind the stockholders as such.[38] The operation of the principle under consideration has wider application than merely binding the stockholders in their capacity as such and a judgment is binding on an officer and director especially where he conducts the litigation, even though he is not by name a party to the record.[39] Where a person is the owner or even the substantial owner of a corporation the courts will dissipate the corporate entity and hold such owner bound by a judgment for or against the corporation and *vice versa*.[40] Likewise, the weight of authority is that the stockholders are concluded by a judgment against the corporation in an action wherein it is sought to assert the stockholder's statutory liability for the obligations of the corporation.[41]

§ 324. Where a Corporation Is a Dummy, the Stockholders' Acts Are Its Acts

Where a corporation is merely a dummy, the courts have power to disregard its corporate existence and to hold that the acts of the stockholders are the acts of the corporation itself. In other words, the law will, under such circumstances, where it is shown that the corporation is but a dummy, hold

[38] Croke vs. Farmers Highline Canal Co., 71 Colo. 514; 208 Pac. 466; Beers vs. Denver &, etc., R. Co., 286 Fed. 886; Bear vs. Brunswick County, 122 N. C. 434; 29 S. E. 719; 65 A. S. R. 711; Young vs. Rohrbough, 88 Neb. 101; 129 N. W. 167.

[39] Nuckels vs. Robinson-Pettett Co., 159 Ky. 214; 166 S. W. 972; Chatham vs. Mecklenburg Realty Co., 180 N. C. 500; 105 S. E. 329; Carlock vs. Lloyd, 43 S. D. 611; 181 N. W. 835; Davidson vs. I. M. Davidson Real Estate Co., 249 Mo. 474; 155 S. W. 1; Cuneo Importing Co. vs. Am. Importing Co., 247 Fed. 413; 159 C. C. A. 467; 241 Fed. 421.

[40] U. S. Envelope Co. vs. Transo Paper Co., 221 Fed. 79; Covington vs. McIntire, 111 Kan. 79; 206 Pac. 319.

[41] 7 Fletcher Cyclopedia Corporations 7419.

that there is no difference in the identity of the corporate fiction and of the stockholders parading behind it.[42]

§ 325. Rule Seems to Be That Where a Corporation Is a Mere Dummy Behind Which the Stockholders Are Hidden, That Their Liability Would Be Measured by That of the Dummy As If It Were Bona Fide

The rule seems to be that where a corporation is but a mere dummy, used as a shield in the endeavor of the stockholders to escape liability, that the liability of the stockholders will be exactly the same and measured by that of the dummy, were it a *bona fide* corporation. In other words, the stockholders in a dummy corporation, when the fiction is stripped aside, will be compelled to stand in the place of and respond for the obligations of the dummy in the same manner as it would if it were a *bona fide* corporate entity with a legal existence and invulnerable to attack.[43]

§ 326. The Ultimate Determination of Corporate Affairs Rests With Stockholders

It must be conceded on all sides that in reality and in the final analysis, that the ultimate determination of corporate affairs rests with the stockholders. So, then it must follow as an illative conclusion that where the stockholders are the final arbiters of the corporate destinies that they may act in the first instance, without the formality usually hedged about corporate conduct, and such action on the part of the stockholders will be construed to be corporate and binding upon it. It is quite absurd to say that the stockholders' acts are not to be deemed valid unless assented to by their agents, the directors. No good reason can be urged why the stockholders, at least by unanimous consent, cannot do a valid corporate act without the formality of a resolution by their servants,

[42] Sterling vs. Trust Co., 141 S. E. 856; 149 Va. 867.
[43] National Bank of Commerce vs. Francis, 296 Mo. 169; 246 S. W. 326; 261 U. S. 618; 43 S. Ct. 362; 67 L. Ed. 829.

the directors. The sound answer is that they can. On this ground it is well held that where the directors own all of the shares they may agree among themselves—not in their capacity as directors, but rather in their character of stockholders—to authorize an agent to sell all of the property of the corporation and that this authorization will be none the less valid because not given at a regular directors' meeting.[44] The rule that the acts of the stockholders bind the corporation when they all act together is not restricted in its application to what is generally known as a "one-man corporation." That is, where one individual owns all of the stock. No good reason is apparent why the rule should not apply with equal force to a case where the corporation officers participating in the transaction own all of the stock. This is but a particular application of the general rule that the courts will, in a proper case, in order to do justice, disregard the fiction of separate corporate entities and have regard for the real substance of the transaction.[45] So, there may be actual corporate conduct, which is not formal corporate action, where that conduct is directed or produced by the whole body, both of officers and stockholders, that is, by every living instrumentality which can possess and wield the corporate franchise, and that conduct is of corporate character.[46]

§ 327. All the Stockholders Entering Into a Contract Manifestly For the Benefit of the Corporation, It Will Bind the Corporation Though Not a Party by Name Thereto

The general proposition that a corporation is to be regarded as a legal entity existing separate and apart from the natural

[44] Wood vs. Wiley Construction Co., 56 Conn. 87; 13 Atl. 137; Woodbridge vs. Pratt & Whitney Co., 69 Conn. 304; 37 Atl. 688; Smith vs. Moore, 199 Fed. 689; 118 C. C. A. 127; Aransas Pass Harbor Co. vs. Manning, 94 Tex. 558; 63 S. W. 627; Jordan vs. Collins, 107 Ala. 572; 18 Southern 137; Swift vs. Smith, 65 Md. 428; 5 Atl. 334; 57 A. R. 336.

[45] Hotaling vs. Hotaling, 193 Cal. 368; 224 Pac. 455; 56 A. L. R. 734

[46] Exploration Merc. Co. vs. Pacific Hdwe. Co., 177 Fed. 825; 101 C. C. A. 39

persons composing it is not disputed, but that the statement that it is a mere fiction existing only in idea, is well understood and not controverted by anyone who pretends to accurate knowledge on the subject. All fictions of law have been introduced for the purpose of convenience and subserving the ends of justice. It is in this sense that the maximum, *in fictions juris semper subsistit aequitas,* is used and the doctrine of the fiction is applied; but when they are urged to an extent and purpose not within the reason and policy of this fiction, they have from the earliest times been disregarded.[47] No reason is perceived why the principle applied to fictions in general should not apply to the fiction that a corporation is a personal entity separate from the natural persons who compose it and for whose benefit it has been invented.[48] It would seem the maxims, *Fictio juris non est ubi veritas,* and *Fictio legis inique operature aliqui damnum vel injuriam,* would come into play in dealing with corporate fictions. So where a contract was made in the names of the stockholders of a corporation, yet manifestly in behalf of the corporation, the corporation was held bound thereby, the corporate fiction being disregarded and the court dealing with the substantive, living and acting parties.[49]

§ 328. Directors Representing Entire Corporate Stock May Issue Bonds Even Though They Do Not Do It in Accord With Articles

The directors of a corporation may, without the formality of

[47] Johnson vs. Smith, 2 Burr 962; State vs. Standard Oil Co., 49 Ohio St. 137; 15 L. R. A. 145; 34 A. S. R. 541; 30 N. E. 279.

[48] State vs. Standard Oil Co., supra. It was even ventured by at least one text writer to suggest that the corporate fictional idea has outlived its usefulness. Taylor on Corporations sec. 51. In State vs. Standard Oil Co. it was urged by counsel that the doctrine of overriding the corporate fiction is a modern heresy largely invented during the last crusade against the principles of the association in business.

[49] State ex rel. vs. Standard Oil Co., supra; see secs. 33, 84, supra, 335, 336, infra.

corporate action or action as a board of directors, issue bonds and debentures of the corporation and this, notwithstanding a provision of the articles of the corporation that no director shall act as such in respect to any matter in which he has an interest; the issuance of the debentures of the company being to a syndicate composed of the five directors of the issuing company, they being, however, the only stockholders of the issuing corporation and such securities being issued in payment of property conveyed to such corporation. It is within the power of the owners of all of the stock of a corporation and who are directors, to conduct the matters in such manner as they see fit, however informal and in whatever manner called or assembled.[50] So a casual meeting of directors by the consent of all of the directors and all being present, will suffice to impress their conduct at such meeting with the formality of corporate action. However, this is not true if there is an objection interposed by any director, to such informality of convening.[51]

§ 329. A Corporation Allowing Its Officers to Exercise Its Functions, Will Be Bound by Their Acts

The directors of a corporation, who constitute the entire body of stockholders, permitting one of their number who was president, treasurer, and general manager of the corporation to exercise all of their functions, and to assume the entire control of the corporate affairs, which corporation received the benefits of a contract entered into in the corporate name, the corporation will be deemed to be as fully bound as if the

[50] In re Express Engineering Works, I Ch. 466 (1920); W. N. 75; 36 Times L. R. 275; 10 B. R. C. 629.

[51] Barron vs. Potter, 1 Ch. 895; 83 L. J., Ch., N. S. 646; 110 L. T. N. S. 929; 30 Times L. R. 401; 58 Sol. Jo. 516; 7 B. R. C. 374; Minneapolis Times Co. vs. Nimocks, 53 Minn. 381; 55 N. W. 546; Robson vs. C. E. Finniman Co., 83 N. J. Law 453; 85 Atl. 356; United Growers Co. vs. Eisner, 22 App. Div. 1; 47 N. Y. S. 906; Troy Mining Co. vs. White, 10 S. D. 475; 42 L. R. A. 549; 74 N. W. 236; First Trust Co. vs. Miller, 160 Wis. 336; 151 N. W. 813. See 7 B. R. C. 383.

entire board of directors by directorate action had solemnly and formally executed the contract.[52]

§ 330. Directors Owning All of the Stock of a Corporation, Their Separate Action Binds the Corporation

The directors owning all of the stock of a corporation, their action however separately, and not as a body, on a contract in the interest of the corporation is binding upon it. This is true despite the rule that is generally understood that directors acting separately cannot bind the corporation. The basic reasoning of this rule is that if the directors own all of the stock, the directors are therefore given power as agents of the stockholders and since they are both principals and agents, and each of their unanimous acts carries with it the authority of directorate action and impliedly they consent thereto as stockholders.[53] Likewise, where the president and secretary of a corporation were all of its stockholders and directors and they executed a mortgage or other contractual obligation, the corporation will be bound thereby, notwithstanding the fact that they did not convene at a board meeting and authorize themselves to execute the mortgage. Manifestly no other source could be looked to for corporate power to accomplish such purpose, they having the power to execute the mortgage or other contract, they may exercise that power in any manner they see fit.[54] That where the directors are all the stockholders they may even waive the formality imposed upon them by statutory enactment, such as that found in the British company's act requiring notice to shareholders and the adoption of resolutions.

[52] Ruttle vs. What Cheer Coal Mining Co., 153 Mich. 300; 117 N. W. 168.

[53] Gerard vs. Empire Square Realty Co., 195 App. Div. 244; 187 N. Y. S. 306.

[54] Pac. State Bank vs. Coats, 123 C. C. A. 634; 205 Fed. 618; 1913E A. C. 846. Directors signing contract individually bind corporation; Holy Cross Min. etc. Co. vs. Goodwin, 223 Pac. 58; 74 Colo. 532; the directors are so far considered the same as the corporation, that a majority of them may act separately and bind the corporation; Buckley vs. Jennings, 95 Vt. 205; 114 Atl. 40.

etc., and may act without such compliance and such action will be binding upon the corporation.[55] In short the rule is the corporation has no such separate entity that it may act counter to wishes of the stockholders.

§ 331. Manager of a Corporation Organizing a New Corporation, and Such New Corporation Accepting the Profits of a Contract With the Old, the New Corporation Will Be Liable Thereon

The manager of a corporation, who organizes a new corporation, of which he is the controlling head and which new corporation accepts the profits and benefits of a contract that was entered into by the old, such as the services of an employee or agent, the new corporation is liable upon such contract, although executed in the name of the old, and an action may be maintained thereon against the new corporate formation.[56]

§ 332. One Owning Substantially All of the Stock of a Corporation, Whose Acts Are Acquiesced in by the Directors, the Corporation Will Be Liable Therefor

Where the president or other officer is the substantial owner of all of the stock of a corporate body and he is allowed by the directors to control and direct the corporation's action, his acts are the corporation's and the corporate entity will be liable to the same extent as if it had the approval of the board of directors in meeting assembled.[57] So where three brothers are the owners of all of the stock of a corporation and occupy the offices thereof, they may informally enter into a contract for the sale of its entire property, and such contract will be binding thereon.[58]

[55] In re Oxted Motor Co., 3 K. B. 32 (1921); W. N. 197; 37 Times L. R. 737; Pueblo Foundry & Machine Co. vs. Lannon, 187 Pac. 1031; 68 Colo. 131; see sec. 85, supra.

[56] Buttle vs. What Cheer Coal Mining Co., 153 Mich. 300; 117 N. W. 168.

[57] McElroy vs. Minnesota Percheron Horse Co., 96 Wis. 317; 71 N. W. 652; Ford vs. Hill, 92 Wis. 188; 66 N. W. 115; 53 A. S. R. 902.

[58] Union National Bank vs. Shoemaker, 68 Mo. App. 592.

§ 333. Directors Owning All of the Stock of a Corporation, Are Not Within the Rule Prohibiting Persons in Fiduciary Capacity From Contractiong For Their Benefit

The rule that the corporate entity will not be permitted to stand in the way of doing substantial justice between or among the actual parties in a transaction so far obtains, that it is now established that where directors own all of the stock of a corporation, they are not within the interdiction of the rule that prohibits persons acting in a fiduciary capacity from contracting for their own advantage, in the name of the beneficiary and such a contract made in the name of the corporation by the unanimous consent of the directors does not contravene any principle of public policy and is not otherwise open or vulnerable to attack.[59]

§ 334. Directors Acting in Accordance With Desires of Stockholders, Form of Action Immaterial in the Absence of Creditors

Practical difficulties involved in situations dealing with the corporate entity and its fictional character are readily solved by the courts through the application of ordinary common sense. The right of stockholders to know about their own business, that is, the business of the corporation, for they are the real owners, would seem to be a right concomitant with the ownership of stock.[60] It therefore follows that if directors of a corporation act in accordance with the wishes of the stockholders in the absence of intervening rights of creditors, the form of such directorate action is wholly immaterial and the corporation cannot escape liability by resorting to formal technicalities as to the manner of the execution of the power conferred upon the directors.[61]

[59] Robison vs. McCracken, 52 Fed. 726; 6 C. C. A. 400.

[60] Farmers Loan & Trust Co. vs. Pierson, 130 Misc. 110; 222 N. Y. S. 532.

[61] Smith vs. Gaylord, 47 Conn. 380; Woodbridge vs. Pratt & Whitney Co., 69 Conn. 304; 37 Atl. 688.

§ 335. If by Brushing Aside Corporate Entities It Appears That the Substantial Intent of the Parties Was to Bind the Corporation, the Form of the Transaction Is Immaterial

The substantial concern of the courts in dealing with corporate transactions, involving an application of the doctrine of overriding the corporate entity, the question generally is: "Have the real parties in interest sanctioned the contract or assumed the liability or approved the act?" and if it appears that such is the case, then the corporation will not be permitted to defeat the substantial ends of justice. So, where a man and his wife and the wife's father are all of the stockholders of a corporation and the man was secretary and treasurer of the corporation and he had so exercised the corporate powers that he was in effect and for all practical purposes the corporation itself—there having been no meeting of directors for a number of years—the corporation will be bound upon his contracts to the same extent and as fully as if there had been formal action taken by the board of directors in meeting duly assembled.[62]

§ 336. Originally Contracts Could Be Made Only in the Name of the Corporation But It Is Now Settled That a Contract For Corporate Purposes in the Name of Its Officers Is a Corporate Contract

It seems that originally the general notion prevailed that for a corporation to be a contracting party that it must appear as a party thereto by its corporate name.[63] Under such rule the inquiries stopped at the point where it was determined whether or not the corporation was in its legal capacity a party to such contract, by name. But, in view of the enlightened authority upon the question of how far effect

[62] Koenig vs. George Logemann & Sons Co., 170 Wis. 619; 176 N. W. 58.

[63] Bank of Augusta vs. Earle, 13 Peters 519; 10 L. Ed. 274.

will be given to the corporate entity, it is now well settled that where a contract is in truth and in fact made in the interest of the corporation by its directors or stockholders, it is not regarded as material whether the legal entity by its corporate name is a party thereto and so, where two stockholders owned substantially all of the stock of a corporation and were directors therein and made a lease in their name but manifestly for corporate purposes, it will be regarded as a corporate contract and on the decease of either of them it will not be treated as the individual property of such decedent.[64] A question of some nicety could arise in a case where a corporate contract is made in the name of a stockholder or officer of such corporation, and that is: Is such an officer or stockholder, personally, liable on such contract? On general principles of the law of agency, it would seem such officer or stockholder contracting for the corporation, in his own name, would be personally liable thereon.[64a]

§ 337. Corporate Entity Will Be Disregarded to Defeat the Defense of Ultra Vires Where Stockholders Knew of the Act That Such Defenses Urged Against

The doctrine of *ultra vires* will not be permitted to be urged as a defense where the evidence shows that the corporation received the benefits of the contract in question and that the stockholders knew of the act of its officer or agent in making such contract. In other words, the court will go behind the mere corporate entity to examine into the true facts of the case and ascertain whether or not the parties in interest knew of the making of such contract, and if it appears that the stockholders knew thereof and that the corporation received the benefits therefrom, then the technical question of whether or not the contract was made without

[64] Watton vs. Colonial Amusement Syndicate, 67 Cal. App. 654; 228 Pac. 42.

[64a] 2 C. J. 813 et seq.

authority or was *ultra vires* will be disregarded.[65] This is an operation of the doctrine that the courts will not permit the fictional entity of corporation to bar out the truth and to prevent the court from dealing with the parties in their individual capacity, leaving aside, for the time being, the fact of the existence or nonexistence of the corporate entity.

§ 338. The Corporate Entity Will Not Be Allowed to Stand in the Way of Showing That the Corporation's Property Was Burned by the Stockholders and That Such Burning Is a Defense by Insurer in an Action on the Policy

It is now well settled that where the corporation's property is burned by the willful and intentional act of its stockholders, that such conduct on the part of the stockholders will be a defense and may be urged as such in an action by the corporation on the insurance policy and in such cases the insurance companies will be permitted to prove that the fire was in fact of incendiary origin and that the stockholders were responsible therefor.[66] It could not be contended that a stockholder merely owning a nominal amount of stock could commit an incendiary act against the corporation's property and thus defeat corporate recovery. The reasonable application of the rule would seem to apply and it would be a defense on the part of the insurer that a stockholder responsible for the destruction of the corporate property substantially owns the corporation. So, too, as we have already had occasion to note, the existence of a defense that would defeat a cause of action were it maintained in the name of the stockholders, is pleadable effectually against a suit in the name of the corporation. The theory underlying adjudications sustaining this

[65] Vander Meer vs. Weurding, 227 Mich. 46; 198 N. W. 828.

[66] Kirkpatrick vs. Allemannia Fire Insurance Co., 102 App. Div. 327; 92 N. Y. S. 466; 184 N. Y. 546; 76 N. E. 1098; Meily vs. London & L. Fire Insurance Co., 142 Fed. 873; 79 C. C. A. 454; 148 Fed. 683; see also semble: Home Fire Ins. Co. vs. Barber, 67 Neb. 644; 60 L. R. A. 927; 108 A. S. R. 716; 93 N. W. 1024.

rule is that stockholders in the final analysis are the corporation and a recovery by it will ultimately inure to the benefit of its shareholders.[67]

§ 339. Where the Pledgee of the Corporate Stock Burns the Corporate Property, the Corporation May Not Recover the Insurance Thereon

The principle of the last preceding section holding that where the stockholders of a corporation, by their incendiary conduct, work a destruction of the corporate property, the corporation may not recover upon an insurance policy covering such property, is held to be operative so as to defeat a recovery where the property is destroyed by fire flowing from the conduct of a pledgee of the corporate stock.[68] Of course, this principle must not be understood as operating unless it should appear that the party responsible for the incendiary conduct is the substantial owner of the corporation, as we have observed in the preceeding section.

§ 340. It Seems That the Mere Pledging of Substantially All of the Assets of One Corporation to Another Is Not Enough to Invoke the Rule of Disregarding the Corporate Entity

It seems that where one corporation pledged all of its assets to another corporation, that this standing alone will not make a case calling for an overriding of the corporate entities and treating both corporations as one, and holding them interchangeably responsible for their obligations. This is especially true where a banking corporation desiring to discontinue the banking business, pledges its assets to another bank and borrows money to pay off its depositors.[69] It could

[67] Home Fire Ins. Co. vs. Barber, supra; sec. 323a, supra.
[68] Felsenthal vs. North Assurance Co., 205 Ill. App. 610; 284 Ill 343; 120 N. E. 268; 1 A. L. R. 602.
[69] Overstreet vs. Citizens Bank, 12 Okla. 383; 72 Pac. 379.

not be contended, however, that a case might not be supposed where a pledge of the assets by one corporation to another, in connection with other facts and circumstances, would not be sufficient to call for the application of the rule ignoring corporate entity and treating two or more corporations as one. And accordingly, it has been held that where the pledgee corporation owns substantially all of the capital stock of another corporation, is not content to confine its functions to those legitimately ascribed to a pledgee, by assuming in addition to taking a pledge of such stock therefor, the stock issued in its name without disclosing its fiduciary capacity, and thereafter sits idly by and allows fraudulent conduct on the part of the corporation manipulated by its board of directors, such pledgee will be responsible therefor and held to full accountability, by reason of the fact that the pledgee had power to control the corporation and failed to do so.[70]

§ 341. Corporation Taking Conveyance From Its Stockholders, Who Are Its Directors and Promoters, Takes Such Subject to Equities Against the Grantors

The doctrine that the corporate entity will not be permitted to stand in the way of reaching and doing substantial justice between or among the parties has further application in cases where corporations are promoted and formed, and the promotors are thereafter the stockholders and directors thereof and convey land to such corporation, the corporation takes such property charged with all of the equities against it in the hands of the grantors. In other words, the corporate entity will not be permitted to be injected into the case to defeat the substantial equities existing by the complainant against the

[70] Des Moines Gas Co. vs. West, 50 Iowa 16. It would hardly do to say that the pledgee of all the assets of a corporation—the pledgee being another corporation— might not be responsible, under any and all circumstances, for the debts of the pledgor, or that such act of pledgee might not constitute a merger or consolidation as effectually as by any other means. A consolidation, or merger may be accomplished by lease of all the property of the lessor corporation. See sec. 231, supra.

property and the promoters, and thereafter the stockholders and the directors of the corporate formation.[71] So, where the stockholders and promoters were tenants in common of the property that is conveyed to the corporation, the rights of such claimant—tenant in common, will be preserved to the same extent as if the corporation had not been formed.[72] Likewise, where a director participates in the negotiations leading up to the transfer to him of the corporate property and which is thereafter in furtherance of his plans, designs, and schemes, transferred to another corporation, which he actively aids in bringing into existence, such transferee corporation cannot seek the mantle of an innocent purchaser and the property in its hands will be treated in all respects as if it had not been brought into existence.[73]

§ 342. Corporate Entity Disregarded to Prevent Recovery on Gambling Transaction

The corporate entity will not be permitted to stand in the way of unearthing gambling transactions, and where a member of an incorporated club is interested in the profits arising from gambling transactions to the extent that such profits are used in paying the expenses of the club and in the purchase of articles and meals for the members thereof, is deemed sufficiently a participant in the actual gambling transactions though he does not play therein, to prevent his recovery of money paid out at the request of another member in settlement of losses in games played therein and in so doing the court will brush aside the corporate existence of the club and deal with the members as such without regard to the existence of the corporate entity.[74]

[71] Franklin Mining Co. vs. O'Brien, 22 Colo. 129; 55 A. S. R. 118; 43 Pac. 1016.
[72] Franklin Mining Co. vs. O'Brien, supra.
[73] Hoffman Steam Coal Co. vs. Cumberland Coal & Iron Co., 16 Md. 456; 77 A. D. 311.
[74] White vs. Wilson, 100 Ky. 367; 38 S. W. 495; 37 L. R. A. 197; 18 Ky. L. R. 892.

§ 343. Where a Corporation Is Formed in the Contemplation of the Carrying Out of an Agreement, the Corporate Entity Will Be Ignored

It seems to be the settled rule that an agreement made by persons interested in contemplation of incorporation, where the interests of others are not affected, controls the conduct of the corporate affairs and that if necessary to enforce the provisions of the agreement as for the division of profits, the corporate fiction will be ignored. An agreement made by persons interested or who really represent the interests of those, afterwards incorporated, and whose agreement was in anticipation of the formation of the corporation and was carried out by it and recognized by it, bound the parties to the agreement. The corporation under the circumstances generally prevailing in this country, following such an agreement would be the mere agency of the associates created for the sake of convenience in carrying out such an agreement as between those who make the bargain.[75] Neither may the stockholders use an existing corporation or form a new corporation for the purpose of avoiding their contracts.[76]

[75] Conover vs. Smith, 256 Pac. 835; 83 Cal. App. 237; Chater vs. San Francisco Sugar Refining Co., 19 Cal. 219; Shorb vs. Beaudry, 56 Cal. 446; Cornell vs. Corbin, 64 Cal. 197; 30 Pac. 629; Hunt vs. Davis, 135 Cal. 31; 66 Pac. 957; Wise Realty Co. vs. Stewart, 169 Cal. 176; 146 Pac. 534; Hocking Valley Railway Co. vs. Toledo Terminal Railway Co., 99 Ohio State 35; 122 N. E. 35; see secs. 285, 291, supra; in re Wilson's Estate, 85 Ore. 604; 167 Pac. 580; Griffin vs. Brody Adler & Koch Co., 167 N. Y. S. 725.

[76] Hocking Valley Railway Co. vs. Toledo Terminal Railway Co., supra.

CHAPTER XVII

DISREGARD OF CORPORATE ENTITY BETWEEN PARENT AND SUBSIDIARY CORPORATION

CONTENTS

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363. Parent corporation is liable for fraud of its subsidiary.

§ 344. Where One Corporation Is a Mere Instrumentality of Another or an Adjunct Thereof, the Corporate Entities Will Be Ignored

The fact that the stockholders of the two corporations, or the greater number thereof, are the same persons, does not operate to destroy the legal identity of either corporation nor does the fact that one corporation exercises largely a controlling influence over the other through ownership of its stock or through the identity of its stockholders, operate to make either the agent of the other or to bring about a merger of the corporations into one. But the corporate entity, notwithstanding these principles, will be disregarded in a case where a corporation is organized and controlled and its affairs are so conducted as to make it merely an instrumentality or an adjunct of another corporation. A corporation organizing another solely for the purpose of handling such organizing corporation's goods and the organizing corporation owns and controls it completely and manipulates the assets of the organized corporation in such a manner as to make it difficult

for the organizing corporation's creditors to reach them, the organizing or parent corporation will be liable for the obligations of the organized or subsidiary corporation.[1] Yet, where one corporation kept up separate entities in every particular and essentially maintained their business separately, with the exception of using the same office and same telephone, was held not enough to hold a parent corporation responsible upon the liabilities of the subsidiary.[2] The use of general language basing liability upon such terms as "agency," "instrumentality," "adjunct," "*alter ego*," "single enterprise," "complete control," and many others has been criticized.[3]

§ 345. General Statement of Liability of Parent Corporation

Some of the controlling circumstances sustaining liability of the parent corporation are sometimes asserted to be ownership of all of the stock of the subsidiary or even a majority of the stock, coupled with control or ownership by the same persons of the stock on both the parent and subsidiary corporation. Sometimes a controlling circumstance is thought to be found in the sufficiency or insufficiency of the capitalization of the subsidiary as measured by that employed in the nominal competitive corporations. Of course, consideration is given to the degree that the subsidiary is financed by the parent, coupled with which is the maintaining of such financing. Likewise, consideration is given where a common directorate is found functioning in both corporations, as also is the case where there are common officers and employees. Decisions are influenced by the extent of the comingling of stockholders' and directors' meetings and also the extent to which both the parent and subsidiary corporation have common

[1] Hunter vs. Baker Motor Vehicle Co., 190 Fed. 665.

[2] Bergenthal vs. State Garage & Truck Co., 179 Wis. 42; 190 N. W. 901.

[3] Berkey vs. Third Avenue Railway Co., 244 N. Y. 84; 155 N. E. 58; Rev. 217 App. Div. 504; 217 N. Y. S. 156; see, however, 155 N. E. 914; Ballantine, Separate Entity of Parent and Subsidiary Corporation, 14 Cal. L. R. 12; 35 Com. L. J. No. 11, 684.

transactions of business. The degree to which interest between the two are favorable one to another has an influencing effect upon holding the entities the same. The manner of bookkeeping will be looked to, but this is not a controlling circumstance. Of course, consideration will be given to the extent to which an officer or director of one corporation is permitted to dictate the policies of the other. It hardly need be said that in such decision will be involved the character of business that such corporations are engaged in and the extent to which the trade or public generally regards the two as separate or one.[4]

§ 346. Ownership of Stock Alone Not Enough to Hold Parent But Stock Ownership Coupled With Control Sufficient

A holding company owning all of the stock of another corporation except shares sufficient to qualify directors, coupled with control and in fact the management of the subsidiary's business is sufficient to make the parent corporation liable for the conduct of the subsidiary. It is well recognized that stock ownership alone does not render the holding company responsible for the subsidiary company, but, if the holding company uses its ownership of stock in such a manner as to actually control and operate the properties of its subsidiary, that is sufficient to make it responsible. In other words, the parent company may not thrust its hand through and from behind the subsidiary corporate entity and as effectively direct its course of conduct as the parent corporation may its own properties and then escape liability for the consequences of its directorship of the subsidiary's property, by means of bolstering up as a panoply the fictional corporate character of the subsidiary. Neither will the mere matter of bookkeeping result in a determination of the question one way or another,

[4] Douglas & Shanks Insulation From Liability Through Subsidiary Corporation, 39 Yale L. J. 193; 29 Yale L. J. 659.

and while consideration will be given to the manner of keeping of the records of the two corporations, it is not controlling, but rather the actual manner of conducting the business controls.[5]

§ 347. Parent Corporation May Not File a Claim in Bankruptcy Against Its Subsidiary

Upon bankruptcy of a subsidiary corporation, the parent corporation will not be permitted to file its claim in the proceedings and share in the proceeds of its subsidiary before other creditors are paid in full and realization upon its claim must be postponed until the ultimate satisfaction of all other claimants.[6] So where one corporation conducts its business by merely resorting to the instrumentality of another entity, the parent corporation investing therein its capital and reaping the profits of the venture, if successful, it seems to be but fair and just that it should make good the losses if a failure results.[7] So where the officers and stockholders of a corporation organize a subsidiary for the purpose of aiding in the prosecuting of the parent corporation's business, one will not be permitted to recover upon notes given to the other, and especially this is true where any element of fraud or bad faith has entered into the transaction, and where there are intervening rights of creditors or third parties.[8]

[5] Costan vs. Manila Electric Co., 24 Fed. (2d) 383; Davis vs. Alexander, 269 U. S. 114; 46 S. Ct. 34; 70 L. Ed. 186; The Willem Van Driel, 164 C. C. A. 147; 252 Fed. 35; Lehigh Valley Railway Co. vs. Delachesa, 145 Fed. 617; 76 C. C. A. 307; Dobbins vs. Pratt Chuck Co., 242 N. Y. 106; 151 N. E. 146; see sec. 70, 316, supra.

[6] Clere Clothing Co. vs. Union Trust & Savings Bank, 224 Fed. 363; 140 C. C. A. 49; S. G. V. Company of Delaware vs. S. G. V. Company of Pennsylvania, 264 Pa. 265; 107 Atl. 721; Hunter vs. Baker Motor Vehicle Co., 225 Fed. 1006; in re Watertown Paper Co., 169 Fed. 252; 94 C. C. A. 528; Colonial Trust Co. vs. Montello Brick Works, 172 Fed. 310; 97 C. C. A. 144; Brown vs. Penn. Canal Co., 229 Fed 444; 235 Fed. 669; 149 C. C. A. 89.

[7] S. G. V. Co. of Delaware vs. S. G. V. Co. of Pa., supra.

[8] Investor's Finance Co. vs. Bodnar, 289 Pac. (Colo.) 599. An owner of a corporation being one with it cannot share in the property on its bankruptcy. Edw. Finch Co. vs. Robie, 12 Fed. (2d) 360.

§ 348. Upon the Bankruptcy of the Parent, a Subsidiary Corporation Will Be Required to Turn Over Its Assets to Be Administered With Those of the Parent

Where a bankrupt corporation has organized another to aid in the development of its business and the officers of the bankrupt own all of the stock of the subsidiary and merely managed a part of the bankrupt's business through such subsidiary, upon the adjudication of the parent corporation in bankruptcy, the subsidiary will be required to turn over to the receiver its property to be administered along with that of the parent.[9]

§ 349. The Affairs of the Parent and Subsidiary Corporation Will Be administered As One in Receivership Proceedings

Where the relationship between the parent and subsidiary corporation is such that there is in fact no difference between the two, the courts will disregard the legal entities, although incorporated under the laws of different states, and administer the affairs of both corporations, in receivership proceedings as one and in the same manner as if there were but a single legal entity.[10]

§ 350. Where Two Corporations Are Practically Identical, One Corporation May Be Held For Property Delivered to the Other

Where two corporations are practically identical, it will be held upon the theory that the corporate entities are the same

[9] In re Muncie Pulp Co., 139 Fed. 546; see secs. 252, 265, 292, supra.

[10] Lake Charles National Bank vs. J. I. Campbell Co., 57 Tex. Civ. App. 362; 122 S. W. 601; Kimberly Coal Co. vs. Douglas, 45 Fed. (2d) 25. Rule governing receivership proceedings and the administration of a parent and subsidary therein, is similar to rule prevailing in bankruptcy proceedings. This is true whether the corporation is owned by an individual, a partnership, or another corporation. See secs. 252, 265, 292, 348, supra.

and will be disregarded that one corporation may be required to pay for property that has been by a third party sold and delivered to the other.[11]

§ 351. A Parent Corporation Organized Under the Laws of One State and Having a Subsidiary Organized Under the Laws of Another Will Be Liable on Lease to Subsidiary

It is the general rule when one corporation makes use of another as its instrumentality through which to transact its business, the principal corporation is in reality and for all legal intents and purposes represented by the agents of the subcorporation and fair dealing and justice demand that the parent is liable the same as if it had done the business in its own name. So, where an Ohio corporation engages in business in Texas through the instrumentality of a Texas corporation of the organization of the Ohio company, the Ohio company and its bondsmen will be liable upon a lease entered into in the name of the Texas corporation.[12]

§ 352. A Parent Corporation Will Be Liable For a Libel Committed by Its Subsidiary

Where the parent corporation organized a subsidiary, to serve as a mouthpiece for the parent's propaganda, the parent will be liable for its own libels, and will not be permitted to interpose the technical distinction of the two distinct organizations to defeat a cause of action against it on the part of another libeled by such subsidiary-controlled corporation and both the parent and the subsidiary will be jointly and severally responsible to the libeled party.[13]

[11] Ivins vs. Hub Machine Welding & Contracting Co., 68 Pa. Super. Ct. 370. One corporation may be—the facts warranting it—regarded the same as another body politic; likewise, a partnership owning a corporation is treated as one with it. See secs. 71, 292, supra.

[12] John Church Co. vs. Martinez, 204 S. W. (Tex.) 486. See sec. 382, supra.

[13] Finnish Temperance Society Sovittaja vs. Publishing Co., 238 Mass. 345; 130 N. E. 845.

§ 353. A Railroad Corporation Operating Its Business Through the Means of Subsidiary Will Be Liable For Personal Injuries Resulting From Such Operation

Where a party is injured or killed in the operation of a railroad or other business by a subsidiary corporation, the parent will be liable and its liability will be established by the fact that the accident occured on the lines of the subsidiary, the trains on such lines being used indiscriminately by the parent and subsidiary and the employees wear the parent's insignia; tickets being sold for passenger travel indiscriminately over the lines and the lines of the subsidiary were treated as a part of the parent's system. Such facts, coupled with other minor facts and circumstances, are sufficient to go to make out a case that the parent is merely transacting its business in the name of the subsidiary.[14] Likewise, where a foreign railway extends its lines into a state and through a domestic chartered corporation, engages in business therein, the foreign corporation binding itself to purchase all of the bonds of its subsidiary and have a single system of management, prorating the revenues derived from the transportation of freight and passengers, and the books of the companies each being open to the inspection of the other, the parent company furnishing all the operating equipment, although receiving the usual compensation therefor, the parent corporation owning a majority of the domestic subsidiary's stocks and bonds, these facts in conjunction with the fact that the domestic corporation owned no rolling stock, are sufficient to establish the proposition that the foreign parent corporation is doing business in the state through the local subsidiary as its representative, and will be held liable in a suit for personal injuries sustained upon the lines of the local subsidiary company.[15]

[14] Pa. Railway Co. vs. Sellers, 127 Pa. State 406; 17 Atl. 987.

[15] Buie vs. Chicago, Rock Island & P. Railway Co., 95 Tex. 51; 55 L. R. A. 861; 65 S. W. 27; see sec. 244, supra.

§ 354. Corporation Owning and Operating a Railroad Through Intervention of a Domestic Corporation, Is Liable For Personal Injuries Sustained on the Subsidiary Line, in Violation of Federal Safety Appliance Act

It is a recognized principle of law, from which there is little dissent among the decisions, that the ownership of stock in and of itself will not render the parent corporation liable for torts or obligations *ex contractu*.[16] But, however, where a railway corporation is unwilling to submit, it being onerated with what it conceived to be excessive filing fees—demanded by one of the states through which its system of railway was operated—and to thus evade the local imposition of the filing fee, a plan was conceived to organize a smaller corporation, partaking of domestic character, for the purpose of taking over the real property in such state and the parent corporation, thereafter operated all trains in that state, but each corporate entity received a proportionate share of the earnings and sustained the operating expenses in the same ratio as the division of profits; all rolling stock and equipment of a movable nature continued to be owned by the dominant corporation, but under the agreement was used by the subsidiary; the plan of operation being that the lines were treated as a continuous railway system, there prevailed at all times the most harmonious relations between the two corporations and at no time was there evidenced any hostility. The time-tables made no mention of the domestic corporation. Under such circumstances an employee injured in the state and upon the properties standing in the name of the subsidiary corporation, by reason of defective appliances, in violation of the Federal Safety Appliance Act,[17] the parent corporation will be liable

[16] Stone vs. Cleveland, Cincinnati, Chicago & St. Louis Railway Co., 202 N. Y. 352; 95 N. E. 816; 35 L. R. A. N. S. 770; Peterson vs. Chicago, R. I. & Pac. Railway Co., 205 U. S. 364; 27 S. Ct. 513; 51 L. Ed. 841; Atchison, Topeka & Santa Fe Railway Co. vs. Cochran, 43 Kan. 225; 23 Pac. 151; 7 L. R. A. 414; 19 A. S. R. 129.

[17] U. S. Comp. Stats. secs. 8605 et seq.

for such injury upon the theory that the subsidiary corporation is a mere instrumentality in the hands of the parent corporation, to extend its operations through a state to the jurisdiction of which the parent corporation elected not to submit.[18] The liability of such parent corporation, of course, does not depend upon a violation of the Federal Safety Appliance Act, but it will be liable for common-law negligence as well.

§ 355. Railway Company May Not Absorb a Competing Line by Reason of an Inhibition of Constitutional Provision, but Controls the Lines Through Another Corporation, the Parent Corporation Is Liable For Personal Injuries

The development of the doctrine that courts in proper cases will be moved to ignore corporate entities has developed so rapidly that it has now become axiomatic, that courts do not hesitate to ignore corporate fiction and draw aside the veil

[18] Specht vs. Mo. Pac. Railway Co., 154 Minn. 314; 191 N. W. 905; Wichita Falls and N. W. Ry. Co. vs. Puckett, 53 Okla. 463; 157 Pac. 112; Gulf Colorado & Santa Fe Ry. Co. vs. Dorsey, 66 Tex. 148; 18 S. W. 444; Wisconsin Central Ry. Co. vs. Ross, 142 Ill. 9; 31 N. E. 412; 34 A. S. R. 49. From the earliest times the joint operators of transportation lines have been held liable especially for torts of any one of the operators or his servants. The theory upon which this liability was predicated was that there was a community of interest in the disposition of profits or a sort of quasi partnership. So when the railroads succeeded the stagecoaches, they likewise assumed this liability incident to the joint operation of stagecoach lines by a number of parties, but in more modern times, when we have come to the point where we no longer quail when confronted with a corporate entity, the liability is generally predicated upon the theory that two corporations are the same and that there is in fact but one corporate organization, although operating under different entities. The early rule holding the stagecoach operators liable was that a stagecoach line divided into sections, the occupant of each section furnishing his own carriages and horses, hiring drivers and paying his own expenses, the money received as fare of the passengers as different turnpike tolls was divided among the parties in proportion to the number of miles run by each and an injury happening to a third person through the negligence of the driver of any one of the coaches, this state of facts was sufficient to sustain a joint action against all of the operators on the line. Bostwick vs. Champion, 11 Wendell 571; Fremont vs. Copeland, 9 Com. L. R. 300; Laugher vs. Pointer, 12 Com. L. R. 321.

of corporate entity when necessary to reach justice and prevent fraud. So, where it appears that a railroad corporation may not absorb a competing line by stock purchase, thereafter procuring a conveyance of the subsidiary's property and thereupon to evade the constitutional prohibition against such absorption, the parent corporation resorts to control of the subsidiary in its own corporate right, as a means of operating in fact of the parent corporation's railroad in such state and thereby evade the constitution and laws of such jurisdiction and an injury occurring to an employee on the lines of the subsidiary, the parent will be held liable therefor.[19]

§ 356. Where a Parent Corporation Organizes Subsidiary For the Purpose of Operating Its Property, the Parent Will Be Liable For Personal Injuries Resulting From the Negligence of the Subsidiary

Where a parent corporation organizes a subsidiary for the purpose of operating its property, but the parent completely and fully controlling the operations of the property in as full and ample a manner as if operated in the parent's own name, the parent will be liable for personal injury resulting from such operation by reason of the negligence of the subsidiary.[20]

§ 357. Where One Railroad Actually Controls Another, Operating Both, Dominant Company Liable For Injury to Freight Occasioned by Subsidiary

Where one railroad actually controls and operates a subsidiary corporation as a single system, of the dominant company, it will be liable for injury to freight due to the negligence of the subsidiary corporation and its employees.[21]

[19] Louisville & Nashville Ry. Co. vs. Carter, 10 S. W. (2d) 1064; 226 Ky. 561; see sec. 368, infra.

[20] Chesapeake Stone Co. vs. Holbrook, 168 Ky. 128; 181 S. W. 953; 1916D L. R. A. 311.

[21] Davis vs. Alexander, 269 U. S. 114; 46 S. Ct. 34; 70 L. Ed. 186; 265 U. S. 577; 44 S. Ct. 635; 68 L. Ed. 1188; case in State Court, 93

§ 358. Where a Ship Brokerage Company Organized and Controlled a Stevedoring Company, It Will Be Liable For Personal Injury to the Subsidiary Company's Employees

A ship brokerage company organized and completely officered and controlled a stevedoring company and furnished the stevedoring company its office, kept its accounts and handled all of its funds, paid its losses, kept its profits as a charge for managing its business, the parent corporation and the subsidiary stevedoring company will be treated as identical as to third persons and both will be held to respond in damages for the negligence of an employee of the stevedoring company in conducting its business resulting in personal injury.[22]

§ 359. A National Corporation May Be the Parent of State Subsidiary Corporation or the Two May Be Regarded As One

It is clear that the fact that one corporation is organized under the national laws as a National Banking Association and another is organized under the state laws will not prevent the two being considered as one, or one the parent and the other the subsidiary. This is the holding in the case of Corsicana National Bank vs. Johnson.[23]

Okla. 159; 220 Pac. 358; Southern Ry. Co. vs. Thomas, 90 S. W. 1043; 28 Ky. L. R. 951.

[22] Foard Co. vs. State of Maryland, 219 Fed. 827; 135 C. C. A. 497; 213 Fed. 51. The doctrine whereby the parent corporation is held liable for the torts of its subsidiary perhaps was aided in its development by the doctrine that whoever participates in the commission of a tort is held liable therefor, as where corporations pollute the waters of a stream, its officers are jointly liable with it, but in modern times the liability of the parent corporation is readily predicated upon the ground that in a case, presenting facts calling therefor, the courts will override corporate entities. Nunnelley vs. Southern Iron Co., 94 Tenn. 397; 29 S. W. 361; 28 L. R. A. 421; see also Monographic Note appended to the above styled case in the L. R. A. Rpt. It has accordingly been held that persons injured by the wrongdoing of a corporation or its agent, may hold either or both liable as joint tort-feasors. Minnis vs. Sharpe, 198 N. C. 364; 151 S. E. 735.

[23] Corsicana National Bank of Corsicana vs. Johnson, 40 S. Ct. 82;

§ 360. National Bank and a State Loan Corporation May Be Considered As Parent and Subsidiary in Dealing With Violations of the National Banking Law

While it is true that a national bank and a loan corporation organized under the state will, notwithstanding identity or substantial identity of stock ownership and the closest affiliated management, be regarded for some purposes as separate corporate entities and as such may be capable of contracting with each other, when it appears that the two are in fact one, the corporate entities will be disregarded and they will be treated as a single corporate organization and participating officers in making excessive loans may not evade the attaching responsibility therefor by the subterfuge of having the state corporation take up the loan that is made in violation of the law by the national corporation and, notwithstanding this juggling of the loan from one to the other, the national bank may maintain an action against its officers for dereliction of duty. The fictional phantasmagoria of the corporate entity may not be used to hide the transaction of excessive loans by national bank officials, when it is intended to evade the effect of such conduct by simply metamorphosing the loan from one supposed entity to another.[24]

§ 361. Officers of National Banking Corporation Cannot Be Held Liable For Misapplication of Funds When Such Were Used in the Discharge of Subsidiary's Obligation, the Two Corporations Being Treated As One

A national banking corporation engaged in the business for which it was granted charter, organizing a department

251 U. S. 68; 64 L. Ed. 141; Bishop vs. U. S., 16 Fed. (2d) 410; see sec. 349, supra. The fact that two corporations are organized under different jurisdictions, as different states, or one under federal authority and the other under state law, does not in any way prevent the entity from being disregarded, or two corporations treated as one. See sec. 360, infra.

[24] Corsicana National Bank vs. Johnson, 251 U. S. 68; 64 L. Ed. 141; 40 S. Ct. 82. However, some of the federal courts have blindly followed

of its business under a separate corporation, under the state laws, the stock of such state corporation being issued to the bank and the bank fully controlling the state corporation's affairs, carrying on the bank's books, the business of the state corporation as a mere department of the bank, the bank will be held liable for the obligations of its subsidiary state corporation and in order to reach just results, the courts will peer through mere names and legal formation to advise itself of the real relationship between the corporations and if there is a practical identity, will disregard the formal separation of the legal entity and in such case where it appears that the officers of a national bank will not be convicted for unlawful misapplication of its funds, where they were applied in the payment of the obligations of the state corporation, that is treated as a mere department of the bank.[25]

§ 362. National Banking Corporation Is Liable For Acts Perpetrated by a State Corporation Its Subsidiary

We have seen in the two preceding sections that national banks may be held liable upon the obligations of corporations that it owns and controls, engaged in business closely allied to that of the bank but the liability of national banks for the acts of its subsidiaries is by no means confined to strictly banking business and cognate enterprises. So a bank organizing a subsidiary corporation under the state law to handle property owned by the bank, the bank supplying to such state corporation all of the capital it possessed, the bank will

the archaic notion that corporate entities may not be pierced or a veil pulled aside and be treated as separate corporations, which were for all practical purposes one and the same. Hooper Mankin Co. vs. Mathew Addy Co., 4 Fed. (2d) 187; Majestic Co. vs. Orpheum Circuit, 21 Fed. (2d) 720; Martin vs. Development Co. of America, 240 Fed. 42; 153 C. C. A. 78; City of Holland vs. Holland City Gas Co., 257 Fed. 679; 168 C. C. A. 629; Allen vs. Philadelphia, 265 Fed. 817; 265 Fed. 807; 254 U. S. 633; 41 S. Ct. 8; 65 L. Ed. 448. It is thought that an analytic examination of the holdings in these cases must necessarily result in the conclusion that they are not in step with the great march of the more sound and equitable view represented by modern authority.

[25] Bishop vs. U. S., 16 Fed. (2d) 410.

be held liable for the acts and conduct of such corporation, and where a suit is brought for damages sustained by a purchaser of property from the state corporation, the consideration for such property being paid to the bank and the property not being as represented by the state corporation, the bank may not escape liability by interposition of the plea of separate corporate entities.[26]

§ 363. Parent Corporation Is Liable For Fraud of Its Subsidiary

It is so well settled by the great weight of modern authority that it has now become hornbook law, that the courts will not permit mere fictional forms of corporate creation to serve as a panoply and shield when it is rightfully charged with the perpetration of fraud, but when the fictional creation of corporate forms—a veritable man of straw—is encountered in the course of the court's investigation, the courts will readily pass on and through corporate forms to the substance of things and deal with and protect the rights of innocent parties, and so in an action against a corporation to rescind a contract for the purchase of stock of such corporation upon the ground of fraud, the defendants will not be permitted to urge the defense that the stock was purchased by the claimant from another corporation to which the defendant corporation had sold it, the evidence being that the two corporations were brought into existence contemporaneously by the same parties and the supposed selling corporation being organized for the purpose of dealing in the stock of the defendant parent company.[27]

[26] Portsmouth Cotton Oil Refining Co. vs. Fourth National Bank, 280 Fed. 879; Am. Nat. Bank vs. Nat. Wall Paper Co., 77 Fed. 85.
[27] Ehler's vs. Bankers Fire Ins. Co., 108 Neb. 756; 189 N. W. 159.

CHAPTER XVIII

RIGHTS AND LIABILITIES OF PARENT AND SUBSIDIARY CORPORATION

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§ 364. A Parent Corporation Will Be Held Liable For Nondelivery of Goods Purchased From its Subsidiary

Where an individual enters into a contract agreeing to purchase all of a certain class of goods that a corporation could supply, the buyer will be entitled, under such agreement, to

all of the goods of both the parent and subsidiary corporations and the parent corporation may not avoid its liability upon a plea that it was a separate corporate entity from its subsidiary and that the contract was with the subsidiary only, and the parent will be held liable upon a nondelivery of the goods called for by the contract.[1]

§ 365. A Corporation Engaged in the Wholesale Business Will Be Held One and the Same With Its Subsidiary Corporation Where the Parent Took Over the Business of Another Corporation and Held It Out As an Agency

A corporation engaged in a wholesale business and taking over a retail business, and holding such retail department, which is a separate corporate entity, out as a mere agency or department of the business of the parent corporation, the two corporations will be treated the same and the parent held responsible for the obligations of its subsidiary under such circumstances.[2]

§ 366. A Manufacturing Corporation Organizing a Sales Corporation, the Two Will Be Treated As One

A manufacturing corporation organizing a sales corporation for the sole purpose of aiding the manufacturing company in the payment of its debts, and transferring to the sales corporation a large amount of the products of the manufacturing concern and taking the sales corporation's evidences of debt therefor, the manufacturing concern continuing to sell its products in the same manner as if the sales corporation had not been organized, the two will be treated as one and upon a bankruptcy of the manufacturing concern, the sales corpora-

[1] Dobbins vs. Pratt Chuck Co., 242 N. Y. 106; 151 N. E. 146; reversing 206 N. Y. S. 5; 210 App. Div. 278.

[2] In re Eiler's Music House, 270 Fed. 915; 274 Fed. 330; 257 U. S. 646; 66 L. Ed. 414; 42 S. Ct. 55.

tion may not hold the products delivered to it by the manufacturing company.[3]

§ 367. Two Railroad Companies Substantially Owning a Terminal Corporation, the Separate Entity of the Terminal Corporation Will Be Disregarded

Railway companies owning what is obviously a mere terminal facility, which terminal facility is in the name of the separate corporate entity, but such facility being a mere agency or instrumentality of the two companies, who control the facility-owning corporation, the separate corporate entity of the facility-owning corporation will be disregarded as an independent public carrier and the terminal company will not be permitted to impose separate carrying charges because of its mere separate technical legal existence. The general rule that ownership alone of corporate stock by one corporation in another does not dissipate the two separate corporate entities and with this rule there cannot be any complaint, but on the other hand where stock-holding companies are such that the parent corporation completely dominates and controls the subsidiary, the general rule is not applicable. That is, where stock ownership has been resorted to, not for the purpose of participating in the corporate affairs of the subsidiary in the normal and usual manner as would any stockholder, but where the ownership is for the purpose of controlling the subsidiary,

[3] Hamilton Ridge Lumber Sales Corporation vs. Wilson, 25 Fed. (2d) 592; contra First National Bank vs. Walton, 262 Pac. 984; 146 Wash. 367. It is indeed a difficult task to essay to harmonize the opinion in the case of First National Bank vs. Walton with the great drift of the enlightened and just trend of decisions at the present time and especially in view of the well considered case from the Washington Supreme Court of Platt vs. Bradner Co., 131 Wash. 573; 230 Pac. 633. See also in accord with Hamilton Ridge Lbr. Sales Corp. vs. Wilson, 25 Fed. (2d) 592; Advance Rumley Threshing Machine Co. vs. Geyer, 40 N. D. 18; 168 N. W. 731. Hamilton Ridge Lumber Sales Corporation vs. Wilson, supra, is in harmony with the rule that upon bankruptcy of an owner of a corporation, the corporate affairs will be drawn in the proceedings and administered therein; see secs. 252, 265, 292, 348, supra.

then the separate corporate existence will not be recognized. So, in a case where railway companies own such terminal corporation and they so manipulate the terminal corporation as it amounts to a mere agency or instrumentality of its stockholders, the separate corporate existence of the terminal corporation will not be recognized, but the two owning corporations will be dealt with in the same manner as if the terminal corporation had no separate legally authorized existence.[4]

§ 368. A Railroad Corporation, Seeking to Avoid the Effect of a Decision, Declaring Its Lease of Another's Property Illegal, the Railroad Company Organizes a Third Corporation to Own the Stock of the Lessor Corporation, Is Liable For the Acts of the Lessor Corporation

Where the L. Railway Company attempted to lease the property of the E. Railway Company and this was thereupon declared illegal by the courts and the property ordered returned to the E. Railway Company, and the L. Railway Company thereupon organizing the L. V. T. Railway Co., and the L. V. T. Railway Company, thus organized, acquired the entire stock of the E. Railway Company and in turn the L. Railway Company owned the entire stock of the L. V. T. Railway Company, the L. Railway Company will be responsible for the acts and misconduct of the E. Railway Company and especially in view of the fact that a passenger who was killed, and damages were claimed for his death, and his ticket was issued by the L. Railway Company over the lines of the E. Railway Co., without mentioning the fact that the transportation was to be over the E. Railway Company's lines.[5] The case of Lehigh Valley Railway Company vs. Dupont[6] is interesting in that there the court ignored the corporate entity of the corporation in whose name the property stood and

[4] Chicago, Milwaukee & St. Paul Ry. Co. vs. Minneapolis Civic & Commerce Ass'n, 247 U. S. 490; 62 L. Ed. 1229; 38 S. Ct. 553; affirming 134 Minn. 169; 158 N. W. 817.

[5] Lehigh Valley Ry. Co. vs. Dupont, 128 Fed. 840; 64 C. C. A. 478.

[6] Supra.

then ignored the existence of the corporation that owned all of the stock of the property-owning corporation and went back and fixed liability on the parent corporation that owned all of the stock of the corporation that owned all of the stock of the property-owning corporation. So likewise, where one railroad company controls others through stock ownership and operates all as a single enterprise under one general management, but each railroad stands in the name of the corporation owning it and the parent company is liable directly to the employees or others being injured upon the tracks of any of the subordinate companies.[7] A contrary result, however, was reached by the court of last resort in New York and some other state courts but it is indeed hard to sustain the position of the New York courts and others subscribing to the doctrine announced thereby.[8] It has likewise been held that a controlling circumstance absolving the parent corporation from liability is found in cases where technical separate entities in all respects in compliance with the law, are kept up.[9]

§ 369. It Is Readily Understood That the Parent May Be Held For Its Transactions and Acts Through the Subsidiary, but It Seems the Subsidiary Is Not Liable For the Acts of the Parent

It is indeed interesting to note that at least one case holds that where a third party enters into a contract with the parent corporation, such third party may not subject the

[7] Lehigh Valley Ry. Co. vs. Delachesa, 76 C. C. A. 307; 145 Fed. 617; see secs. 353 et seq., supra.

[8] Stone vs. Cleveland, Cincinnati, Chicago & St. Louis Ry. Co., 202 N. Y. 352; 95 N. E. 816; 35 L. R. A. N. S. 770; Atchison, Topeka & Santa Fe Ry. Co. vs. Cochran, 43 Kan. 225; 7 L. R. A. 414; 19 A. S. R. 129; 23 Pac. 151; Mathews vs. Atchison, Topeka & Santa Fe Ry. Co., 60 Kan. 11; 55 Pac. 282; Atchison, Topeka & Santa Fe Ry. Co. vs. Davis, 34 Kan. 209; 8 Pac. 530; 34 Kan. 199; 8 Pac. 146; Louisville & Nashville Ry. Co. vs. Howard, 14 Ky. L. R. 864.

[9] Martin vs. Development Co. of America, 153 C. C. A. 78; 240 Fed. 42; see sec. 355, supra.

subsidiary to liability in a suit brought therefor.[10] The permeating theory of the court, clearly discernible throughout the decision, is traceable to the idea that the liability to the parent attaches for acts of the subsidiary upon the basis of principal and agent. Had the court clearly refused to apply the doctrine that the subsidiary would not be liable for an act of the dominant corporation, even though the entities might be considered as one, it manifestly could not have been sustained and as the case stands it is of highly doubtful authority. However, the court does observe that "perhaps it would be too much to say that a subsidiary can never be liable for a transaction done in the name of the parent."

§ 370. Subsidiary Corporation Cannot Recover For Products Sold to the Parent, the Stock of the Subsidiary Having Passed Into Hands of Other Parties

A subsidiary corporation whose stock had been pledged as collateral to a mortgage which had been sold on a foreclosure sale and had therefore passed into the hands of third parties, could not maintain a claim against the parent corporation or its receivers for a balance shown to be due the subsidiary organization, the two corporations being organized to evade the laws of a foreign country where the subsidiary was operating.[11] The court in the case of New York Trust Company vs. Island Oil & Trans. Co.,[12] could not reach the result it did without overriding the corporate entity and dealing with the real substantial parties as they were, and had the court applied the same rule and dealt with the parties as they actually existed, the facts warranting the inference that the two corporations were the same, it could not have reached the conclusion that it did in the case of Kingston Dry Dock Company

[10] Kingston Dry Dock Co. vs. Lake Champlain Trans. Co., 31 Fed. (2d) 265. See, however, the J. B. Austin, Jr., 1 Fed. (2d) 451.
[11] New York Trust Co. vs. Island Oil & Transportation Co., 34 Fed. (2d) 655.
[12] Supra.

vs. Lake Champlain Trans. Company.[13] It is clearly manifest, upon a close analysis of the two opinions, that conflicting rules have been developed in the two cases by the Circuit Court of Appeals of Second Circuit. There is an attempt, however, to distinguish the decision in the case of New York Trust Company vs. Island Oil & Trans. Corporation, upon the ground that there was merely a simulacrum of the real transaction between the parent and subsidiary, but that does not reach and solve the question at issue. If the corporations are the same when substance is considered and form is ignored, it is not necessary to appeal to any other theory in order to hold one liable for the acts of the other.

§ 371. Parent Corporation Will Be Held Liable For Loans Made to Its Subsidiary

A corporation organized under the laws of one state for the convenience of a corporation existing under the laws of another and the subsidiary is financed by the parent, the subsidiary will be held to be merely a simulacrum of the parent corporation and the parent will be held to respond in suit upon loans made to the subsidiary. It is the well established rule of law prevailing in a number of states that where the dominant corporation controls the subsidiary, the parent is liable for the debts of its subcorporation.[14]

§ 372. Where a Parent Corporation Is Organized in Conjunction With Two Subsidiaries, and the Parties Interested Treating All Three As One, the Parent Will Be Liable Upon Obligations of the Subsidiaries

Where a parent corporation and two subsidiaries are organized to act and do act in conjunction and are treated by

[13] 31 Fed. (2d) 265, supra, sec. 369, where the case of Kingston Dry Dock Co. vs. Lake Champlain Trans. Co. is analyzed.

[14] Dillard & Coffin Co. vs. Richmond Cotton Oil Co., 140 Tenn. 290; 204 S. W. 758; Madison Trust Co. vs. Stahlman, 134 Tenn. 402; 183 S. W. 1012; see 372, infra.

the interested parties as virtually branches of a single corporate organization, having among themselves mutual and independent interests and cooperating together in the furtherance of the common interest and policy and for the advancement of the purposes and development of the property of the parent, it will be liable for the reimbursement of endorsers upon the notes of one of the subsidiaries, to save them harmless from loss by reason of their indorsement obligation. The common interest among the parent and its subsidiaries is sufficient consideration to fasten liability upon the parent for such obligation.[15]

§ 373. A Corporation Controlling Through Stock Ownership and Conducting the Business of Another Corporation by Virtue of Such Ownership Is Subjected to the Strictest Accounting

The parent corporation will be held to the observance of the highest rectitude in its transaction with its subsidiary and it will be held to the strictest accountability and as a result of these principles, the parent corporation has the burden of proving their fairness. And where a corporation under such circumstances diverted the funds that properly would go to make up a sinking fund for the retirement of indebtedness of the subsidiary, the parent corporation will be held liable to the bondholders.[16]

§ 374. The Law Disregards Corporate Forms and in So Doing Will Hold That a Foreign Corporation Is Doing Business in the State Through a Subsidiary

In consonance with the general tendency on the part of the courts to brush aside and override corporate forms in the interest of justice, it is now thought to be well settled

[15] Kendall vs. Klapperthal Co., 202 Pa. 596; 52 Atl. 92.
[16] Pa. Canal Co. vs. Brown, 229 Fed. 444; 235 Fed. 669; 149 C. C. A. 89; 242 U. S. 646; 37 S. Ct. 240; 61 L. Ed. 543; see sec. 210.

that the courts will look through such forms to the substance of matter and to ascertain whether a parent corporation is doing business in a state through and by virtue of the manipulation of a subsidiary, and when it is ascertained that the parent is in fact present in the state by virtue of its control of its subsidiary, the parent will be subject to all of the liabilities that would attach were it present itself within the state.[17] The maxim, *qui facit per alium facit per se*, would apply in such cases but such result is reached only by dissipating corporate entities.

§ 375. A Corporation Transacting Business in a State Through the Instrumentality of a Subsidiary Is Required to Comply With the Laws Relating to Foreign Corporations Doing Business Therein

A corporation doing business in a state through the means of subsidiaries, as for instance where a Delaware corporation, for the purpose of owning the stock and of financing a Pennsylvania corporation, has the same officers and substantially the same stockholders and the business of the Delaware corporation being to maintain its office, hold its directors' meetings, register its bonds, and make loans to the Pennsylvania subsidiary, is doing business within the state of Pennsylvania and its compliance with the statute that provides in substance for the unlawfulness of any corporation doing business in Pennsylvania, until it is filed in the office of the secretary of state—the information usually required of foreign corporations to comply with the laws of another state and attaching a penalty for such noncompliance as a penal offense—and a failure to so comply with such a statute will sustain a plea to a cause of action on the part of such corporation within such foreign state, that it is doing business in such state without complying with the statutes relating to foreign corporations, and when it seeks to enforce obligations within such foreign state, it will

[17] United Fuel Gas Co. vs. Railroad Comm. of Ky., 13 Fed. (2d) 510.

be repelled from the courts thereof. In order to accomplish this position, the courts will apply the well settled rule that they will look beyond the mere artificial person which incorporation confers, and if necessary to work out equitable ends, will ignore juristic forms.[18]

§ 376. Corporation Forms Will Be Disregarded to Compel a Corporation Owning a Railroad to Operate It

A foreign corporation engaged in the business of lumbering and manufacturing, and operating a railroad as a common carrier in connection therewith, but in fact, engaged in the business as a carrier to the public generally, may not evade its liabilities to continue the operation of the railroad by the organization of a subordinate subsidiary or affiliated corporation and leasing the railroad thereto, the incorporators of the lumber company being the stockholders of the railroad company, and a state railroad commission may by the disregarding of the corporate entity of the railroad company, compel the continuance of the operation, if public convenience and necessity require it and the courts will sustain the orders of such commission, made in such cases.[19]

§ 377. Railroad Company, Owning a Subsidiary Telegraph Company Will Be Held Responsible Upon the Contracts of Its Subsidiary

A railroad company engaged in the railroad business after developing in its own proper name, a telegraph system which it thereafter caused to be incorporated by the railroad company's officers, and which railroad company furnishing the necessary capital for the operation of the telegraph company thereafter entered into a contract with another in the name of such telegraph company, the railroad company will

[18] Colonial Trust Co. vs. Montello Brick Works, 172 Fed. 310; 97 C. C. A. 144; Pa. Knitting Mills vs. Bibb Mfg. Co., 12 Pa. S. Ct. 346.
[19] Brooks Scanlon Co. vs. Railroad Comm., 144 La. 1086; 81 Southern 727.

be held responsible therefor upon a breach of such contract. The railroad company may not escape liability after a judgment has been had against the telegraph company, by a disposal of the telegraph company's holdings, leaving the telegraph company a mere empty shell without assets or property; it will be held under this state of facts that the money arising from such sale in the hands of the railroad company is a trust fund which the law will direct the application thereof in liquidation of such judgment.[20] It is manifest that this decision is predicated upon the assumption that the two corporations are in substance a single corporation.

§ 378. A Parent-Holding Corporation Having Under Its Control Six or Seven Subsidiaries May Be Compelled to Produce Its Books With Those of the Subsidiaries in an Action Against Subsidiaries

A parent-holding corporation having under its domination and control, by means of stock ownership, a number of other corporations engaged in different departments of different units of a business, and all being financed by the parent, which it dominates and controls by virtue of nomination of directors and stock ownership, having practically the same officers, may be held in a proceeding or action to which the subsidiaries are parties, to produce the books and records of the parent together with those of the subsidiaries, for the purpose of having a full and fair investigation and uncovering of alleged fraudulent transactions in the suit of stockholders.[21]

§ 379. Stockholders Are the Equitable Owners of the Corporate Property

We have already seen that where an individual owns or practically owns all the stock of a corporation and controls

[20] Baltimore & Ohio Telegraph Co. vs. Interstate Telegraph Co., 54 Fed. 50; 51 Fed. 49; 4 C. C. A. 184.
[21] Martin vs. D. B. Martin Co., 88 Atl. 612; 10 Del. Ch. 211.

its operations and policies, the corporation and the individual are in many cases considered by the courts as one and the same.[22] Indeed it is now generally recognized that the stockholders of a corporation may equitably be treated as the owners of the corporate property, or in other words, the stockholders are, in the final analysis, the equitable owners of the corporate property and will be treated by the courts as such.[23]

§ 380. Corporation Owned by Two Persons, There Being No Creditors, the Stockholders May Divide the Property

A corporation owned by two persons to all substantial intents and purposes, there being no creditors or interested third parties, they may divide the assets or property of the corporation and such division will be treated as the declaration of

[22] In re Wilson's Estate, 85 Ore. 604; 167 Pac. 580; Smith vs. Moore, 199 Fed. 689; 118 C. C. A. 127; M. Groh's Sons vs. Groh, 80 App. Div. 85; 80 N. Y. S. 438; but see 177 N. Y. 8; 68 N. E. 992; Linn & Lane Timber Co. vs. U. S., 196 Fed. 593; 116 C. C. A. 267; 203 Fed. 394; 121 C. C. A. 498; 236 U. S. 574; 59 L. Ed. 725; 35 S. Ct. 440; see sec. 70 et seq., supra.

[23] Aransas Pass Harbor Co. vs. Manning, 94 Tex. 558; 63 S. W. 627; Toyaho Creek Irrigation Co. vs. Hutchins, 21 Tex. Civ. App. 274; 52 S. W. 101; Phoenix Assurance Co. vs. Davenport, 16 Tex. Civ. App. 283; 41 S. W. 399; John Church Co. vs. Martinez, 204 S. W. 486; Dillard & Coffin Co. vs. Richmond Cotton Oil Co., 140 Tenn. 290; 204 S. W. 758; Boston & Texas Corp. vs. Guaranty Life Ins. Co., 233 S. W. 1022; King vs. Barnes, 109 N. Y. 267; 16 N. E. 332; 107 N. Y. 643; 13 N. E. 942; 1 Silvernail Ct. App. 529; Swift vs. Smith, 65 Md. 428; 57 A. R. 336; 5 Atl. 534; First National Bank vs. Winchester, 119 Ala. 168; 72 A. S. R. 904; 24 Southern 351; Anderson vs. Burgess, 110 Ore. 265; 223 Pac. 244; Bashford Burmister vs. Hammons, 283 Pac. (Ariz.) 926; Scott vs. Brown, 157 N. E. (Ind.) 64; Wabash R. Co. vs. Iowa & S. W. R. Co. 200 Iowa, 384; 202 N. W. 595; Revloc Supply Co. vs. Troxell, 281 Pa. 424; 126 Atl. 774; Loventhal vs. Gilmore, 123 Misc. 703; 206 N. Y. S. 121. A statute providing as a condition to holding office in a municipality that such officer should "be the owner of property assessed upon the last preceding assessment role" of the muncipality, is satisfied by ownership of stock in a corporation which in turn owns property so assessed. The theory being such, stockholder is the owner of such corporate property. Loventhal vs. Gilmore, see sec. 36, supra. Stockholders are so far interested in corporate property as it is generally deemed that they are benefited by a loan to it. Bankers Trust Co. vs. Beinbauer, 233 N. W. (Iowa) 34.

a dividend and will vest in such stockholders the title to the property or funds so divided and thereafter the corporation may not enforce a return thereof. The stockholders of a corporation may even divide the corporate property where there are creditors, if the division is made subject to such debts.[24]

§ 381. Where a Corporation Agrees to Give a Mortgage Upon Its Property, But Through an Oversight or an Error It Was Executed by the Stockholders, the Mortgage Will Be Sustained

A corporation having obligated itself to execute a mortgage upon its property, but in the drafting of such instrument, through a misprision of the draftsman, the stockholders of the corporation were inserted in such mortgage in lieu of the corporation itself, and such stockholders executed the same, is sufficient to bind the corporate property even though the corporate entity did not execute or sign said mortgage.[25]

§ 382. Corporate Entity Ignored to Allow Surety on Employee's Bond to Defend Against False Statements of Officers of the Corporation

The corporate entity will be ignored and brushed aside in order to admit of the defense on the part of the surety companies, or others in a suit upon fidelity bonds of employees of the corporation, that the corporation or officers thereof had fraudulently and falsely induced the surety to sign said bonds. In other words, the corporate entity will not be held so far aloof from its officers and stockholders as to free the entity from fault in making such false and fraudulent representa-

[24] In re Wilson's Estate, 85 Ore. 604; 167 Pac. 580; Anderson vs. Burgess, 110 Ore. 165; 223 Pac. 244. The only theory that this conclusion could be reached is that the stockholders are equitable owners of the corporate property. See sec. 370, supra.

[25] Bundy vs. Ophir Iron Co., 38 Ohio State 300; First National Bank vs. Winchester, 119 Ala. 168; 72 A. S. R. 904; 24 Southern 351; see sec. 85, supra.

tions and the surety may interpose the same as a defense upon such bonds by the corporation itself.[26]

On the other hand where a bond is given by a contractor pursuant to the Act of February 24, 1905 (33 Statutes at Large, 811, Chap. 778, Compiled Statutes 1916, Section 6923), and such contractor thereafter incorporates himself and the business is continued under substantially the same management, the corporate form will be disregarded and liability of such surety continued, notwithstanding such incorporation.[26a]

§ 383. The Corporate Entity Will Be Brushed Aside in Order to Prevent a Corporation From Recovering Money That Has Been Used in the Purchase of Its Stock by the Consent of All of the Stockholders

Where all of the stockholders and directors either participated in or consented to the use of corporate funds to purchase outstanding stock of the corporation, in such case a recovery of such funds so used cannot be had in the corporate name for the reason that such recovery would, in effect, ultimately result in a benefit to the stockholders and directors who had consented thereto. The theory that such purchase amounted to a misappropriation of the corporate assets will not sustain recovery,[27] and corporate entity will be disregarded and the parties treated in their individual capacities.[28]

§ 384. Corporation May Not Evade Liability by Change of Name

The mere similarity of names of corporations and the fact

[26] McIntosh vs. Dakota Trust Co., 52 N. D. 752; 40 A. L. R. 1021; 204 N. W. 818.

[26a] Ill. Surety Co. vs. John Davis Co., 244 U. S. 376; 37 S. Ct. 614; 61 L. Ed. 1206. See sec. 352, supra.

[27] Ostego Paper Stock Co. vs. Slosberg, 230 Mich. 260; 202 N. W. 991. This is in harmony with the general rule that if stockholders could not maintain or defend an action neither may the corporation, sec. 323a, supra; Home Fire Insurance Co. vs. Barber, 67 Neb. 644; 60 L. R. A. 927; 108 A. S. R. 716; 93 N. W. 1024.

[28] Ibid.

that they both deal in the same commodities will not suffice to call for the rule that separate entities in proper cases will be ignored or treated as one,[29] but on the other hand, neither may a corporation free itself from liability by the mere change of its name, even though that change may result by reason of incorporating under the laws of a different jurisdiction. It may be laid down as a sound proposition that so long as the substance of the corporate form may be traced and identified, that liability follows and no amount of substitution or changing of forms will be sufficient to free the corporation from the liability that justly attaches.[30]

§ 385. Conversion of a Corporation From De Facto to De Jure Will Not Affect Liability

We have seen in the last preceding section that the mere change of name or the assumption of a new corporate form under the laws of a different jurisdiction will not serve to free the corporation, when it is traced and identified, from liability properly attaching to the *quondam* corporate formation. Intimately connected with that proposition is the question where a corporation is in existence as a *de facto* organization and it abandons that imperfect state and assumes the form of a *de jure* entity, in such case it may be said with confidence that this simple metamorphosis will not work the result of freeing the corporate formation from its liabilities and obligations, in existence against the *de facto* organization.[31]

[29] Koch vs. Speedwell Motor Car Co., 24 Cal. Apps. 123; 140 Pac. 598.

[30] Damascus Mfg. Co. vs. Union Trust Co., 119 Ohio St. 439; 164 N. E. 530; White vs. Atlanta B. & A. R. Co., 5 Ga. Apps. 308; 63 S. E. 234; Dean vs. LaMotte Co., 59 Mo. 523; Armour vs. E. Bennett Sons, 123 Fed. 56; 62 C. C. A. 142. In Armour vs. E. Bennett Sons, the position that the change of name will not enable the corporation to avoid liability is obiter. Blair vs. St. Louis H. & K. R. Co., 22 Fed. 36; 24 Fed. 148; Skirvin Operating Co. vs. Southwestern Electric Co., 71 Okla. 25; 174 Pac. 1069; 15 A. L. R. 1104.

[31] Georgia Ice Co. vs. Porter, 70 Ga. 637.

§ 386. De Facto Corporation Sufficient to Prevent Recovery Against Stockholders As Partnership

If it appears in a suit, where the stockholders and directors of a corporation are sued as partners, that there was a *de facto* corporation, that seems sufficient to warrant the court in holding that the stockholders are not partners and that recovery may not be had against such stockholders as partners.[32]

§ 387. Transfer From One Corporation to Another, Which Amounts to a Mere Change of Name, Corporate Entities Disregarded and Property Held Liable For Obligations

A transfer, in its last analysis, amounts to merely a change of name of the corporation and if attempt is made to secrete and put beyond the reach of the creditors the assets of such corporation, the corporate entity will be ignored and overridden and the assets in the hands of the corporation, in the new name, will be held subject to the indebtedness existing against the corporation in the old name.[33]

§ 388. Courts Will Not Disregard Corporate Existence If to Do So Will Injuriously Affect Innocent Stockholders

Courts, in appropriate instances, readily look through the forms of things to their substance and may, in a proper case calling for such action, ignore corporate forms, but that cannot be done where it appears that there are any innocent stock-

[32] Berwald vs. Hamilton Brown Shoe Co., 22 S. W. (2d) Tex. 760. The court also held in this case that where the plaintiff's pleadings sought a recovery upon the theory that the defendants were operating an insolvent corporation and were therefore guilty of a tort in the obtaining of the plaintiff's goods, that the evidence showing a de facto corporation was sufficient to prevent a recovery against the defendants as individuals.

[33] Blair vs. St. L. H. & K. Ry. Co., 22 Fed. 36; 24 Fed. 148.

holders whose interest will require them to adhere to the corporate fiction. So, where some promoters organized a number of investment corporations in conjunction with a Massachusetts Trust and succeeded in filching from almost innumerable persons small amounts of money, the corporate entities will not be disregarded, if to do so would injuriously affect innocent stockholders, and the funds of all of the corporations, the creations of the same promoters, will be treated as a single common fund. In other words, where the interest of various stockholders in the different corporations could not be equitably adjusted by so disregarding corporate forms, the theory of corporate fiction will be adhered to.[34]

§ 389. The Corporate Existence May Not Be Set Aside in Order to Hold a Nonparticipating Stockholder For Fraudulent Misconduct of Another Stockholder

A corporate existence may not be set aside, where it appears that the object of the contention that the entity should be disregarded is to visit liability upon all of the stockholders as partners or to charge responsibility for misconduct upon all. If only one of the stockholders was guilty of misconduct, the corporate entity will be permitted to endure in the interest and for the protection of nonparticipating stockholders in the fraud or misconduct of another stockholder.[35] Thus it seems clear that where it is sought to dissipate the corporate entity, that will not be permitted if the ultimate result of such disregarding of the entity would be visited upon innocent stockholders or third parties, and liability may not be charged against them if the corporate entity is considered.

[34] Spear vs. H. V. Green Co., 246 Mass. 259; 140 N. E. 795; see sec. 384, supra.

[35] Weaver vs. Atlantian Construction Co., 258 Pac. 111; 84 Cal. App. 154.

CHAPTER XIX

DISREGARD OF CORPORATE ENTITY IN PATENT INFRINGEMENT CASES

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§ 389a. The Courts Reject the View That Corporate Fiction Can Be Made to Serve As a Shield Against Violation of Patents

The courts absolutely and entirely reject the not uncommon

view that the fiction of a distinct corporate existence can be made to serve as a shield against the consequences of the individual's wrongdoing, and where it appears that upon the presentation of a case showing active participation by an officer of a corporation in a patent infringement, the courts will not be slow to disregard the corporate device and visit personal liability upon the guilty stockholders.[1]

§ 390. A Corporation May Not Be Organized For the Purpose of Infringing a Patent

Persons may not form themselves into a corporation, the business of which is a necessary infrigement of a patent, and when they attempt to so form a corporation for that purpose, they will not be permitted to escape individual liability for the acts done in the corporate name. The form of a corporation cannot be interposed as a shield by the incorporators to protect themselves against wrongful acts, such as the infrigement of patent rights of another. If it were otherwise, the organizing of an insolvent or worthless corporation, in whose name the wrong was done, would enable patent infringers to destroy the value of the patent and escape the consequences of such wrongful acts.[2]

[1] Weston Electrical Instrument Co. vs. Empire Electrical Instrument Co., 177 Fed. 1006; 100 C. C. A. 670; 166 Fed. 867.

[2] St. Louis Stamping Co. vs. Quinby, 21 Fed. Cas. 212; Fed. Cas. No. 12, 240a; 5 Banning & Arden 275; 18 O. G. 571; Owl Fumigating Corp. vs. Cal. Cyanide Co., 30 Fed. (2d) 812; 24 Fed. (2d) 718. The liability for infringement of patent rights attaching to stockholders of a corporation may be predicated upon the ground of disregarding the corporate entity or upon the theory that the infringement is a tort and under the common-law rule all participants in a tortious act are responsible for the whole of the consequences. While the case of Owl Fumigating Corp. vs. Cal. Cyanide Co. did not sustain the contention that corporate entities should be disregarded, the court clearly recognized the principle and stated the general rule to be that where one corporation is a mere agency or department of another and is used as an instrumentality to perpetrate fraud, justify wrong, avoid litigation or to escape liability for what in substance are its own acts, the courts will put aside the fictional screen and determine the truth and place responsibility where it actually belongs.

§ 391. A Corporation Owning and Controlling Another Will Be Responsible For a Patent Infringement Through Such Subcorporation

Application of the principle that the doctrine of separate legal entity of corporations, as distinguished from its members, cannot be invoked as a cover for an illegal transaction, but in such case the court will look beyond the corporate form to the purpose of it and whatever would be binding upon the person composing it, will be binding upon the corporation. Whether the stock is owned and controlled by a single person, natural, or artificial, is immaterial and an infringement of a patent by a parent corporation, through its subcorporation organization, will be sustained and the parent corporation will be visited with the consequences resulting from such infringement, or corporate forms will be removed as obstructions in the way of justice to reach and adjudicate the interests of the parties and to fix responsibility where it properly belongs. This rule is so far enforced that the parent corporation, having assumed the charge of the litigation and conducted the same, will be liable in litigation even though it is not a technical party to the record.[3]

§ 392. The Doctrine of Estoppel Applicable As Against the Assignor of the Patent, Is Operative Against a Corporation Subsequently Formed by Him

An assignor of a patent is estopped by his assignment and likewise a corporation subsequently formed by him will be estopped by such assignment, the corporation being entirely

[3] Searchlight Horn Co. vs. Am. Graphophone Co., 240 Fed. 745. See, however, apparently to the contrary, Glucose Sugar Refining Co. vs. St. L. Syrup & Preserving Co., 135 Fed. 540. Upon what theory the last cited case could be sustained it is difficult to conceive when it would seem manifest that the president of a corporation who directs the corporate infringement of the patent could be held not responsible, either as a participant in the commission of a tort or by reason of brushing aside the corporate entity.

owned and controlled by him. The operation of the principle that the corporation is estopped is by no means restricted in its application to cases where the corporation is owned and controlled by the assignor, but it will be given operation and effect even if other parties have a substantial interest therein, if it can be made to appear that such other parties had knowledge of the patent assignment at the time of the acquisition of such interest.[4] It has been well said that the men behind a corporation responsible for its doings, and representing it as individuals made a contract, cannot escape its just obligations by metamorphosing.[5] In other words, parties holding a patent right may not sell the same and thereafter organize a corporation and through the instrumentality of the corporation infringe the patent and escape the consequences.

§ 393. Corporate Entity Disregarded to Hold Responsible Party For Costs in Infringement of Patent Case

No person or persons can organize a sham corporation with the intention of working through it and its name for their own individual purposes and escape liability for their wrongful conduct. Where it appears that three persons using a corporation owned and controlled by them—they owning all of the stock and fully and completely controlling and dominating such corporation, which is a defendant in a patent-infringement case and costs having been adjudged against such defendant corporation, its owners—the three individuals may be required to pay the defendant corporation's costs and may even be attached for nonpayment of the same, under federal equity rules.[6]

[4] National Conduit Mfg. Co. vs. Conn. Pipe Mfg. Co., 73 Fed. 491. It is readily apparent in this case that the court simply refused to be blinded by the erection before its eyes of the fictional legal personality of a corporate entity.

[5] Philadelphia Creamery Supply Co. vs. Davis & Rankin Bldg. & Mfg. Co., 77 Fed. 879; see secs. 286, 323, supra.

[6] Robert Findlay Mfg. Co. vs. Hy-grade Lighting & Fixture Corp., 288 Fed. 80.

§ 394. Corporation Dominating Another, Together With Owning Its Stock, Sufficient to Hold Stock-owning Corporation Responsible For Patent Infringement

Where the evidence indicates that a patent-infringing corporation is a mere instrumentality of its dominating company, which has acquired the stock of the infringing company for the purpose of using that corporation as a cover for its own transactions and completely dominated the infringing company, the purported acts of the infringing company will be charged to the dominating company, the dominating company using the name of the infringing company merely in order to be fully covered on the patent infringement, and the dominating company having supplied from its own employees and officers completely the employees and officers of the infringing company.[7]

§ 395. One Corporation Owning and Controlling Another, Including Goodwill, and Operating Its Plant, Is Responsible For Patent Infringement

Where it appears that one corporation owns the controlling majority of the stock of another and the controlling corporation furnishes an infringement apparatus, the directors in both corporations being the same, perhaps would be sufficient to fix liability for a patent infringement upon the controlling corporation, but the controlling corporation will certainly be responsible where it is shown not only that it is the owner of the majority of the stock and that some of the directors of

[7] Radio Craft Co. vs. Westinghouse Electric & Mfg. Co., 7 Fed. (2d) 432; 291 Fed. 169. The court in this case applied the principle that where stock control has been resorted to, not for the purpose of participating in the affairs of the corporation in the normal and usual manner, but for the purpose of controlling the company so that it may be used as a mere agency or instrumentality of the owning company, the courts will look through the screen of separate corporate control and place the responsibility where it actually belongs. See also Southern Realty Investment Co. vs. Walker, 211 U. S. 603; 29 S. Ct. 211; 53 L. Ed. 346.

one company are the directors of the other, but also that the stock-owning corporation absolutely controls and owns the entire property of every kind, including the business and goodwill of the infringing corporation and is operating and conducting the plant and business as a department of the stock-owning company's business—such stock-owning corporation having advertised its entry into the particular field of commerce—that the infringing corporation was engaged in—and advertising that it had acquired the plant of the infringing corporation, will certainly be sufficient to make the parent corporation liable for the subsidiary corporation's conduct.[8]

§ 396. Where Adjudication in a Patent-infringing Case Is Had Against a Subsidiary Corporation, a Plea of Res Adjudicata Will Be Sustained in an Action Against the Dominant Corporation

A patent-infringing case having been prosecuted to a final judgment against a subsidiary corporation, and thereafter a separate and distinct suit is filed in another jurisdiction against the dominating corporation of such subsidiary, the defendant in the second suit may interpose the plea of *res adjudicata* by reason of the judgment against its subsidiary, and the plea will be sustained where it appears that the defendant in the first suit was a mere sales agent of the former and that the defendant in the second suit, the dominant corporation, owns all of the stock of the judgment defendant in the first action and completely controls it. In such case the identity of interest, if the corporate entities are disregarded, could not be clearer or closer. There was but a single interest involved in both actions.[9]

[8] Westinghouse Electric Manufacturing Co. vs. Allis Chalmer's Co., 176 Fed. 362; 100 C. C. A. 408; Rev. 168 Fed. 91. Gates Rubber Co. vs. B. F. Goodrich Rubber Co., 42 Fed. (2d) 652, where it is said: "The chancellor will always disregard the corporate entity in determining the real relation between two corporations."

[9] Hart Steel Co. vs. Railroad Supply Co., 244 U. S. 294; 61 L. Ed. 1148; 37 S. Ct. 506.

§ 397. A Corporation Succeeding to the Business and Assets of Another During Pendency of Patent Litigation Will Be Responsible For Judgment Obtained

In a suit for infringement of patent, a corporation which purchases the business of the alleged infringer while the suit is pending and assumes to pay the debts of its predecessor, will be held liable for the judgment obtained in the infringement suit and may not evade the effect of this position by reason of the fact that it had made a promise to its predecessor that it would pay the infringer's debts and that such promise was not made to the judgment plaintiff.[10]

§ 398. Corporation Succeeding a Partnership Is Bound by the Contract of Such in the Sale of Patent

In consonance with the rule prevailing generally, that a corporation succeeding a partnership or organized out of it, or where a partnership is merely converted into corporate formation that such corporation shall be liable upon the obligations and contractual undertakings of its predecessor, is the rule that where a partnership is bound by an agreement pertaining to a patent that a corporation organized, officered, and owned by the partnership will likewise be bound by such contract. In such case where it appears that the men behind a corporation are responsible for its doings and are the recipients of its profits and they as individuals or partners have made the contract under consideration, they cannot escape its just obligations by a metamorphosing themselves into a juristic personality.[11]

[10] Philadelphia Rubber Works vs. U. S. Rubber Reclaiming Works, 276 Fed. 613; 277 Fed. 171; 257 U. S. 660; 42 S. Ct. 187; 66 L. Ed. 442. The rule in patent-infringement cases is no different to position maintained in other cases involving one corporation succeeding another. It is generally true that one corporation succeeding another, under such circumstances as to make the successor liable, the successor is bound by such judgment. See sec. 139, supra. That is such change takes place while an action is pending against the succeeded corporation, it is not necessary to do more than to amend the proceedings so as to insert the name of the succeeding corporation. See sec. 203, supra.

[11] Philadelphia Creamery Supply Co. vs. Davis & Rankin Bldg. & Mfg. Co., 77 Fed. 879.

§ 398a. A Corporation Having the Same Officers, Largely the Same Directors and Infringing Patent on Property of Another Together With Stock Ownership Makes Both Corporations Liable Therefor

Where a corporation is engaged in infringing a patent and it appears that its officers were the same as those of another corporation, that its board of directors was largely composed of directors of such other corporation, owned practically all of the stock of the infringing corporation and that the infringement took place on the property of such other corporation, that seems sufficient to make both corporations liable. While it is true that community of officers and directors and stock ownership might not in and of itself be sufficient to render both corporations liable for such acts of infringement of patent, yet these circumstances coupled with the fact that the infringement took place on property of the corporation that it was sought to hold responsible for the acts of the infringing corporation, makes out a case. Such facts and circumstances it seems warranted the conclusion that such other corporation was a party to the infringment and engaged therein.[12]

[12] Union Sulpher Co. vs. Freeport Tex. Co., 215 Fed. 634; 234 Fed. 191; 255 Fed. 961; 167 C. C. A. 253; 249 U. S. 618; 63 L. Ed. 804.

CHAPTER XX

RIGHTS AND LIABILITIES IN DEALING WITH TWO CORPORATIONS WHICH ARE THE SAME

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§ 399. Government Lands Being Obtained by Fraud of Which an Individual Has Knowledge, a Corporation Organized by Him Has the Knowledge Imputed to It

Government lands having been obtained by fraud which the patentee thereof, transferred to another who had full knowledge of such fraud and the grantee of such fraudulent patentee thereafter organized a corporation and in turn transferred the lands to it, the knowledge of such organizer of such corporation is imputed in law to the corporate formation itself. Undoubtedly, as a general rule, a corporation is in law a person or an entity entirely distinct from its stockholders and officers. It may have interests distinct from theirs. Their interest, if it is enforced, may be adverse to its interest, and by reason of this proposition of law there has arisen a presumption that their knowledge for many purposes is not its knowledge, but while this presumption should be enforced to protect the corporation, on the other hand it should not be carried so far as to enable the corporation to become a means of fraud or a means of evading its liability. It may be safely said that today there is a great tendency exhibited on the part of the courts to look beyond the corporate form to the purpose of it and to the officers who are identified with that purpose.[1] Corporate entities will be so overridden as to charge a reorganized corporation with notice of injunction issuing against the former corporate organization, but both corporations being controlled by the same officers, agents and stockholders.[2] Indeed, it is now a rule of law well recognized and thoroughly sustained by the adjudicated cases, that knowledge or actual

[1] McCaskill Co. vs. U. S., 216 U. S. 504; 54 L. Ed. 590; 30 S. Ct. 386.
[2] Farmers Fertilizer Co. vs. Ruh, 7 Ohio App. 430.

notice of all corporators, including the president of an incorporated company, who are associated together to carry forward a common enterprise, is knowledge or notice of the corporation itself and where such incorporators are bound by such knowledge, actual or constructive, the company would likewise be bound.[3]

§ 400. Where Two Corporations Are Formed by the Same Stockholders and a Mortgage Is Foreclosed on Property Executed by One of Them, the Other Entity Will Not Be Permitted to Enjoin Foreclosure Proceedings

Where there are two corporations identical in name, but organized under the laws of different states and it being true that there was no formal merger of the two corporations, they technically remaining separate and distinct, yet where a mortgage is foreclosed against property, the mortgage having been executed by one, the other will not be permitted to enjoin the proceedings, it appearing that the two corporations were owned by the same stockholders and that they were organized in the furtherance of a single corporate enterprise.[4] There is but a single theory upon which the court could reach this result and that is that it abrogated the barriers of corporate entities and dealt with the substance of things and declined to be hampered or shackled by form. It should be borne in mind, however, that identity of stock ownership and close affiliation and management does not necessarily merge corporate entities, where the association goes no further than that.[5] Neither does the fact that two corporations having directors or officers in common, bar the right of one corporation to sue the other.[6]

[3] Simmons Creek Coal Co. vs. Doran, 142 U. S. 417; 12 S. Ct. 239; 35 L. Ed. 1063. As to estoppel, see secs. 286, 323, 392, supra.

[4] Ala. & G. Mfg. Co. vs. Riverdale Cotton Mills, 198 U. S. 188; 25 S. Ct. 629; 49 L. Ed. 1008; Rev. 62 C. C. A. 295; 127 Fed. 497.

[5] Corsicana National Bank of Corsicana vs. Johnson, 251 U. S. 68; 64 L. Ed. 141.

[6] Jones Lbr. Co. vs. Wisarkana Lbr. Co., 125 Ark. 65; 187 S. W. 1068; see secs. 26, 69, supra.

§ 401. Two Corporations Sustaining Such Relationships As Warranting the Conclusion That They Are One, They Will Be Interchangeably Liable Upon Contracts

Where two corporations are engaged in and so commingled and intermingled their affairs and business that the inference may be indulged that they are the same corporation, they will be interchangeably liable upon contracts. So where a corporation engages an attorney for the purpose of rendering services to its auxiliary corporate formation, the contracting corporation will be liable for such compensation. In other words, the difference between the technical legal entities will not be indulged to the detriment of third parties contracting with either corporate formation.[7] It seems that the liability in such cases is not confined to contractual obligations but embraces torts as well.[8]

§ 402. A Corporation Owned by a Single Individual Is Bound Upon His Contracts For Attorneys and Other Employment Contracts

A party owning all of a corporation, except one share which is owned by his wife and such party, employs an attorney to defend a divorce action, an action may be maintained against the majority stockholder of the corporation and the corporation for such attorney fees in the divorce action.[9] The opera-

[7] Kelley vs. Ning Yung Benevolent Ass'n, 2 Cal. App. 460; 84 Pac. 321; W. R. Grace & Co. vs. Luckenbach S. S. Co., 258 Fed. 49; 248 Fed. 953; 267 Fed. 676; 254 U. S. 644; 65 L. Ed. 454; 41 S. Ct. 14. In this case the principle that where two corporations are the same, either by the stock being concentrated in the hands of the same stockholders or by virtue of one corporation owning the stock of another, it seems that they will be held indiscriminately liable upon the contractual obligations of either. See also Gladys Belle Oil Co. vs. Clarke, 296 Pac. (Okla.) 461, where the principal relationship between two corporations was that they had the same president and one was held liable for goods furnished to other.

[8] In re Santa Barbara, 299 Fed. 147; 299 Fed. 152.

[9] Clark vs. Schwaegler, 104 Wash. 12; 175 Pac. 300; see also Boothe

tion of the principle in this case cited in the footnote, clearly seems to be that where an individual is the substantial owner of all of the corporate stock, the court will deal with such stockholder and the corporation indiscriminately and they will be jointly and severally bound for the undertakings of each other. So where an employee is engaged by an individual and such individual thereafter incorporates the business for its expansion and continuance and such employee aids therein and becomes a director of such corporate form, but such individual is the substantial owner of the corporation, the difference between such corporation and its owner constitutes such in name only, and the corporation is bound thereby and a judgment will be rendered in suit on such contract of employment entered into between such employee and said individual against the jural personality. When these facts appear it is ample to hold the corporation thereon.[10]

§ 403. Where All Stockholders Enter Into a Contract of Employment, the Corporation Will Be Liable Thereon

We have already seen that where a single stockholder enters into a contract of employment, the corporation and the stockholders will be treated indiscriminately dealing with the liability thereon, and of course, this principle being sound in application, it would be likewise true that where all of the stockholders of a corporation engage the services of an attorney or enter into other contractual employment, the corporation will be liable for the compensation thus incurred by the stockholders. It is perhaps safe to say that if the stockholders in their individual capacity would be liable upon the contracts, they owning the corporation, it will likewise be liable.

vs. Summitt Coal Mining Co., 55 Wash. 167; 104 Pac. 207; 19 A. C. 1255. It would seem to follow from the holding in Clark vs. Schwaegler, supra, that where a husband is owner of a corporation upon a divorce being granted, the corporate form would present no obstacle to court making any equitable division of such property warranteed by the facts in same manner as if the corporation did not exist.

[10] Davis vs. Fanny Briggs Carr Inc., 288 Pac. (Cal.) 710.

In other words, if the parties owning all of a corporation enter into a contractual relationship, as that of employing an attorney, then the corporation will be bound. To reach this result the court merely takes the position that it will not be blinded as to the true facts by a mere juristic figment.[11] The courts in our day refuse to be gyved with the iron fetters of the juristic corporate fiction.[12]

§ 404. Two Corporations Organized Under the Laws of Different States and Owned by the Same Stockholders and With a Single Purpose in View Will Be Treated As One, and Upon Insolvency of Either, the Affairs of Both Will Be Administered

In consonance with the principle announced, where two corporations are organized under the laws of different states but have the same stockholders, and the same objects in view, it seems clear enough that on the insolvency of either ancillary proceedings may be inaugurated in the jurisdiction of the organization of the other and wind up the affairs of both corporations contemporaneously.[13] It is immaterial whether this result is reached upon the theory that one is a parent and the other a subsidiary corporation or whether they are regarded as auxiliary units operating in consonance for the accomplishment of the ultimate common purpose or whether they are treated as corporations separate and distinct for technical purposes but yet, in proper cases, will be treated as a single corporate organization, for in any case in order to accomplish the end of treating both corporations as one, an abrogation of the corporate entities is called for.[14]

[11] Campbell vs. Hanford, 67 Cal. App. 155; 227 Pac. 234; see sec. 399 et seq., supra; see secs. 124, 292, 349, 368, supra.
[12] Sec. 399 eq seq., supra.
[13] Day vs. Postal Telegraph Co., 66 Md. 354; 7 Atl. 608; see secs. 124, 292, 349, 368, supra.
[14] Sec. 399 et seq.

§ 405. An Agreement Made by Persons in Contemplation of Incorporation, Others Not Being Affected, Binds the Corporation

The principle we have been discussing has kaleidoscopic application, and so it is now well settled law that an agreement made by persons interested in contemplation of incorporation, where the interests of others are not affected, controls the conduct of the corporation's affairs after it is brought into existence. Such an agreement will be binding upon the corporation when it appears that it is made by persons interested in or who really represent the interest of those afterward incorporated and whose agreement is in anticipation of the formation of the corporate personality and especially is this true where, after the forming of a body politic is accomplished, it was recognized by such body. This doctrine has been resorted to, to sustain and enforce a contract for a division of profits.[15]

§ 406. Where One Corporation Owns All of the Stock in Another and the Property of the Stock-owned Corporation Is Sold on a Judgment Against the Stock-owning Corporation, the Stock-owned Corporation May Not Complain Thereat

Where one corporation owns all of the stock in another and the corporation owning the stock is a judgment debtor and the property of the corporation that is thus owned by the other, is sold on execution issued on such judgment, the corporation owning the property and is in turn owned by another corporation, may not complain at such action, and an action to quiet title to real estate thus sold will not lie at the instance of the corporation whose property is sold on execution issued against the corporation that owns the stock of the complaining company. In other words, where one corporation owns all of the stock of another, it seems that their property

[15] Conover vs. Smith, 88 Cal. App. 227; 256 Pac. 835; see secs. 85, 330, supra.

judgment debtor or in whose name the title to such property resides.[16]

§ 407. Corporation May Not, by Juggling of Entities, Evade Law Against Leasing of Railroads

Where a railroad company is prohibited by law from making a lease in another state, it will not be permitted to thus evade the law by the creating of a local domestic corporation. The corporation may not by the misnomer of papers and the use of a lessee change the substance of the transaction. It must not be thought that the courts are powerless to strip off disguises to thwart the purpose of the law; when any disguise in fact appears, they can and will be readily disrobed.[17]

§ 408. Where a Street Railway Company Is the Same With a Construction Company, the Street Railway Company Will Be Held Liable For Trespasses of the Construction Company

An action of trespass will lie against the street railway company where there is no difference between the corporate entities of such street railway company and the construction company. In other words, by a dissipation of the corporate fictions, the act of one fixes liability upon the other.[18]

§ 409. Where Two Corporations Are the Same, a Judgment by One Against the Other Is Void As Far As Creditors Are Concerned

Where two corporations are owned and controlled by the

[16] Lost Burros Gold Mining Co. vs. Inyo County Bank, 83 Cal. App. 679; 257 Pac. 209.

[17] Stockton vs. Central Railroad Co., 50 N. J. Eq. 52; 17 L. R. A. 97; 24 Atl. 964; see sec. 368, supra.

[18] West Chicago Street Ry. Co. vs. Morrison, Adams & Allen Co., 160 Ill. 288; 43 N. E. 393; in re Santa Barbara, 299 Fed. 147; 299 Fed. 152; see sec. 401, supra. See secs. 35, 242, supra, relating generally to liability for torts.

same stockholders, having the same officers, and such state of facts exists as calls for the application of the doctrine that corporate entities will be overridden, then a judgment by one against the other, in so far as creditors of either are concerned, is utterly void.[19]

§ 410. Where a Number of Corporations Organize Another in the Interest of Their Combined Business, It Will Not Be Treated As an Entity Separate From Its Owners

It is immaterial what form associated corporations take in order to carry on a part of their business. It is immaterial whether they are called subsidiary companies or otherwise designated, for courts will look through the form to get at the real intent of the association of individuals or other corporations forming the organization, and if rights of other parties intervene, the real purpose of the corporate organization will be given its proper effect in the interest of square dealing and for the effectuation of justice. So where a number of corporations, as railroads, organize another, as a refrigerator company, at all times owned by the railroad companies and they in fact paying for its stock, they selecting its directors and making their officers its officers and absolutely and completely controlling it and dominating it, taking unto themselves the refrigerator company's profits, the refrigerator company will not be held as a separate entity or carry the force and effect of an independent corporate existence.[20] So where a railroad corporation, through one of its subsidiaries, controlled another railroad and dominated its affairs, the corporate form will be brushed aside and the parent railroad company and its subsidiary will be treated as one. And under such circumstances, the parent railroad corporation will be treated as the majority stockholder and will

[19] McDonald vs. Charleston C. & C. Ry. Co., 93 Tenn. 281; 24 S. W. 252; see sec. 88, supra.

[20] Wabash Ry. Co. vs. Am. Refrigerator Transit Co., 7 Fed. (2d) 335; 270 U. S. 643; 46 S. Ct. 208; 70 L. Ed. 776.

be compelled to assume a fiduciary role attaching to majority stockholders as to the minority.[21]

§ 411. Set-Off Allowable Between Debtor of a Corporation and Its Receiver Where Stockholder Is Indebted to the Corporation's Debtor

In an action where a receiver of a corporation brings a suit against an alleged debtor of such corporation, and where the corporation has a single stockholder, a set-off will be allowed between such receiver and the corporate debtor. In other words, the corporate entity will be disregarded in such action by the receiver against a corporate debtor, and the receiver will be held to stand in the place of the sole stockholder of the corporation, and if such stockholder is indebted to the corporate debtor, the accounts will be adjusted by set-off.[22]

[21] Southern Pacific Co. vs. Bogert, 250 U. S. 483; 39 S. Ct. 533; 63 L. Ed. 1099; 156 C. C. A. 489; 244 Fed. 61. In this case the Southern Pac. Co. attempted thru control by its subsidiary to dominate affairs of Houston & Tex. Central Railway Co. and caused it to be reorganized as Houston & Tex. Central Railroad Co.; and in granting relief to minority stockholders of the old Houston Co., the court ignored separate corporate form of Southern Pacific Company's subsidiary and granted relief to minority stockholders in same manner as if subsidiary did not enter into the matter at all.

[22] Knight vs. Burns, 22 Ohio App. 482; 154 N. E. 345; see sec. 20, supra.

CHAPTER XXI

DISREGARD OF CORPORATE ENTITY IN DEALING WITH TAX MATTERS

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412. A corporation may not be used for the purpose of evading tax.
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414. A holding corporation and a subsidiary will not be treated as one in order to allow the parent to escape taxes.
415. It has been held that the holder of stocks, exchanging them for stocks in a new corporation, taking over the business of the old is liable for a tax under a statute providing for taxation of gain in purchase or sale of property.
416. A tax on corporations doing business within a state may not be laid against a parent corporation whose only interest is stock within a subsidiary, within the state.

§ 412. A Corporation May Not Be Used For the Purpose of Evading Tax

Where the corporate formation is used for the purpose of evading the law, this will not be permitted by the courts and the legal entity cannot be interposed so as to defeat justice. Therefore, where a realty corporation was formed for the sole benefit of its stockholders for their convenience in handling and managing properties, payment of interest charges to such stockholders is not a payment required to be paid as a condition to the continued use or possession or the properties and will not be allowed as a credit under the federal statutes.[1]

[1] *Corporation Tax Law of 1909, 36 Statute at Large 112, C. 6, sec. 38;* U. S. vs. Barwin Realty Co., 25 Fed. (2d) 1003; Nixon vs. Lucas, 42 Fed. (2d) 833; see sec. 482.

§ 413. Corporate Form Will Not Serve to Make Property Subject to Income Tax

A holding company owning all of the stock in other corporations involved in the matter, except qualifying shares held by the directors, which company with others constituted a single enterprise when the transaction was stripped of technicalities and formalities and corporate entities were ignored, the enterprise was producing, buying, transporting, refining, and selling oil; the subsidiary companies retained their earnings but did make some loans *inter se* and the funds of all of the companies were invested in the properties or retained as actual necessary funds to carry on the business and at the beginning of a given year the parent corporation decided to take over the previously accumulated earnings and surplus and did so. However, disregarding the forms surrounding the transaction of the business, the result was merely that the parent company became the holder of property or funds that had been in the name of one of its companies. It was no richer than before, such transaction being effected largely by entries upon the respective corporate entity's books. The fact that such parent corporation and its subsidiary were distinct entities in contemplation of law does not prevent the consideration that they were related as parts of one enterprise, all owned by the parent company, and by mere bookkeeping entries and distribution of debits and credits to the parent corporation would not make the parent subject to income tax.[3]

[3] Gulf Oil Corp. vs. Llewellyn, 248 U. S. 71; 63 L. Ed. 133; 39 S. Ct. 35; 242 Fed. 709; 158 C. C. A. 1; 245 Fed. 1. So where one corporation owns another they will be treated as one for income-tax computation. Southern Pac. Co. vs. Lowe, 247 U. S. 330; 38 S. Ct. 540; 62 L. Ed. 1142. The rule of this case is statutory now, 43 Sts. 288; 26 U. S. C. sec. 993; see, however, contra Nixon vs. Lucas, 42 Fed. (2d) 833, where the court held that partners owning a corporation were not entitled to a deduction for money advanced to their corporation. Concededly, the three partners were the corporation; see also, contra Walker vs. Gulf & I. Ry. Co., 269 Fed. 885. However, see in accord with text Western Md. Ry. Co. vs. Comm. of Internal Revenue, 33 Fed. (2d) 695.

§ 414. A Holding Corporation and a Subsidiary Will Not Be Treated As One in Order to Allow the Parent to Escape Taxes

Under a statute providing that a corporation's property shall be assessed in the name of the corporation and so long as the corporation pays all its taxes, the stockholders will not be required to list for taxes their shares, but in order to bring a stockholder within the purview of the statute, it must appear that the corporation owns tangible property in the state acquired in good faith for corporate use and purposes, upon which the taxes have been paid. So, a holding company owning the stock of a corporation, whose stockholders are exempt under such statute, will not relieve the stockholders of the holding company from taxes on their stock and for the purpose of taxes, it seems that the courts refuse to treat the holding company and its subsidiary as one.[3] So where two manufacturing corporations built a plant, which was operated by a third corporation, the stock of which the other two corporations own, the stock-owning companies and the operating company were not engaged in the manufacture of products so as to exempt the property from taxes, under a statute providing that property would be exempt from other than state taxation, but in order to be thus exempt such property must be in the course of manufacturing and must be products of persons or corporations actually engaged in manufacturing.[4]

[3] Commonwealth vs. Muir, 170 Ky. 435; 186 S. W. 194.

[4] Ayer & Lord Tie Co. vs. Commonwealth, 208 Ky. 606; 271 S. W. 693. It is submitted that these two cases, Commonwealth vs. Muir and Ayer & Lord Tie Co. vs. Commonwealth, are not sound; that if in truth and fact, disregarding or abrogating, the mere fictional existence of the corporation would reach the real substantial truth, that, that ought to be done and cases holding to the contrary are not in keeping with the trend of the great weight of authority and that it can make no difference that the question arose in a tax proceeding as in any other case. The Kentucky court has not hesitated to disregard corporate forms where it resulted in greater taxes to the commonwealth. Commonwealth vs. Southern Ry. Co., 237 S. W. 11; 193 Ky. 474; 271 S. W. 693; Southern Ry. in Kentucky vs. Thomas, 90 S. W. 1043; 28 Ky. L. R. 951.

§ 415. It Has Been Held That the Holder of Stocks, Exchanging Them For Stocks in a New Corporation, Taking Over the Business of the Old, Is Liable For a Tax Under a Statute Providing For Taxation of Gain in Purchase or Sale of Property

The Supreme Judicial Court of Massachusetts held that the holder of stocks was subject to taxation as for gain when the transaction simply amounted to a new charter being obtained and an exchange of stock in the old company for stock in the new. However, the stockholders in the new corporation received a greater amount in par value than the stockholders in the former company. The court took the position that the corporations were separate entities though the property owned by the old corporation was all of the assets that the new corporation had and that a stockholder who had received increased par value of stock in the new corporation, was subject to taxation under a statute providing for the taxing of gains from a purchase or sale of intangible property.[5]

[5] Osgood vs. Tax Commissioner, 235 Mass. 88; 126 N. E. 371. It is submitted that this position is unsound. It seems that there is a manifest tendency on the part of the courts to adhere more rigidly to the corporate entity theory in tax proceedings than otherwise if it will result in taxation, but clearly the rule announced in the last cited case is in conflict with the position of the Supreme Court of the United States in Gulf Oil Corporation vs. Llewellyn, 248 U. S. 71; 39 S. Ct. 35; 63 L. Ed. 133; 242 Fed. 709; 158 C. C. A. 1; 245 Fed. 1. An English court voiced the position of the courts in dealing with taxation and question of corporate entities, where it says: "All I would wish to observe that in matters of this kind, especially in revenue matters, it seems to me that one ought to look in the substance and not merely matters of machinery of form and there is a great deal to be said, I think, in favor of the larger view taken by the attorney general, that in effect and substance this English Company is, through the American Co., doing the business they do." St. Louis Breweries vs. Apthorpe, 79 Law Times Rep. N. S. 551. It is difficult to perceive upon what theory there should be a rule governing the decisions of courts upon a particular question of law when revenue matters are involved, that should be different when the same point arises in any other case. Such position on the part of the courts smacks too much of the idea of royalty. Apthorpe vs. Peter Schoenhofen Co., 79 L. T. N. S. 98.

§ 416. A Tax on Corporations Doing Business Within a State May Not Be Laid Against a Parent Corporation Whose Only Interest Is Stock Within a Subsidiary Within the State

The mere fact that a portion or even all of the stock of a subsidiary corporation doing business within the state of New York is owned by a foreign corporation, will not serve to establish the position that the foreign corporation is engaged in business within the state so as to subject it to state tax law on the privilege of corporations doing business within the state, provided that the affairs with the subsidiary are controlled by its own officers and are not subjected to the control of the holding company.[6]

[6] People vs. American Bell Telephone Co., 117 N. Y. 241; 22 N. E. 1057; Procter & Gamble vs. Newton, 289 Fed. 1013.

CHAPTER XXII

DISREGARD OF CORPORATE ENTITY IN CONNECTION WITH VIOLATION OF STATUTES

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419. Corporate entities will be abrogated to discover violation of the Federal Anti-Trust Law.
420. Corporate entity will be sustained in such manner that an officer may not claim the constitutional privilege of it.
421. The corporate fiction will be abrogated to discover violation of the Clayton Law.
422. Corporations may not be manipulated so as to evade the provisions of the Alien Enemy Trading Act.
423. A corporation owned by citizens of belligerent antagonist will make the property of such corporation enemy property.
424. Corporate entity will be abrogated to allow recovery by government against stockholders of tax on distilled spirits.
425. The corporate entity will not serve as a cover for a monopoly.
426. Corporate entity may not be interposed to shield against prosecution for a criminal act.
427. A corporation organized for unlawful purposes, its stockholders will be personally liable on its obligations.

§ 417. Corporate Entity Will Not Serve to Shield Its Controlling Head From Prosecution For Using Mails to Defraud

An individual using the mails to defraud may not panoply himself against the criminal consequences of his acts by organizing a corporation and carrying on the fraudulent scheme in its name. In such case the question in its last analysis when

stripped of legal verbiage, the one who has organized the corporation, of which he is the active and controlling factor and is the sole owner or practically so of all of its capital stock, may not shield himself from the consequences of his acts as the chief actor in the affairs of the corporation, by claiming that he is not individually liable for any of its acts.[1]

§ 418. Corporate Entities Will Be Abrogated to Uncover Violation of the Hepburn Act

The Hepburn Law of the United States[2] provides that it is unlawful for any railway carrier to transport in interstate commerce, articles or commodities manufactured, mined or produced by it or under its authority or which it may in whole or in part own or in which it may have any interest, direct or indirect. Under such act the exercise by a railway carrier corporation of its power to own stock in another corporation engaged in the business of manufacturing, mining or producing or owning commodities in such a manner as to deprive the manufacturing company of its power of autonomy and to make it for all practical purposes but an agency, dependency or department of the railroad company, violating the provision of the Hepburn Act and no pretext of separate corporate existence may be interposed to prevent the courts holding such act as violating the statute.[3]

§ 419. Corporate Entities Will Be Abrogated to Discover Violation of the Federal Anti-Trust Law

Corporate entities will not be permitted to stand in the way of unearthing violations of the Federal Anti-Trust Law and so, where the stockholders of two competing interstate railway companies conceived the idea of forming a stockholding

[1] Redmond vs. U. S., 8 Fed. (2d) 24; see sec. 426, infra.
[2] Act June 29, 1906.
[3] U. S. vs. Lehigh Valley Railroad Company, 220 U. S. 257; 55 L. Ed. 458; 31 S. Ct. 387; see also U. S. vs. Delaware & Hudson Co., 213 U. S. 336; 53 L. Ed. 836; 29 S. Ct. 527.

corporation, which acquired the stock of the railroad companies by exchange of its own stock, in such case the court will brush aside the corporate fiction to ascertain the true transaction and deal with it as such.[4] Of course, the same rule would find adhibition in dealing with state anti-trust laws, where it was sought to hide behind the corporate fiction.

§ 420. Corporate Entity Will Be Sustained in Such Manner That an Officer May Not Claim the Constitutional Privilege of It

It seems that an officer of a corporation may not claim the privilege of the corporation accorded it by constitutional provisions against self-incrimination. Perhaps, such holding is reached upon the theory that the right to claim the privilege against disclosure is a personal one.[5] It is a little difficult to see, if an individual owned all of the stock of a corporation—if the corporation is his *alter ego*—why he should not be permitted to claim the privilege against disclosures in violation of the constitutional rights of the corporation. It is submitted that the spirit of the constitution would give him this right in the same manner as it would if he were doing business under a fictitious name. The better rule would seem to be if an individual owns all the stock of a corporation, the state or government in dealing with that corporation will treat it in the same manner as if the state or government were dealing with such individual directly and it will be granted all the rights under the laws that such individual might enjoy.[6] This rule, it is submitted, is the sounder and juster one. No good reason appears as to why this rule should not apply to constitutional guarantees as well as other laws.

[4] Northern Securities Co. vs. U. S., 193 U. S. 197; 48 L. Ed. 679; 24 S. Ct. 436; U. S. vs. Leigh Valley Ry. Co., 254 U. S. 255; 65 L. Ed. 253; 41 S. Ct. 104; see secs. 316, supra, 425, infra.

[5] Hale vs. Henkel, 201 U. S. 43; 26 S. Ct. 370; 50 L. Ed. 652; McAlister vs. Henkel, 201 U. S. 90; 50 L. Ed. 671; 26 S. Ct. 385.

[6] See sec. 235, supra.

§ 421. The Corporate Fiction Will Be Abrogated to Discover Violation of the Clayton Law

Under the Clayton Act,[7] corporations are prohibited from acquiring stock of competing corporations, where the effect of such acquisition is to reduce competition, and in such case the courts will abrogate the corporate entities in order to arrive at the truth and to uncover conduct obnoxious to the provisions of the Clayton Act, and where it appears that one corporation, by means of stock ownership controls a number of its competitors, the corporate entities will not be permitted to stand in the way of the enforcement of the statute.[8]

§ 422. Corporations May Not Be Manipulated So As to Evade the Provisions of the Alien Enemy Trading Act

The corporate fiction may not be resorted to for the purpose of evading the provisions of the Alien Enemy Trading Act. The courts of belligerent nations will not allow themselves to be blinded by a mere fiction of law when it is essayed to interpose the same for purposes far beyond the contemplation of the inventors of such fiction. So where alien enemies attempt to evade provision of statutes prohibiting trading with such enemies or from doing business in a country contrary to such an act, the efforts will prove abortive, and to uncover such attempts corporate entities will be dissipated.[9]

§ 423. A Corporation Owned by Citizens of Belligerent Antagonist Will Make the Property of Such Corporation Enemy Property

It seems that the courts will disregard the corporate entity

[7] Clayton Act sec 7; Comp. Stats. sec. 8335g.

[8] Federal Trade Commission vs. Thatcher Mfg. Co., 5 Fed. (2d) 615; United States vs. United Shoe Machinery Co., 234 Fed. 127; 227 Fed. 507.

[9] (The Tolmie, 59 Sol. J. 26.) The holdings on the subject of this

in dealing with the seizure of property of an enemy of the country in which the court is sitting, and accordingly it was held by a British Prize Court that a vessel flying the Dutch flag and owned by a corporation organized under the laws of that country and was registered in Holland, the stock of which was owned and controlled by German subjects, would be regarded as a German vessel and enemy property.[10] However, it should be noted that a domestic corporation is not necessarily an alien enemy because it is principally owned and controlled by subjects of an enemy government.[11] It has also been held in the United States that a New Jersey corporation owned and controlled by German subjects would not become an alien enemy upon the declaration of war between the United States and Germany.[12]

§ 424. Corporate Entity Will Be Abrogated to Allow Recovery by Government Against Stockholders of Tax on Distilled Spirits

The laws of the United States[13] enact that if proprietors, possessors of, and every person in any manner interested in the use of any still, distill, distillery or stillery apparatus shall be jointly and severally liable for taxes imposed by law on the distilled spirit products therefrom, and accordingly it has been held that the corporate entity will not serve as a shield to protect the stockholders of such corporation from the payment of the taxes provided for in the statute.[14]

section are in hopeless conflict. See n. 5 B. R. C. 304, 333; 7 B. R. C. 708. See sec. 481, infra, where the corporate entity was ignored in construction of a treaty provision.

[10] The Hamborn (1918) P. Eng. 19; see also in re W. Hagelberg Akiten-Gesellschaft, 2 Ch. (Eng.) 503; 86 L. J., Ch. 18; 115 L. T., N. S. 444.

[11] In re Hilcks, 1 K. B. (Eng.) 48; 86 L. J., K. B. 204 (1916); H. B. R. 160; 115 L. T. N. S. 490; 7 B. R. C. 708.

[12] Fritz Schultz, Jr., vs. Raime, 100 Misc. 697; 166 N. Y. S. 567; 99 Misc. 626; 164 N. Y. S. 454.

[13] Sec. 3251 Revised Statutes of U. S.

[14] U. S. vs. Wolters, 46 Fed. 509; Richter vs. Blasingame, 110 Cal. 530; 42 Pac. 1077.

§ 425. The Corporate Entity Will Not Serve As a Cover For a Monopoly

It is generally held that the corporate entity may not be used for the purpose of shielding or hiding the monopolistic conduct of its stockholders. Differently stated, stockholders of a corporation may not hide behind the corporate fiction while they obtain a monopoly on commerce or any commodity.[15] So, where a corporation combines with its stockholders or members for the purpose of creating a monopoly of milk, the corporate entity will, if necessary, be disregarded to discover such monopoly, having for its object the fixing of prices.[16]

§ 426. Corporate Entity May Not Be Interposed to Shield Against Prosecution For a Criminal Act

The corporate entity may not be used as a shield against prosecution for criminal conduct, such as embezzlement. In other words, stockholders of a corporation may not embezzle money intrusted to the corporation and defend upon the ground that there was a corporate entity to which the money was intrusted. In such case, the corporate form will be treated as a mere instrumentality by which the act of embezzlement was accomplished and in no sense does the intervention of the

[15] State vs. Creamery Pkg. Mfg. Co., 110 Minn. 415; 126 N. W. 126; Distilling & Cattle Feeding Co. vs. People, ex rel Moloney, 156 Ill. 448; 41 N. E. 188; 47 A. S. R. 200; Stockton vs. Central Ry. Co. of N. J., 50 N. J. Eq. 52; 24 Atl. 964; 17 L. R. A. 97; U. S. vs. Del. Lackawanna & W. Railroad Co., 238 U. S. 516; 35 S. Ct. 873; 59 L. Ed. 1438; Reversing 213 Fed. 240; Ford vs. Chicago Milk Shippers Ass'n, 155 Ill. 166; 27 L. R. A. 298; 39 N. E. 651; Reversing 46 Ill. App. 576; Northern Securities Co. vs. U. S., 193 U. S. 197; 48 L. Ed. 679; 24 S. Ct. 436; U. S. vs. Lehigh Valley Ry. Co., 254 U. S. 255; 65 L. Ed. 253; 41 S. Ct. 104; United States vs. MacAndrews & Forbes Co., 149 Fed. 823.

[16] Ford vs. Chicago Milk Shippers Ass'n, supra. In this case it seemed that the corporation Chicago Milk Shippers Ass'n, combined with its members for the purpose of creating a monopoly on milk and the court assumed to disregard the corporate entity. It would seem that this was wholly unnecessary as the corporation and its stockholders, in this instance, acted not together but as separate and distinct individuals and entities. See secs. 316, 419, supra.

instrumentality lessen the fraudulent conversion of the money by the corporate stockholders.[17] However, it has been held that in order to fix criminal responsibility upon an officer of a corporation for so planning and conducting its business as to result in fraudulent misappropriation or conversion of monies of third persons intrusted to it, it should be shown that such course of business was either, in its essential characteristics, illegal and devised and carried on for purposes having a criminal result, or that with his knowledge and under his direction it was carried on in the particular case as to effect the criminal result.[18] It seems that at least one court went far afield in holding the president of a corporation not liable for the carrying on of the business of a bucket shop in violation of the penal statute.[19] The better rule would seem to be that an agent or officer of a corporation, through whose act an offense is committed against the law, is himself guilty of the same offense.[20] The inconsistency of the position that a corporation might be guilty of the violation of the criminal law and its officers and stockholders not be guilty would seem the more apparent in cases where it has been held that corporations may commit larceny or send obscene matter through the United States mails and the like, for how could a corporation—the inane fiction—commit such crimes requiring a positive affirmative act without the intervention of the instrumentality of a human hand participating in such act?[21]

§ 427. A Corporation Organized For Unlawful Purposes, Its Stockholders Will Be Personally Liable on Its Obligations

In an action against the incorporators and stockholders of a

[17] State vs. Milbrath, 138 Wis. 354; 131 A. S. R. 1012; 120 N. W. 252. See also Redmond vs. U. S., 8 Fed. (2d) 24.

[18] State vs. Carmean, 126 Iowa 291; 106 A. S. R. 352; 102 N. W. 97.

[19] State vs. Miner, 233 Mo. 312; 135 S. W. 483.

[20] Overland Cotton Mills Co. vs. People, 32 Colo. 263; 75 Pac. 924; 105 A. S. R. 74.

[21] U. S. vs. New York Herald, 159 Fed. 296; U. S. vs. MacAndrews & Forbes Co., 149 Fed. 823; see sec. 417, supra.

corporate formation to recover monies paid in as wagers upon the rise and fall of price of grain, etc., such incorporators may not defend against an action for such recovery upon the theory that there was a legally chartered corporate entity for apparently lawful purposes, the evidence showing that the corporation was but a cloak used for the purpose of shielding its incorporators and stockholders in the commission of illegal acts.[22] While the cited case clearly applies the principle that the courts will not be blinded by the interposition of a corporate entity, but will brush it aside and do justice among the parties, yet the court clearly applies another familiar principle of law that all of the parties participating in an unlawful act are responsible for the consequences thereof.

[22] McGrew vs. City Produce Exchange, 85 Tenn. 572; 4 A. S. R. 771; 4 S. W. 38.

CHAPTER XXIII

DISREGARD OF CORPORATE ENTITY IN CONNECTION WITH FIRE INSURANCE ON CORPORATE PROPERTY

CONTENTS

Section
428. A stockholder has an insurable interest in the corporation's property in proportion to the amount of his stock.
429. The acquisition of all of the stock of a corporation is not such a change of interest as avoids an insurance policy.
430. It has been held that ownership of all of the stock in a corporation will not sustain a recovery on policy containing a provision that the interest of the assured must be absolute.
431. If corporation reorganizes so as to create new corporation, there is a change of possession as will defeat recovery on insurance policy.

§ 428. A Stockholder Has an Insurable Interest in the Corporation's Property in Proportion to the Amount of His Stock

It is clear, in view of the position of courts in our time, to disregard or override the corporate fiction in the interest of justice, that a stockholder, by the simple disregard of the corporate entity, has an insurable interest in the corporation's property.[1] In dealing with this question Judge Brewer succinctly disposed of the matter as follows: "Now if the corpo-

[1] Seaman vs. Enterprise Fire & Marine Ins. Co., 21 Fed. 778; Warren vs. The Davenport Fire Ins. Co., 7 A. R. 160; 31 Iowa 464. Judge Brewer analyzed and discussed very ably the opinion in Phillips Bechel & Co. vs. Knox Mutual Fire Ins. Co., supra; Seaman vs. Enterprise Fire & Marine Ins. Co., supra. Wailes vs. Davies, 158 Fed. 667; Aetna Fire Ins. Co. vs. Kennedy, 161 Ala. 600; 135 A. S. R. 160; 50 Southern 73; Riggs vs. Commercial Mutual Ins. Co., 125 N. Y. 7; 21 A. S. R. 716; 10 L. R. A. 684. See, however, dictum Phillips Bechel & Co. vs. Knox County Mutual Ins. Co., 20 Ohio 174.

ration owns but a single piece of tangible property, the destruction of that property by fire or other loss certainly destroys the value of his (the stockholder's) stock or at least diminishes it. He has an interest in the protection of that property. In this case it appeared that the corporation owned a steamboat; that was substantially all its assets. Now the destruction of that property diminishes the value of the stock held by this plaintiff. He had an interest in the preservation of that property and he had an insurable interest. If the property was the entire property of the corporation the destruction of the property practically wiped out the value of his stock, so that I think it is fair to say that a stockholder in a corporation has an insurable interest in the personal tangible property of the corporation. The policy was taken by the defendant upon his interest. The destruction of the property destroyed that interest and he is entitled to recovery."[1] The cited decisions are in harmonious keeping with the principle that the corporate fiction will be abrogated in the furtherance of justice and they are readily sustained on that principle.

§ 429. The Acquisition of All of the Stock of a Corporation Is Not Such a Change of Interest As Avoids an Insurance Policy

It is common for insurance policies to provide that any change of interest, title, or possession of the property insured other than by death of the insured will avoid the policy. But where a single individual acquires all of the stock of a corporation, the corporation being the insured in an insurance policy containing such provision, is not sufficient to work a forfeiture or avoidance of the policy and in case of fire the corporation may recover thereon, and this is true even in jurisdictions where the rule has been adopted that one person becoming the owner of all the shares in a corporation, operates as a dissolution of the corporation to the extent that

[1] Seaman vs. Enterprise Fire & Marine Ins. Co., supra.

it suspends exercise of the rights under the franchise until the owner transferred the stock in good faith, so as to maintain an organization under the statute.[3] The position of the court in Hamburg Bremen Fire Insurance Company of Hamburg, Germany, vs. Ohio Valley Dry Goods Company[4] is not in complete consonance with the rule found in Louisville Banking Company vs. Eisenman, and like decisions,[5] for if the corporate franchise is suspended by acquisition of all of the stock by a single individual, it would seem that such an ownership would result in that individual becoming the owner of the corporate property and would seem to be a change contemplated by the inhibition generally found in policies against change of interest or possession.[6] It must be conceded, however, that the holding in Hamburg Bremen Fire Insurance Company vs. Ohio Valley Dry Goods Company,[7] is in accord with the soundest principles of justice.

§ 430. It Has Been Held That Ownership of All of the Stock in a Corporation Will Not Sustain a Recovery on Policy Containing a Provision That the Interest of the Assured Must Be Absolute

It is a common provision found in insurance policies that they shall be void if the interest of the insured is not the sole and unconditional ownership of the property described in the policy or that the interest is not correctly stated to the companies or in the policy or endorsements thereon. In an action on a policy containing this provision the conclusion was reached that it was a complete defense to an action thereon where it appeared that the stockholders of a corporation

[3] Hamburg Bremen Fire Ins. Co. of Hamburg Germany vs. Ohio Valley Dry Goods Co., 160 Ky. 252; 169 S. W. 724; Louisville Banking Co. vs. Eisenman, 94 Ky. 83; 21 S. W. 531-1049; 14 Ky. L. R. 705; 19 L. R. A. 684; 42 A. S. R. 335.

[4] Supra.

[5] Supra.

[6] See sec. 84, supra.

[7] Supra.

caused the policy to be issued to themselves as owners covering the insured property which was in the name of the corporation.[8] We have already seen that a stockholder has an insurable interest in the corporate property[9] and in view of these holdings it is indeed difficult to understand upon what theory the court could hold that such a provision in a policy would avoid it. By application of the highly commendable doctrine that corporate entities will not be permitted to stand in the road of the court in doing full justice among the real parties in interest, a more just result could have been reached. The court in this case could and should have brushed aside the corporate entity and adjudged a recovery.

§ 431. If Corporation Reorganizes So As to Create New Corporation, There Is a Change of Possession As Will Defeat Recovery on Insurance Policy

As to whether or not a reorganization of a corporation is such as to defeat a recovery on an insurance policy, providing against the change of title, ownership or possession, is dependent upon whether or not the reorganization is a mere continuation of the insured corporation or by the reorganization a new corporate entity and substantially different, is brought into existence. If it appears that a new corporation is brought into existence in the scheme of reorganization, then it may not recover upon the policy of insurance providing against change of title, possession, etc., but if, on the other hand, the corporate entity in substance continues, although under a new or different name, a recovery would be warranted in such case.[10] It is submitted, however, that the cases cited in the footnote can hardly be sustained on principle. It

[8] Syndicate Ins. Co. vs. Bohn, 65 Fed. 165; 12 C. C. A. 531; 27 L. R. A. 614.

[9] See sec. 429, supra.

[10] Bowling vs. Continental Ins. Co., 86 W. Va. 164; 17 A. L. R. 376; 103 S. E. 285; Cremo Light Co. vs. Parker, 118 App. Div. 845; 103 N. Y. S. 710; Miles Lamp Chimney Co. vs. Erie Fire Ins. Co., 164 Ind. 181; 73 N. E. 107.

would seem to follow, in view of the trend of decisions of today, that if the personnel of the corporate enterprise remained the same, with substantially the same interests, the change of title in the mere corporate entity ought not on the soundest principles of justice avoid recovery on the policy. It indeed seems far-fetched that the mere metamorphosis of legal entities will absolve insurance companies from their binding and solemn obligations. This question might be of considerable importance in cases arising where an individual or a partnership organized himself or themselves, as the case may be, into corporate entities and in pursuance of such plan for the changing from the operation of the business in an individual name or in a partnership name, to that of a corporation. Would this be sufficient to defeat recovery upon insurance policies taken out on such property in the individual or partnership name? It is submitted that in order to so defeat the recovery, in such case the change must be more than the manner and form of doing business. In dealing with this situation some of the courts used the apt illustration[11] that by changing from the partnership form to the corporate form, it merely amounts to the same parties with another coat on. Then would it follow that by so simple a change the real party in interest should lose a valuable right under contractual relations with the insurance company? It is submitted that the position of the court in so holding would be unsound. It is therefore difficult to differentiate the situation suggested with that in the cases of reorganization of a corporation where the parties remain the same, regardless of any technical change in the legal entity. The views that we have suggested find support in some of the adjudicated cases and accordingly it has been held that where one owning substantially all of the capital stock of a corporation conveyed the corporate property in his individual name, it appearing that the corporation had not kept up strict

[11] Andres vs. Morgan, 62 Ohio State 236; 56 N. E. 875; 78 A. S. R. 712.

corporate organization and had not at all times functioned as corporations generally do, the grantee of such a title was the sole, absolute and unconditional owner of the property in fee within the requirements of the insurance policy stipulating therefor.[12]

[12] Phoenix Assurance Co. of London vs. Deavenport, 41 S. W. 399; 16 Tex. Civ. App. 283; see sec. 85, supra.

CHAPTER XXIV

OVERRIDING CORPORATE ENTITY IN REGARD TO RIGHTS AND LIABILITIES OF STOCKHOLDERS OF CORPORATION

CONTENTS

Section

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434. Corporate entity will be overridden to hold its stockholders upon a guaranty of indebtedness.

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436. Sometimes courts go to the extreme to sustain the corporate entity.

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439. A party purchasing goods from one corporation may counterclaim against it for an indebtedness due such purchaser from another corporation, the corporations being the same.

440. Corporate entities will not be treated as one where to do so would allow parties to take advantage of their own wrong.

441. Corporate entities disregarded to uncover usurious transactions.

442. A railroad corporation owning a majority of stock of another railroad corporation and the stockholders of the stock-owning company owning practically all of the balance of the stock, is sufficient to treat both corporations as one.

443. A railroad company agreeing with some individuals to charge them one-half the rate it charges other shippers and agreeing to pay over a certain portion of money it charges certain shippers to such individuals, a corporate entity will be ignored to uncover the transaction.

444 Corporate entities will be ignored to uncover rebating in freights.

445. Foreign corporation delivering gas at a state line and which is thereupon received by a domestic corporation and distributed, such foreign corporation owning the domestic corporation is a public utility within the state.

446. It is the modern rule, sustained by ample authority, that an individual cannot escape liability by incorporating himself and placing his property in the name of the corporation and such corporation will not serve as a shield when it is sought to hold its owner on a separate agreement between husband and wife.

447. The corporate entity will not be brushed aside to hold a corporation that owns all of the stock of another corporation but had disposed of its holdings in such other corporation prior to a breach of covenants.

448 A bank dealing with a corporation as a separate legal entity and recognizing it as such by extending credit to it may not thereafter seek satisfaction from its stockholders.

449. A corporation owned by three men and being a close corporation and two of such owners sign a contract for sale of stock and corporate assets, the contract will not be construed as one for sale of stock only.

450. A corporation owning a number of subsidiaries will be compelled to off-set an account due to one of the subsidiaries with an account due from the parent corporation to its creditors.

451 Quasi entity of Massachusetts Trust disregarded.

452. Organization of a corporation to succeed an existing business, either partnership or corporate, not within the statutes of fraud.

§ 432. Corporate Entity Will Be Abrogated to Defeat the Plea of Statute of Limitations Against Government, It Seeking to Cancel Fraudulent Land Patents

A party having obtained fraudulent patents to public lands will not be permitted to secretly transfer the property to a corporation, which he owns or of which he is the practical owner, for the purpose of keeping the title concealed until the statute of limitations shall run, for in such case the court will disregard the corporate entity and treat it as a mere *alter ego* of its practically sole stockholder and the statute of limitations in such case will not avail on behalf of the corporate entity apart from its owner. Neither is the situation changed by the

fact that before the filing of the bill by the government to cancel the land patents, some of the stock of the corporation had been pledged as collateral security.[1]

The same rule would apply if the situation arose between individuals, and the corporate entity would be disregarded to prevent an inequitable plea of the statute of limitations. On the other hand, if it would be inequitable or unjust to deny the right of the plea of Statute of Limitations by reason of recognition of the corporate entity, it will be ignored and the plea sustained.[1a]

§ 433. Where Two Corporations Own a Third and All Three Are Engaged in the Same Enterprise, the Corporate Entities Will Be Disregarded and Treated As Public Utilities

Owners of property may not by the resort to the fiction of corporate ownership, limit the effect and jurisdiction of the Public Utilities Commission. So where two corporations own a public-utility property and attempt by the organization of a third corporation to evade the jurisdiction and power of the Public Utilities Commission, this will not be permitted and the three corporations will be treated as a single enterprise and dealt with accordingly by the Public Utilities Commission.[2]

§ 434. Corporate Entity Will Be Overridden to Hold Its Stockholders Upon a Guaranty of Indebtedness

The corporate entity will not be permitted to stand in the way of holding stockholders who are guarantors upon the indebtedness of the corporation, as in a case where the stock-

[1] Linn & Lane Timber Co. vs. U. S., 236 U. S. 574; 59 L. Ed. 725; 35 S. Ct. 440; 116 C. C. A. 267; 196 Fed. 593; 121 C. C. A. 498; 203 Fed. 394; see sec. 121, supra.

[1a] Olympia Min. Co. vs. Kerns, 24 Idaho 481; 135 Pac. 255; 236 U. S. 211; 35 S. Ct. 415; 59 L. Ed. 542.

[2] Ohio Mining Co. vs. Public Utilities Commission, 106 Ohio St. 138; 140 N. E. 143; see sec. 445, infra.

holders guarantee the indebtedness of their corporation and during the time that such guarantee is in force and before its revocation, the charter of the corporation expires and thereafter a new corporation is organized with the same stockholders, and conducts the same business as the old, such stockholders will not be permitted to plead when sued, upon the guaranty that the new corporation is a different entity to the old and they will accordingly be held on such guarantee although the credit was extended to the new corporation.[3]

§ 435. A Member of a Partnership Owning a Corporation, Which Corporation Was Indebted to the Firm Upon the Insolvency of the Corporation, the Firm Will Not Be Permitted to Share in the Assets Until Other Creditors Are Paid in Full

A member of a firm owning a corporation, which corporation becomes indebted to the firm and thereafter becomes insolvent, on distribution of the corporation's assets, the claim of the firm, of which the owner of the corporation is a member, will be denied the right of participating in the distribution of the assets of the corporation until other creditors are paid in full. This is upon the theory that the corporation and the member of the firm are identical, and to allow the firm to share in the assets of the corporation would be inequitable in so far as other creditors are concerned.[4] It seems in this case that there was no question of fraud or even misconduct involved, but the court applied the principle that a corporation and its owner may be treated in the interest of justice as one, and having reached the conclusion that a corporation and its owner are as one, then the court had to apply the principle of law that a firm, or a partnership, as a creditor of one of the partners, may not share in distribution

[3] Cooper Grocer Co. vs. Eppler, 204 S. W. 338; see, however, 221 S. W. 963; Goodwin vs. Abilene State Bank, 294 S. W. (Tex.) 883; 287 S. W. 1111; 20 S. W. (2d) 1090; see also sec. 99, supra.

[4] Pott vs. Schumucker, 84 Md. 535; 35 L. R. A. 392; 57 A. S. R. 415; 36 Atl. 592.

of the individual assets of a partner until the individual creditors are paid in full.[6]

§ 436. Sometimes Courts Go to the Extreme to Sustain the Corporate Entity

It is indeed a struggle for some of the courts, even in this day, to free themselves from the gyves of the assumed sacredness of the corporation fiction. The Supreme Court of Minnesota in the recent case of Belle City Malleable Iron Co. vs. Clark,[6] to deny a recovery to a corporation that owned all of the stock of another corporation, to which latter a guarantee in writing had been given, the plaintiff took the position that the corporation owning all of the stock of the other and such owned corporation were identical, but the court denied this contention and followed the antiquated doctrine of Button vs. Hoffman[7] and held that the owner of all of the stock of such corporation could not maintain an action in its own name upon the guarantee. The court even went so far as to approve the position that the lack of directors in itself did not effect a dissolution of the corporation, and while that may be true so far as technical dissolution is concerned, yet it seems that it is a far-fetched position to sustain a corporate fiction, for it is doubtless true such condition would work a suspension of corporate functions. It is submitted, however, that the great weight of modern authority runs counter to the position of the learned court in Belle City Malleable Iron Co. vs. Clark.[7a] It seems that the Minnesota court held to the

[6] Kirby vs. Carpenter, 7 Barb. (N. Y.) 373; Read vs. Bailey, 3 App. Cas. 94; Walton vs. Butler, 29 Beav. 428; 54 Reprint 693; Amsinck vs. Bean, 22 Wall 395; 22 L. Ed. 801; in re Hamilton, 1 Fed. 800; Maryland Fidelity, etc., Co. vs. Helwig, 113 Kan. 174; 213 Pac. 666; McCormick's App., 55 Pa. 252; Killefer vs. McLain, 70 Mich. 508; 38 N. W. 455; Harmon vs. Clark, 13 Gray 114; Somerset Potter's Works vs. Minot, 10 Cush. (Mass.) 592; Gibbs vs. Humphrey, 91 Wis. 111; 64 N. W. 750.

[6] 215 N. W. 855; 172 Minn. 508.

[7] 61 Wis. 20; 20 N. W. 667; 50 A. R. 131.

[7a] 20, 75, 84, 237, supra; 439, 519, 534, infra.

very extreme in its blind homage to the fetish of corporate entity, but it was left for the Court of Errors and Appeals of New Jersey to outdistance the Minnesota court in that direction and in that case some promoters of a corporation, before it was organized, executed a contract in the name of the proposed corporation, which assumed to partially comply with the statutes but fell far short of even a *de facto* corporation, and held that the promoters were not liable upon such contract.[8] It seems that this supposed corporation had progressed no further in its attempt of organization than to sign the articles or certificate of incorporation and filed them in a county in New Jersey. It is indeed difficult to see upon what theory such a flimsy effort on the part of the promoters to comply with law may be used as a justification to evade their then existing liability and it is harder still to understand how a court could bring itself to the position to hold that such an act on the part of the defendants would completely armor them against the attacks of their creditors upon a contract entered into at a time when there was not a simulacrum of a corporation in existence. It is safe to say that such decisions as those coming from Minnesota and New Jersey will not long be looked upon as authority.

§ 437. Corporate Entity Ignored to Give Real-Estate Broker Commission

A real-estate broker is entitled to his commission from the owner of real estate where he introduces or brings together the owner of the real property and a corporation, and such owner later sells the same real estate to another corporation with identically the same stockholders and officers. In such case, in order to do justice between the parties, the court will treat the two corporations as identical and will hold the owner of the real estate liable to the broker for commissions upon the theory that it was in truth and in fact sold to the party

[8] Burstein vs. Palermo, 140 Atl. 326.

that he had put the owner of the real estate in contact with. It is not enough to defeat the ends of justice that corporations are distinct entities, for courts will look more to their substances rather than form in determining questions of substantial justice, and will allow substance to prevail over mere matters of form.[9]

§ 438. Stockholders of a Corporation Using It As a Mere Instrumentality, Are Individually Liable For Labor Bestowed Upon the Property in the Name of the Corporation

The rule sustained by the great weight of authority in our day is that where it sufficiently appears that a corporation is but an instrumentality for the transaction of the business of its stockholders, such stockholders are held to the same rule of accountability as the corporation and will be individually liable for work and labor bestowed upon property standing in the name of the corporation. In other words, the stockholders will not be permitted to stand by and to say to those who have performed work upon their property standing in the name of the corporation, "You can't collect from us but you must go to our shadow—the corporation—although but a shadow it be."[10]

§ 439. A Party Purchasing Goods From One Corporation May Counterclaim Against It For an Indebtedness Due Such Purchaser From Another Corporation, the Corporations Being the Same

A party purchasing goods from a corporation may counterclaim and set off the amount that is due to him from another corporation when sued for such goods, the money being due the purchaser of the goods from such other corporation for work and labor performed by reason of his doing certain construction work, it appearing that the stockholders and officers of

[9] Steiner vs. J. P. Stotter Co., 23 Ohio App. 249; 154 N. E. 66.
[10] Varni vs. Anglo-Am. Land Co., 284 Pac. 520.

both corporations are identical and were therefore, by giving operation to the principle that corporate entities may not stand in the way of doing justice between the parties, the set-off will be allowed and a recovery will be had only for the amount due after deducting the money due the purchaser under the contract.[11] The operation of the principle that corporate entities will be overridden for the purpose of dealing with the individuals, is by no means hampered or restricted in its operation by reason of the fact that it becomes necessary to treat corporations created under the laws of different jurisdictions as a single corporate entity.[12]

§ 440. Corporate Entities Will Not Be Treated As One Where to Do So Would Allow Parties to Take Advantage of Their Own Wrong

The corporate form will not be nullified to allow one to take advantage of his own wrong or for the purpose of allowing a wrongdoer to enjoy fruits of fraud.[13] A landlord executed a lease with a corporation under the laws of one state for a term of years and thereafter without the landlord's knowledge or consent, the corporation was converted from an entity under the laws of such state to a corporation of the same name under the laws of another state, and all of the property was transferred to such new corporation and the same stockholders owned stock in the new corporation in the same proportion as in the old, and a modification of the lease was thereafter obtained in the name of the new corporation upon which its name and seal were affixed, but the fact of the organization of such new corporation or that the modification was made in its name was fraudulently concealed from the landlord. Under such circumstances it was held that the minds of the contracting parties never met upon the modification and that

[11] Bloch Queensware Co. vs. Metzger, 70 Ark. 232; 65 S. W. 929.
[12] Bloch Queensware Co. vs. Metzger, 70 Ark. 232; 65 S. W. 929; see secs. 224, 351, supra.
[13] Salina Canyon Coal Co. vs. Klemn, 290 Pac. (Utah) 161.

by reason of such concealment of the organization and existence of the new corporation and its having signed the modification, were sufficient to prevent the modification from becoming effective.[14]

§ 441. Corporate Entities Disregarded to Uncover Usurious Transactions

A brokerage partnership, consisting of two members, which owned a corporation engaged in the loan business, which corporation loaned a sum of money to another, stipulating upon the face of the loan and the papers evidencing the transaction a legal rate of interest, but upon the same day the brokerage firm took a contract from the borrower for a salary and a commission due as brokers in the sale of the borrower's goods, the salary and commissions to be paid in yearly installments and to cover the exact period of the loan. The salary amounted to exactly 2% additional interest, therefore making the contract usurious. The entity of the loaning corporation will be disregarded and it and the brokerage partnership will be treated as one and the salary and commissions under such circumstances held to be usury.[15] The circuit court of appeals reversed M. Lowenstein & Sons vs. British American Mfg. Co.,[16] on a question of fact, but did not repudiate the principle that a corporate form may be put aside to uncover usurious taint entering into a transaction, and it is submitted the appellate court went a long way to reach a reversal of the

[14] Brighton Packing Co. vs. Butcher's Slaughtering & Melting Ass'n, 211 Mass. 398; 97 N. E. 780. It must be submitted, however, in spite of element of fraud, that this case goes rather far afield in maintaining the corporate entity and is of doubtful soundness in view of the great weight of authority in recent years overriding corporate entities.

[15] M. Lowenstein & Sons vs. British-Am. Mfg. Co., 300 Fed. 853. See, however, 7 Fed. (2d) 51. The better and sounder rule is announced by the Supreme Court of Cal., Western State Acceptance Corp. vs. Tuttle, 290 Pac. 574, to the effect that corporate entities will be ignored to uncover usury.

[16] Supra, 7 Fed. (2d) 251.

lower court on the question of fact. An extreme case to uphold a Shylockian transaction comes from the court of last resort in New York.[17] In that case a party sought to borrow a sum of money offering a real-estate mortgage as security and on being informed by a broker that a loan could not be obtained without payment of a bonus in excess of the legal rate of 6%; that such bonus being usurious, no loan would be made to an individual borrower, but that a corporation could obtain such a loan as under the statute it could legally contract to pay the bonus, or rather a corporation under the New York statute could not plead usury. The borrower actuated by a desire to obtain the loan formed a corporation of which he owned all the stock and conveyed the real estate he proposed to hypothecate for such loan to it. Thereupon a lender was induced to loan the sum of $27,000, taking a mortgage from the corporation for $45,000 with interest at 6%. After default in payment, the mortgage was foreclosed, and thereafter the borrower brought an action to call into question the usury of the transaction and to have the mortgage cancelled. The court denied the contention of borrower and refused him relief, holding that in absence of proof that the loan was in fact made to the plaintiff (the owner of the corporation) and the corporation was used as a mere cloak, the corporate entity would not be disregarded.

If the facts of this case are insufficient to call for a disregard of the corporate fiction, then it is submitted that it would be no easy matter to suppose a case that would be sufficiently flagrant as would move the court to ignore the corporate form. On the general proposition of bowing down at the shrine of the corporate fetish this case goes to a greater extent than the case of Berkey vs. Third Avenue Railway Co.,[18] from the same court. In both of these cases the court recognizes the rule but so found the facts as to make the cases not within its adhibition.

[17] Jenkins vs. Moyse, 254 N. Y. 319; 172 N. E. 521.

[18] Berkey vs. Third Ave. Ry. Co., 244 N. Y. 84; 155 N. E. 58, 914; Rev. 217 App. Div. 504; 217 N. Y. S. 156; see also sec. 16, supra.

§ 442. A Railroad Corporation Owning a Majority of Stock of Another Railroad Corporation and the Stockholders of the Stock-owning Company Owning Practically All of the Balance of the Stock, Is Sufficient to Treat Both Corporations As One

Where a railroad corporation owns all of the stock of a second railroad corporation and the stockholders of the stock-owning corporation own practically all of the balance, and even though the two corporations kept up, in a measure, separate entities and maintained separate individualities, but had operated both lines of railroad which connected as a continuous line, therefore under these facts it follows that the railroad, consisting of the lines owned by both corporations, will be treated as a single unit and rates fixed accordingly and the railroad commission under such circumstances will not be permitted to fix a so-called joint rate.[19]

§ 443. A Railroad Company Agreeing With Some Individuals to Charge Them One-Half the Rate It Charges Other Shippers and Agreeing to Pay Over a Certain Portion of Money It Charges Certain Shippers to Such Individuals, a Corporate Entity Will Be Ignored to Uncover the Transaction

Where a railroad company agreed to charge certain individual shippers one-half the freight that it charged other shippers in consideration of such favored shippers connecting a pipe line with the railroad, and also agreeing for the same consideration to pay over to the favored shippers certain portions of the freights collected from others, and where a corporation is thereafter organized and the pipe line is in the name of such corporation, the illegal freights collected from others, the portion under the contract with such favored shippers having been paid to the corporation, it is no defense when a suit is brought against the favored shippers that the

[19] State vs. Chicago & N. W. Ry. Co., 133 Minn. 413; 158 N. W. 627.

monies were paid to their corporation—the owner of the pipe line—and the other shippers that had been discriminated against may recover against the favored shippers and their corporation, the monies thus illegally obtained, and in order to accomplish this result the corporate entity of such corporation will be brushed aside.[20]

§ 444. Corporate Entities Will Be Ignored to Uncover Rebating in Freights

A corporate entity will not shield the violators of the federal statute, commonly known as the Elkins Law, making it an offense to give rebates of freights under any device whatsoever. A scheme devised to evade the provision of such law whereby a railroad company which did not have power to loan money on or to deal in coal lands, organized another corporation and through it contracted with a coal company to loan to such coal company a large amount of money, bearing interest at 2%, and the railroad company itself borrowed the money on its own note with interest payable at 4% and by that means obtained the total tonnage of the coal company. It is immaterial how many corporate entities there may be to brush aside in order to get at the facts in such case, and the organizing of a corporation for the purpose of making the loan and covering up the real transaction will not avail, and the entities will be brushed aside and the circumstances of the transaction dealt with accordingly.[21]

§ 445. Foreign Corporation Delivering Gas at a State Line Which Is Thereupon Received by a Domestic Corporation and Distributed, Such Foreign Corporation Owning the Domestic Corporation Is a Public Utility Within the State

A foreign corporation engaged in the delivering of gas for public consumption which it delivers to the state line where it

[20] Brundred vs. Rice, 49 Ohio St. 640; 34 A. S. R. 589; 32 N. E. 169.
[21] Vandalia Ry. Co. vs. U. S., 141 C. C. A. 469; 226 Fed. 713; 239 U. S. 642; 36 S. Ct. 163; 60 L. Ed. 482.

is thereupon received by a domestic corporation and distributed by such domestic corporation, which domestic corporation is owned or practically so by the foreign corporation, makes the foreign corporation a public utility within the state and subject to the jurisdiction of the Public Utilities Commission. The rule is now firmly established in many jurisdictions and is sound in principle and wholesome in application, that when one corporation acquires and holds all of the stock of another, save qualifying shares for making up the necessary membership of the board of directors for the purpose of preservation of the corporate organization and conducting its affairs, and is the motivating power that energizes the activities of the stock-owned corporation, the two corporations practically become merged, and the same to all intents and purposes.[22] So where a corporation is engaged in the production of electricity, and furnishes the same in wholesale quantities to two other corporations, which in turn retail the same to consumers, the producing company owning all of the stock of the retailing corporations, except qualifying shares, the entities of the three corporations will be treated as one.[23]

§ 446. It Is the Modern Rule, Sustained by Ample Authority, That an Individual Cannot Escape Liability by Incorporating Himself and Placing His Property in the Name of the Corporation and Such Corporation Will Not Serve As a Shield When It Is Sought to Hold Its Owner on a Separate Agreement Between Husband and Wife

It is the modern rule sustained by ample authority that an

[22] Gallatin Natural Gas Co. vs. Public Service Commission, 79 Mont. 269; 256 Pac. 373; Ohio Mining Co. vs. Public Utilities Commission, 106 Ohio State 138; 140 N. E. 143; Southern Ohio Power Co. vs. Public Utilities Commission, 110 Ohio State 246; 143 N. E. 700; 34 A. L. R. 171.

[23] Ohio Mining Co. vs. Public Utilities Commission, supra; Southern Ohio Power Co. vs. Public Utilities Commission, supra; see sec. 433, supra.

individual cannot escape liability for his wrongful acts by incorporating himself and placing his property in the name of a corporation wholly or practically owned by himself. In such case the courts will not permit themselves to be blinded or deceived by mere forms of law but, regardless of fiction, will deal with the circumstances of the transaction involved as if the corporate entities did not exist and as the justice of the case may require. So where a husband and wife separate and the husband is the owner of a corporation, and to secure the wife upon settlement between her and the husband, the stock of the corporation is placed in the hands of a trustee but the voting power and control of the corporation is retained by the husband, and in such separation agreement it was stipulated that the husband would not do or perform any act or procure any act to be done in his individual capacity or in his capacity of stockholder or director in the corporation that would in any manner impair or lessen the value of the stock or the corporation's property, and the husband thereafter continued to conduct the corporation, but organized another corporation which he owned and controlled and for the purpose of enriching the second corporation he committed certain acts that constituted a spoliation of his separation agreement to the detriment of the beneficiaries thereunder, and such conduct on his part, that had resulted beneficially to the second corporation, not only made the husband personally liable but likewise the second corporation was liable for such misconduct of its owner.[24]

§ 447. The Corporate Entity Will Not Be Brushed Aside to Hold a Corporation That Owns All of the Stock of Another Corporation But Had Disposed of Its Holdings in Such Other Corporation Prior to a Breach of Covenants

A corporation taking a lease for a term of years and the

[24] Keating vs. Hammerstein, 125 Misc. 334; 209 N. Y. S. 769; 196 App. Div. 18; 187 N. Y. S. 446; see sec. 491a, infra, as to question of dower rights, etc.

stock of the lessee corporation having passed into the hands of another corporation, which stock-owning corporation held such stock for a time and thereafter disposed of the same, the lessor may not maintain an action against such stock-owning corporation where there was a breach of the covenants contained in the lease after such disposition of the stock by the stock-owning corporation. In such case the facts do not warrant ignoring the corporate entity and the corporate fiction will be adhered to and liability denied.[25]

§ 448. A Bank Dealing With a Corporation As a Separate Legal Entity and Recognizing It As Such by Extending Credit to It May Not Thereafter Seek Satisfaction From Its Stockholders

Where a bank deals with a corporation as a separate legal entity distinct from its stockholders, contracting in its corporate capacity and at the same time contracting with the stockholders in their individual capacity and at all times treating the corporation as a legal entity, recognizing it as such and dealing with it in that capacity, the courts will not invoke the rule that in a proper case the corporate entity and its stockholders will be treated as one, or phrased otherwise, that the corporation will be treated as an association of individuals.[26]

§ 449. A Corporation Owned by Three Men and Being a Close Corporation and Two of Such Owners Sign a Contract For Sale of Stock and Corporate Assets, the Contract Will Not Be Construed As One For Sale of Stock Only

Three men owning a corporation, it being a close corporation and conducting its affairs informally, and where two of

[25] Majestic Co. vs. Orpheum Circuit, 21 Fed. (2d) 720.
[26] Pierce vs. National Bank of Commerce, 13 Fed. (2d) 40; 273 U. S. 730; 71 L. Ed. 863; 47 S. Ct. 240; see, however, sec. 237, supra.

them, without formal corporate action, sign a contract for sale of all of the stock of the corporation and the assets likewise of the entity, the contract will not be limited in its operation as one of sale of stock only. In such case the corporate entity will be ignored to the extent of holding the contract as a sale for both stock and assets. The legal entity under such circumstances is no more than an agency through which the property was acquired and the business activities conducted. The familiar rule will be applied in such case that courts are not, in modern times, concerned with outward forms, but on the contrary will disregard forms and look to the substance of every transaction.[27]

§ 450. A Corporation Owning a Number of Subsidiaries Will Be Compelled to Offset an Account Due to One of the Subsidiaries With an Account Due From the Parent Corporation to Its Creditor

A corporation owning a number of subsidiaries and conducting the business in such manner that the subsidiaries amount to mere departments, the grouped operations of the dominant corporation and its subcompanies being such as to make but a single enterprise, the business of all of the corporations being transacted through the managing company, the dominant corporation, then where, in the course of the conduct of such business, a concern that is selling merchandise to the parent corporation becomes indebted to one of the subsidiaries, offsets will be had of the parent's obligation against the obligation due to the subsidiary company. In other words, all of these corporations are treated as a single

[27] Sudduth vs. Storm King Coal Co., 268 Fed. 433; Kalamazoo Spring & Axle Co. vs. Winans Pratt Co., 106 Mich. 193; 64 N. W. 23; Eureka Iron & Steel Co. vs. Bresnahan, 60 Mich. 332; 27 N. W. 524; Conely vs. Collins, 119 Mich. 519; 78 N. W. 555; 44 L. R. A. 844; see secs. 85, 330, supra. The rule announced by this section that where there are three stockholders in a close corporation and two of them could practically sell the corporation and its assets, comes within the rule that stockholders may sometimes be regarded as partners, sec. 297, supra.

legal entity, that is to say, as one business or enterprise, and when this position is conceded, it is an easy matter to apply elementary principles of law governing set-offs and proper adjustments.[28]

§ 451. Quasi Entity of Massachusetts Trust Disregarded

In recent times there has been a great deal of experimentation with the organizing of quasi private corporations and among other things the harvest from this experimentation is a well defined organization in the law generally known as the Massachusetts Trust, and such trusts have many of the characteristics and attributes of the juristically created corporation. It is generally provided for the nonliability of the shareholders or members for the undertakings of the trusts and this nonliability is usually upheld.[29] An interesting question arises in connection with these quasi corporations or Massachusetts Trusts, to-wit: Will the contractual or quasi corporate form assumed by such organization be ignored or disregarded to the same extent and in the same manner, in a proper case, as the corporate fiction is now set aside and disregarded of corporations? Manifestly the affirmative answer to this question must be true, for if the law and the courts are powerless to set aside this voluntary creation of the individuals composing it, and treat them in their individual capacities, it would be placing such organization on a higher plane than corporations organized with the sanction and forms of law. So it is thought to be safe to say that the quasi entity of a Massachusetts Trust and similar associations will be disregarded to the same extent as the corporation fiction is ignored. Such organizations are treated as corporations when questions involving mergers and successions of corporate rights are presented.[30] Of course, what has been

[28] Gay vs. Hudson River Electric Power Co., 109 C. C. A. 66; 187 Fed. 12; see secs. 20, 237, 317, 439, supra, 519, infra.

[29] Spotswood vs. Morris, 12 Idaho 360; 6 L. R. A. N. S. 665; 85 Pac. 1094.

[30] American Railway Express Co. vs. Commonwealth, 190 Ky. 636;

said of Massachusetts Trust would be equally true in dealing with joint stock companies, voluntary associations and the like.

§ 452. Organization of a Corporation to Succeed an Existing Business, Either Partnership or Corporate, Not Within the Statutes of Fraud

A partnership that is organized into a corporation and the corporation undertaking to assume the debts of the partnership is not a promise within the contemplation of the statute of frauds requiring that contracts or undertakings be evidenced by a writing.[31] So, the vote of the directors of a corporation assuming payment of the debts of its predecessor would in any event, it has been held, be a sufficient memorandum in writing to comply with the statutes, if any compliance is necessary, and the signature of the recording officer in attestation of the verity of the minute entries is a sufficient compliance for the execution of the document necessary under the terms of the statute.[32] The principle under discussion has also been held to apply in cases where the indenture of transfer contains terms of agreement that the transferee would assume the debts of the transferor is not signed by the transferee, will not avoid the legal effect of the document under any provisions of the statute of frauds.[33] Likewise an agreement by a consolidated corporation in consideration of the transfer to it of the property of the constituent companies to pay the debts of the companies going to make up the consolidated corporation is an original undertaking on its part and no writing evidencing such contract is necessary in order to make it binding and effective.[34] All of these cases might

228 S. W. 433; 30 A. L. R. 543; 263 U. S. 674; 42 S. Ct. 47; 44 S. Ct. 4; 68 L. Ed. 500.

[31] Schufeldt vs. Smith, 139 Mo. 367; 40 S. W. 887; Leckie vs. Bennett, 160 Mo. App. 145; 141 S. W. 706.

[32] Lamkin vs. Baldwin & L. Mfg. Co., 72 Conn. 57; 43 Atl. 593, 1042; 44 L. R. A. 786.

[33] Forbes vs. Thorpe, 209 Mass. 570; 95 N. E. 955.

[34] In re Amsdell Kirchner Brewing Co., 240 Fed. 492.

well be sustained upon that principle, thoroughly established in numerous neoteric judicial pronouncements, that corporate entities will not be permitted to stand in the way of doing justice, the simple principle being, as we have seen, that a succeeding body politic may not take the assets of its predecessor and repudiate the attendant liability.[85] In order for this principle to go into operation, the courts will pierce the penetralia of the juristic fiction of corporate entity.

[85] Secs. 201 et seq., supra, secs. 454, infra, nn. 4 and 5.

CHAPTER XXV

RIGHTS AND LIABILITIES UNDER CONSTITUTIONS AND STATUTES IMPOSING LIABILITIES ON SUCCEEDING CORPORATIONS

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§ 453. Legislation and Constitutional Provisions in a Number of States Fix Liability Upon Succeeding Corporation

In a number of states within the last few decades, there have been enacted legislation or constitutional provisions adopted

fixing liability upon purchasers of the assets and franchises of certain classes of corporations, usually those of a quasi public nature.[1]

§ 454. Ohio Statute Fixing Liability Upon Successor of Railroad Company

The Ohio statute, in substance, provides that any company may lease or purchase any part or all of a railroad constructed or in the course of construction by another, if the lines of railroad of such companies are continuous or connected and not competing, upon such terms as may be agreed upon by such companies, and after such purchase, the purchasing company shall be vested with all of the rights and powers in respect to the location, construction, completion and operation of such railroad and of branches thereto of the company from which it purchased said railroad, including the power to acquire and appropriate property therefor by condemnation and shall be subject to all duties, obligations and restrictions of said company. It seems that under such a statute the word "obligation," which the purchasing company assumes, is not sufficiently comprehensive to embrace within its significance a contract of the transferor company by which it has engaged to haul freight for another.[2] It is respectfully submitted, however, that Rice vs. Norfolk & W. Ry. Co.[3] is unsound, for it is generally conceded that these statutory enactments and constitutional provisions are declarations and clarifications of existing common-law principles,[4] and it is well established that

[1] Such provisions are so closely allied to the subject matter discussed in this volume of limitations of the corporate entity that a treatment of them is thought to be justified in these pages. This is especially true since many of the statutory enactments and constitutional provisions announce rules closely akin to common-law principles. Moreover, many of such provisions are affirmed to be mere declarations and clarifications of common-law doctrines. See sec. 467, infra.

[2] Rice vs. Norfolk & Western Ry. Co., 82 C. C. A. 447; 153 Fed. 497.

[3] Supra.

[4] Klosterman vs. Mason County Cent. Railroad, 8 Wash. 281; 36 Pac. 136; Campbell vs. Marietta & Cincinnati R. R. Co., 23 Ohio St.

by the application of common-law principles, a corporation may not transfer its entire property and thus avoid the performance of its obligations or contractual undertakings.[5] So, manifestly, when the Ohio legislature enacted the statute under consideration, it was not the intention of the law-making body to limit and restrict the liability of corporations as it then existed at common law, but it must have been the legislative intent to broaden the scope of such liability.

§ 455. Kentucky Statute

It seems that Kentucky has a provision in its code intended to apply to all corporations, which provides that the consolidated corporation shall be vested with all of the rights, privileges, franchises, exemptions, property, business, credits, assets and effects of constituent corporations without deed or transfer and shall be bound for all of their contracts and liabilities. Under this statute it has been held that where a consolidation takes place, the consolidated company is liable for money obtained from parties by representations which were untrue.[6] In addition to the statute aforesaid, Kentucky has a constitutional provision that no corporation shall lease or alienate any franchise so as to relieve the franchise or property held thereunder from the liability of the lessor or grantor, lessee or grantee, contracted or incurred in the operation, use or enjoyment of such franchise or any of its privileges. It is indeed difficult to understand how the court, under such pro-

168; Auglaize Box Board Co. vs. Hinton, 100 Ohio St. 505; 126 N. E. 881; Santa Fe Electric Co. vs. Hitchcock, 9 N. Mex. 156; 50 Pac. 332; Chicago M. & St. P. R. Co. vs. Third National Bank, 134 U. S. 276; 33 L. Ed. 900; 10 S. Ct. 550; Goddard vs. Fishel-Schlichten Importing Co., 9 Colo. App. 306; 48 Pac. 279; Colorado Springs Rapid Transit Ry. Co. vs. Albrecht, 22 Colo. App. 201; 123 Pac. 957.

[5] Schaake vs. Eagle Automatic Can Co., 135 Cal. 472; 63 Pac. 1025; Altoona vs. Richardson Gas & Oil Co., 81 Kan. 717; 26 L. R. A. N. S. 651; 106 Pac. 1025; Pittsmont Copper Co. vs. O'Rourke, 49 Mont. 281; 141 Pac. 849; Hoggan vs. Price River Irrigation Co., 55 Utah 170; 184 Pac. 536; Jennings Neff & Co. vs. Crystal Ice Co., 128 Tenn. 231; 47 L. R. A. N. S. 1058; 159 S. W. 1088.

[6] Mercer Lincoln Pine Knob Oil Co. vs. Payne, 268 S. W. 585; 206 Ky. 207.

vision of the organic law of the commonwealth, could have ever reached the conclusion that in spite of this constitutional provision a corporation could purchase all of the tangible property of another and would not be charged with the duty that such former corporation owed under a contractual undertaking.[7]

§ 456. Missouri Statute

The Missouri statute provides that the effect of the consolidation of railroad companies is to impose upon the consolidated company all of the obligations and liabilities which rested upon either of them, and it has been accordingly held that under this provision as to any right of action that existed prior to consolidation continues thereafter and will be enforced against the consolidated company, as the effect of the consolidation under such statute is nothing more or less than a mere change of name.[8]

§ 457. Tennessee Statute

The Tennessee statute provides in substance that the consolidated company shall have all the powers, rights and privileges of the original company and be subject to the same rules, conditions and liabilities as the constituent companies. It further provides that a consolidation under this provision implies between the companies the assent to the transfer and acceptance of the rights and liabilities as set forth in the act and it is held under such provision that the consolidated company to all intents and purposes stands in the place of the constituent corporation.[9]

[7] Bailey vs. Southern Ry., 110 Ky. 231; 61 S. W. 31; see sec. 465, infra.

[8] Wright vs. Kansas City Ft. S. & M. R. Co., 141 Mo. App. 518; 126 S. W. 517; Karn vs. Ill. Southern Ry., 114 Mo. App. 162; 89 S. W. 346; Kinion vs. K. C. & Ft. S. & M. R. Co., 39 Mo. App. 574.

[9] Miller vs. Lancaster, 5 Cold. 514 (Tenn.).

§ 458. Alabama Statute

The Alabama statute provides in substance that upon consolidation of corporations, the consolidated corporation will be entitled to the property and rights of the uniting corporations and liable for the debts and obligations of each of them, and under such statute when a consolidation takes place within the terms of its provisions, the consolidated company is liable for all of the debts of the original constituent companies, and under this statute, it is immaterial so far as affecting liability is concerned, that the company liable consolidates with another and that such other consolidates at a later time with the third, the result being that the final consolidated corporation will be liable, and such provision is broad enough, it seems, to embrace tortious acts as well as contractual obligations.[10]

§ 459. Georgia Statute

The Georgia code substantially provides that all corporations, foreign or domestic, operating the franchise of a corporation chartered under the laws of the state of Georgia are subject to its burdens and can be sued when and where and for like causes of actions for which suits could have been maintained against such other corporation, when it is in the possession of the franchise so acquired or usurped. Under this provision it has been held that the mere fact that a railroad company is in the business of and operating a line of railroad which formerly belonged to another corporation, would not have the effect of rendering the company so operating and in possession of such railroad, liable for damages growing out of a contract entered into by the former company whereby goods were lost. Neither would such provision fix liability for a tort of the predecessor on the successor.[11] It is indeed difficult

[10] Birmingham Ry. Light & Power Co. vs. Enslen, 144 Ala. 343; 39 Southern 74.

[11] Seaboard Airline Ry. Co. vs. Leader, 115 Ga. 702; 42 S. E. 38.

to conceive how the court could have ever reached the decision announced under this statute. Of course, this statute is very inartificially drawn but nevertheless it is quite apparent, even from its crude expression, that it was the legislative intent to fasten liability upon a succeeding corporation for the obligations and liabilities of its predecessor, and undoubtedly such rule as announced by the court in Seaboard Airline Railway Company vs. Leader,[12] would not be followed at this time, especially in view of the holding of the same court in Atlantic & Birmingham Ry. Co. vs. Johnson.[13]

§ 460. Kansas Statute

The Kansas statute provides, substantially, that any two or more railroad companies in that state are authorized to consolidate and form one company with all the rights, powers, privileges and immunities and subject to the obligations and liabilities to the state which belonged to or rested upon either of the companies making such consolidation. Under this statute the succeeding corporation is liable in a cause of action growing out of a tort existing against one of the constituent companies.[14] Under such statute the consolidated company is answerable for torts of the constituent corporation in the absence of evidence or stipulation to the contrary.[15] It is indeed difficult to see how stipulations or evidence to the contrary could affect the consolidated company's liability under the statute, unless the stipulation is with a party holding the obligation or to whom the consolidated company is liable, or unless the evidence discloses some legal ground of non-

[12] Supra. This holding is in line with Georgia's untenable position that a corporation may not be held for any obligation that was created prior to its incorporation; see secs. 140, 141, supra. But this position of the courts is out of harmony with Atlantic & Birmingham R. Co. vs. Johnson, 56 S. E. 482; 11 L. R. A. N. S. 1119; 127 Ga. 392.

[13] 127 Ga. 392; 11 L. R. A. N. S. 1119; 56 S. E. 482.

[14] Berry vs. Kansas City Ft. S. & M. R. Co., 52 Kan. 774; 34 Pac. 805; 52 Kan. 759; 40 Pac. 288; 55 Kan. 186; 39 A. S. R. 381; 36 Pac. 724.

[15] Hutchinson & S. R. Co. vs. Fair, 58 Kan. 813; 48 Pac. 591.

liability. It surely cannot be the law that others than the obligee can stipulate away his right of action given him by the statute. In addition to this, Kansas has another code provision enacting that the purchasers of a railroad at a foreclosure sale may organize a new company but that such organization shall in no wise affect any liability against the old corporation, existing at the time of the organization of the new company; however, under such provision the succeeding company is not liable on a contract of employment of its predecessor. The court reached this conclusion on the theory that the statute under consideration did not apply to reorganizations taking place after such sale under foreclosures, that such could not have been the legislative intent, as to so hold would render foreclosure proceedings meaningless and futile.[16]

§ 461. Michigan Statute

The Michigan statute provides substantially that if the capital stock of any of such corporations shall be withdrawn and refunded to the stockholders before the payment of all of the debts of the corporation, for which such stock would have been liable, the stockholders of such corporation shall be jointly and severally liable to any creditors of the corporation for an action founded on the statute to the amount of the sum refunded to him or them. Under this statute it was held that an employee who had been employed by the preceding company had no cause of action against the successor. Of course, it is readily apparent that this statute was never intended to embrace any such liability within its terms, but in view of the fact that the better reasoned common-law rule is that the succeeding corporation is liable, it is difficult to sustain the opinion of the court in the case note—not because of the statute, but in spite of it—and especially in view of the fact that the succeeding corporation, prior to the transfer, owned

[16] Keeler vs. Atchison T. & S. F. Ry. Co., 34 C. C. A. 523; 92 Fed. 545.

practically all of the stock of its predecessor.[17] In Chase vs. Michigan Telephone Co.,[18] it was largely a matter of shifting corporate entities, and in the light of the neoteric decisions discarding the corporate fiction, when in the interest of justice and the exigencies of the case demanded, the corporate fiction will be set aside.

§ 462. Wisconsin Statute

The Wisconsin statute substantially provides that parties purchasing railroads at mortgage sale shall have the same power and be granted the same immunities, rights and privileges as the former company had and even provides that the succeeding corporation may conduct its business under the charter of the former corporation. It is held, however, that under such statute, the succeeding corporation cannot be the same and is not liable for the debts of the former.[19] However, the court held that where the former company had appropriated a right of way and the value thereof had been assessed according to the laws of the state of Wisconsin and a new company was organized and continued to operate the railroad over the right of way that had thus been appropriated, such new company was liable for such right of way.[20]

It is submitted that these decisions are correct regardless of the statute in view of the doctrine obtaining in our day. If the foreclosures were free from fraud they would bar further pursuit of the property in the hands of the purchaser, while if the reorganization is simply a matter of shifting corporate entities, then manifestly they would not be permitted to impede the course of justice in following the property that is liable for their liquidation. It seems that such statutes neither add to nor take away from the ample body of common law.

[17] Chase vs. Michigan Telephone Co., 121 Mich. 631; 80 N. W. 717.
[18] Supra.
[19] Vilas vs. Milwaukee Prairie du Chien Ry. Co., 17 Wis. 497; Smith vs. Chicago N. W. Ry. Co., 18 Wis. 21.
[20] Pfeifer vs. Sheboygan & Fond du Lac R. R. Co., 18 Wis. 155.

§ 463. New York Statute

The New York law provides, substantially, that all debts and liabilities incurred by a constituent corporation shall attach to the consolidated corporation and be enforced against it and its property. Under such statute the term "debt" means what one owes to another and "liability" means an obligation which may or may not ripen into a debt, and under such a statute, it is held that a mortgage lien is not embraced in either of the terms "debt" or "liability," and that the holder of a mortgage lien against one of the consolidating companies may not expand his rights under the statute to include property of the consolidated corporation that is not impressed with a mortgage lien. It therefore follows that under such statute the holder of a debt or liability is in a better position, so far as the consolidated company is concerned, if there is sufficient property to pay in full all creditors, than the holder of a mortgage against one of the constituent companies and part of its property. It seems the mortgagee is confined in his remedies to the property impressed with mortgage lien.[21] Formerly in New York, the statute had provided that the consolidated or succeeding company should respond for debts and liabilities incurred by its predecessor, except mortgages, and under that statute it was held that interest coupons of a mortgage indebtedness would sustain an action against the new corporation and apparently that all of the property of the consolidated or succeeding corporation would be subject to go to the satisfaction of such interest coupons on such mortgage indebtedness.[22]

§ 464. Pennsylvania Statute

The Pennsylvania statute provides, in substance, that the

[21] Irving Bank-Columbia Trust Co. vs. N. Y. Ry., 292 Fed. 429; 44 S. Ct. 38; 263 U. S. 713; 68 L. Ed. 520.

[22] Polhemus vs. Fitchburg Ry. Co., 123 N. Y. 502; 26 N. E. 31; 50 Hun. 397; 3 N. Y. S. 327; see, however, Janes vs. Fitchburg Ry. Co., 50 Hun. 310; 20 N. Y. St. Rep. 168; 3 N. Y. S. 165.

continuation of all rights of creditors and all liens upon the property of each of the constituent corporations go unimpaired in the hands of the consolidated or succeeding corporation and that the respective constituent corporation shall be deemed to be evidence to preserve the rights of creditors and lien holders and all debts and liabilities of the constituent corporation shall attach to the new corporation and be enforced against it in the same manner as if the consolidation had not taken place or in the same manner as if it had not succeeded to the debtor corporation's right and liability. Under this statute it is held that it is immaterial how much commingling of assets there may be that the mortgage liens continue and follow the property that is impressed with them.[28]

§ 465. California, Utah, Idaho, Washington, and Kentucky Constitutional Provisions

California, Utah, Idaho, Washington, and Kentucky have constitutional provisions substantially the same, providing that the legislature shall not pass any law permitting the leasing or alienation of any franchise so as to release or relieve the franchise or property held thereunder from any of the liabilities of the lessor or grantor or lessee or grantee contracted or incurred in the operation, use or enjoyment of such franchise or any of its privileges. Under this constitutional provision the succeeding corporation is liable for damages for personal injuries for which the predecessor corporation is liable and it is immaterial that the action is not prosecuted to judgment until the transfer takes place. It is essential, however, from the wording of the constitutional provision, that the obligation or liability sought to be proved against the succeeding company should be incurred in the operation, use or enjoyment of such franchise or some of its

[28] Columbia & Montour Elec. Co. vs. No. Branch Transit Co., 258 Pa. 447; 102 Atl. 214.

privileges.[24] Under these provisions the claimant may only assert his rights against the property of the predecessor corporation in the hands of its successor and may not hold the succeeding corporation personally liable, but such provisions do not prevent the court from holding such succeeding corporation liable personally under the common-law rule.[25] However, the Kentucky court has held that the word "franchise," as used in these constitutional provisions, means the franchise to be a corporation,[26] but undoubtedly the sounder rule is that any franchise referred to in the constitutional provision includes all franchises, both primary and secondary.[27] It is also reasonably clear that the expression "or property thereunder" means such property as is held and used in the operation of the franchise.[28]

§ 466. Massachusetts Statute

By special act of the legislature of the commonwealth of Massachusetts, a railroad was authorized to purchase the right, franchise, and property of another railroad and the latter was authorized to convey to the former its franchise and property, rights, easements, privileges and powers and provided further that the receiving corporation would be subject to all duties, liabilities, obligations, and restrictions to which the transferring corporation was subject, and under this statute it was held that the receiving corporation would be responsible directly in an action for tort committed by the selling corporation prior to the transfer.[29]

[24] Seymour vs. Boise R. R. Co., 24 Idaho 7; 132 Pac. 427; Cooper vs. Utah Light & Ry. Co., 35 Utah 570; 102 Pac. 202; 136 A. S. R. 1075; City of South Pasadena vs. Pasadena Land & Water Co., 152 Cal. 579; 93 Pac. 490; Klosterman vs. Mason County Central Ry. Co., 8 Wash. 281; 36 Pac. 136; Bailey vs. So. Ry. Co., 110 Ky. 231; 61 S. W. 31; 112 Ky. 424; 22 Ky. L. R. 1397; see sec. 455, supra.

[25] Lee vs. So. Pac. Ry. Co., 116 Cal. 97; 58 A. S. R. 140; 47 Pac. 932; 38 L. R. A. 71; Seymour vs. Boise R. R. Co., supra.

[26] Bailey vs. So. Ry. Co., supra.

[27] Cooper vs. Utah Light & Ry. Co., supra.

[28] Cooper vs. Utah Light & Ry. Co., supra.

[29] New Bedford Ry. Co. vs. Old Colony Ry. Co., 120 Mass. 397.

§ 467. It Is Generally Held That Statutes Imposing Liability Upon a Buying Corporation For the Obligations of the Old Are but Declarations of the Common Law

The rule is established, by the decisions dealing therewith, that legislative enactments and constitutional provisions fixing liability upon succeeding corporations for the obligations of their predecessors are but declarations of what the courts would hold to be the law irrespective of such provision. In other words, such provisions are merely declarations or clarifications of the existing common law upon the subject.[30]

§ 468. Under Statutes Prescribing Creditors May Follow Assets in the Hands of Succeeding Corporation For Liabilities of Its Predecessor, Have a Lien

Under statutes generally prescribing for the following of assets in the hands of purchasing corporations for obligations of the seller, it is generally held to be true that the holders of such obligations have a lien upon and against the assets so transferred and it seems immaterial how many times such assets have changed hands.[31] And, it is generally true that a creditor of such corporation may not be deprived of his equitable lien on corporate assets by any sort of agreement or arrangement that corporations may enter into between and among themselves, without the consent of such creditor, to the effect that such transferee will or will not assume corporate debts.[32]

[30] Klosterman vs. Mason County Railroad Co., 8 Wash. 281; 36 Pac. 136; Chicago, Milwaukee & St. Paul Ry. Co. vs. Third National Bank, 134 U. S. 276; 10 S. Ct. 550; 33 L. Ed. 900; Campbell vs. Marietta & Cincinnati Ry. Co., 23 Ohio St. 168; Rice vs. Norfolk & Western Ry. Co., 153 Fed. 497.

[31] Compton vs. Wabash & St. L. & P. Ry. Co., 45 Ohio St. 592; 16 N. E. 110; 18 N. E. 380; Seymour vs. Boise Ry. Co., 24 Idaho 7; 132 Pac. 427.

[32] John H. Giles Dyeing Machine Co. vs. Klauder Weldon Dyeing Machine Co., 212 App. Div. 771; 209 N. Y. S. 616; 198 App. Div. 564; 190 N. Y. S. 726; 233 N. Y. 470; 135 N. E. 854.

§ 469. It Seems That the Lien Given by Statutes or Constitutional Provisions Extends to Torts As Well As Contracts

It seems that the lien created by statutory enactments or constitutional provisions is not confined in its operation to contractual obligations, but that liability arising from tortious conduct is embraced within the provision giving the holders of obligations against a prior corporation a lien upon the assets transferred to a successor, and this is certainly true after an action has been brought and damages arising from the commission of a tort have been assessed and ripened into a judgment, and it is immaterial that the judgment is not obtained against either corporation until after the transfer has taken place.[33] Neither is the liability of the succeeding corporation affected by the taking of a judgment against the obligated constituent company and this seems to be true where the claim that is reduced to judgment is contractual or otherwise.[34]

[33] Cooper vs. Utah Light & Ry. Co., 35 Utah 570; 102 Pac. 202; 136 A. S. R. 1075; Chicago S. F. & C. Ry. Co. vs. Ashling, 160 Ill. 373; 43 N. E. 373; 56 Ill. App. 327.

[34] In re Utica National Brewing Co., 154 N. Y. 268; 48 N. E. 521; 19 App. Div. 627; 46 N. Y. S. 1102.

CHAPTER XXVI

DISREGARD OF CORPORATE ENTITY TO HOLD STOCKHOLDERS OF FOREIGN CORPORATION AND IN CONSTRUCTION OF TREATIES AND CONTRACTS AND IN CONNECTION WITH DECEDENT'S ESTATES, ETC.

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498a. A joint-stock company succeeding to the property rights of a corporation likewise will be held responsible for its obligations.

§ 470. Corporations Organized in One State For the Purpose of Doing Business in Another Only, Are Generally Denominated "Tramp" Corporations

Where the stockholders or incorporators of a company organize it under the laws of one state and entertain at the time thereof no intention of doing business therein, but the purpose of being is to transact all of the business of the corporation in a state other than that of its creation, it is generally denominated a "tramp" corporation.[1] It is submitted, however, that to designate such corporation as a "tramp" corporation is more or less of a misnomer. It would seem that the appellation "tramp" corporation would apply to those corporations that migrate in a broader sense than that of merely incorporating in one state with no intention of doing business therein, but for the purpose of transacting business in another, and would apply to corporations that move about from place to place when the field of operation is not limited by one more or a dozen states but operate throughout the country as chautauquas and circus corporations and the like.

§ 471. "Tramp" Corporation Recognized by Comity

By virtue of comity existing between the different jurisdictions, throughout the United States, it is generally held that a "tramp" corporation will be accorded recognition and permitted to do business as a foreign corporation, although it is incorporated under the laws of a state in which it was never intended to transact any business whatsoever.[2] In some cases

[1] Cumberland Telegraph & Telephone Co. vs. Louisville Home Telephone Co., 114 Ky. 892; 24 Ky. L. R. 1676; 72 S. W. 4; State vs. Georgia Co., 112 N. C. 34; 19 L. R. A. 485; 17 S. E. 10.

[2] Second National Bank vs. Lovell, 13 Ohio Dec. 972; 2 Cinc. R. 397; Oakdale Mfg. Co. vs. Garst, 18 R. I. 484; 23 L. R. A. 639; 49 A. S. R. 784; 28 Atl. 973; State vs. Topeka Water Co., 60 Pac. 337; 61 Kan. 547; Cumberland Telegraph & Telephone Co. vs. Louisville Home Telephone Co., 24 Ky. L. R. 1676; 114 Ky. 892; 72 S. W. 4; State vs. Cook, 80 S. W. 929; 181 Mo. 596; Demarest vs. Flack, 13 L. R. A. 854; 128 N. Y. 205; 28 N. E. 645; 16 Daly 337; 11 N. Y. S.

even in the absence of any fraud or illegality the favor of comity is not extended to so-called "tramp" corporations, and under the rule of those cases they are treated largely as partnerships when it is found their entire activities are confined to a jurisdiction other than that of their creation.[3] The law of comity will not even permit a partnership to engage in business in a state where a foreign corporation is a member thereof. If such partnership engages in business in a state without its foreign corporation member complying with local laws, the same consequences attach to the partnership business as if such foreign corporation were engaged in business in such state directly—without the intervention of the partnership relation.[4]

§ 472. Limitations on Comity

It is only by virtue of comity that foreign corporations of the character denominated "tramp" corporations have been permitted to do business in a state other than that of their creation and incorporated for that purpose. But comity does not mean that such corporation may come into a state contrary to local laws or in contravention of the policy of the state entered or may transact business in such state when the same is detrimental to local interests.[5] So, it is generally true,

83; Vinegar Co. vs. Schlegel, 143 N. Y. 537; 38 N. E. 729; Lancaster vs. Amsterdam Improvement Co., 24 L. R. A. 322; 140 N. Y. 576; 35 N. E. 964; Reversing 72 Hun. 18; 25 N. Y. S. 309.

[3] Empire Mills vs. Alston Grocery Co., 4 Willson Civ. Cas. Ct. of Apps. (Tex.) sec. 221; 12 L. R. A. 366; 15 S. W. 200; Journal Co. vs. Nelson, 113 S. W. 690; 133 Mo. App. 482; Cleaton vs. Emery, 49 Mo. App. 345; Hill vs. Beach, 12 N. J. Eq. 31; Taylor vs. Branham, 17 Southern 552; 35 Fla. 297; 48 A. S. R. 249; 39 L. R. A. 362; Land Grant Ry. & Trust Co. vs. Coffey, 6 Kan. 245; 25 Pac. St. Rep. 149; Booth vs. Wonderly, 36 N. J. L. 250.

[4] Harris vs. Columbia Water & Light Co., 108 Tenn. 245; 67 S. W. 811; Ashland Lumber Co. vs. Detroit Salt Co., 114 Wis. 66; 89 N. W. 904.

[5] Cowell vs. Colorado Springs Co., 100 U. S. 55; 25 L. Ed. 547; Mannington vs. Hocking Valley Ry. Co., 183 Fed. 133; Blodgett vs. Lanyon Zinc Co., 120 Fed. 893; 58 C. C. A. 79; Am. De Forest Wireless Tel. Co. vs. San Francisco Sup. Ct., 17 L. R. A. N. S. 1117; 153 Cal. 533; 96 Pac. 15; 126 A. S. R. 125; Skinner vs. Southern Home Building & Loan Ass'n, 46 Fla. 547; 35 Southern 67; Duke vs. Taylor, 37 Fla. 64;

that the state wherein such corporation is functioning will not permit it to exercise powers not embraced within its charter provisions or powers, which corporations organized under the laws of such state are not permitted to exercise, and manifestly such corporation will not be permitted to do business in the state at all other than of its creation where it is organized for the purpose of evading the laws of either of the state of its creation or a state that it seeks to enter.[6] The reason underlying the principle of comity is that it is well recognized, while a nation or state possesses exclusive jurisdiction within its boundaries, neither constitutions nor statutes have any intrinsic force *ex proprio vigore* beyond the territory of the sovereignty which enacts them, and the respect which is paid to them elsewhere depends on comity alone. This is a gnome of the law, self-evident and universal in its adhibition.[7] Any other rule would result in a chaotic condition in the law.

§ 473. Foreign Corporation Cannot Do an Act Prejudicial to Local Interest or in Contravention of Local Laws

We have already seen that a corporation organized in one state may in harmony with the laws of another, be permitted

19 Southern 172; 53 A. S. R. 232; 31 L. R. A. 484; Webster vs. Ore. Short Line Ry. Co., 6 Idaho 312; 55 Pac. 661; State vs. Topeka Water Co., 61 Kan. 547; 60 Pac. 337; Helena Power Transmission Co. vs. Spratt, 35 Mont. 108; 10 A. C. 1055; 88 Pac. 773; 8 L. R. A. N. S. 567; Martyne vs. Am. Union Fire Ins. Co., 216 N. Y. 183; 110 N. E. 502; 168 App. Div. 380; 153 N. Y. S. 433; Clark vs. Memphis St. R. Co., 123 Tenn. 232; 130 S. W. 751; Seattle Gas & Electric Co. vs. Citizens Light, etc., Co., 123 Fed. 588; State vs. Topeka Water Co., supra; People vs. Alaska Pacific S. S. Co., 187 Pac. 742; 182 Cal. 202; Blair vs. Perpetual Ins. Co., 10 Mo. 559; 47 A. D. 129; Empire Mills vs. Alston Grocery, 4 Willson Civ. Cas. Ct. of App. (Tex.) sec. 221; 12 L. R. A. 366; 15 S. W. 200.

[6] See authorities cited in n. 5, supra; Owen vs. Shepard, 59 Fed. 746; 8 C. C. A. 244; Van Steuben vs. Central Ry. Co., 178 Pa. 367; 34 L. R. A. 577; 35 Atl. 992; Myatt vs. Ponca City Land & Improvement Co., 78 Pac. 185; 14 Okla. 189; 68 L. R. A. 810; Demarest vs. Flack, 128 N. Y. 205; 28 N. E. 645; 13 L. R. A. 854; 16 Daly 337; 11 N. Y. S. 83.

[7] Land Grant R. & T. Co. vs. Coffey Co., 6 Kan. 245; Myatt vs.

to migrate there and to do business in such jurisdiction other than that of its creation,[8] but by no means, when a corporation is admitted into a state to transact its business there, is there consent, tacit or otherwise, for such corporation to perform acts in contravention of local laws or policy or to do anything in such jurisdiction that would be detrimental or prejudicial to local interests.[9] A corporation will not be permitted, in a jurisdiction other than that of its creation, to perform acts that are beyond the purview of its charter powers. Neither may a corporation, by entering another jurisdiction, assume unto itself privileges that the domestic corporations of such jurisdiction are not permitted to exercise.[10]

§ 474. A Corporation Will Not Be Permitted in a Foreign Jurisdiction to Do Acts in Evasion of the Laws of the State Where It Is Created or of the Laws Where It Is Permitted to Do Business

No policy of comity will admit a foreign corporation into a jurisdiction for the purpose of evading laws of the state of its creation, and if it is organized for that purpose, it will not be accomplished. Neither may a corporation be organized in

Ponca City Land & Improvement Co., 14 Okla. 189; 78 Pac. 185; 68 L. R. A. 810; Bank of Augusta vs. Earle, 13 Peters 519; 10 L. Ed. 274.

[8] See sec. 471, supra.

[9] Paul vs. Virginia, 8 Wall 168; 19 L. Ed. 357; Runyon vs. Coster, 14 Peters 122; 10 L. Ed. 382; Bank of Augusta vs. Earle, 38 U. S. 518; 10 L. Ed. 274; Clarke vs. Central Railroad & Banking Co. of Ga., etc., 50 Fed. 338; 15 L. R. A. 683; Falls vs. U. S. Savings, etc., Co., 97 Ala. 417; 13 Southern 25; 38 A. S. R. 194; 24 L. R. A. 174; Clark vs. Memphis Street Ry. Co., 123 Tenn. 232; 130 S. W. 751; Fowler vs. Bell, 90 Tex. 150; 37 S. W. 1058; 59 A. S. R. 788; 39 L. R. A. 254; Booth & Co. vs. Weigand, 28 Utah 372; 79 Pac. 570; 30 Utah 135; 83 Pac. 734; 10 L. R. A. N. S. 693; Presbyterian Ministers' Fund vs. Thomas, 126 Wis. 281; 105 N. W. 801; 110 A. S. R. 919; State vs. Minneapolis & Northern Elevator Co., 17 N. D. 23; 114 N. W. 482; 138 A. S. R. 691; Myatt vs. Ponca City Land, etc., Co., 14 Okla. 189; 78 Pac. 185; 68 L. R. A. 810; Seamans vs. Temple Co., 105 Mich. 400; 63 N. W. 408; 28 L. R. A. 430; 55 A. S. R. 457.

[10] 14a C. J. 1219.

one jurisdiction to do business in another in evasion of the laws of such latter jurisdiction.[11]

§ 475. The Fact That a Corporation Is Organized Under the Laws of Another State and Permitted to Do Business in a State Other Than That of Its Creation, Does Not Prevent Courts From Disregarding Corporate Entity

The principles of comity are well recognized and securely established by authority, to permit corporations organized in one state to go into another state and there function as a body politic which will, by virtue of the principles of comity, be treated in all respects as a corporation of the local jurisdiction, but when this much is conceded, it must not be assumed that a foreign corporation doing business in a state other than that of its creation is immune from the application of the doctrine that in a proper case the corporate entity will be disregarded, for the courts will as readily brush aside the corporate entity, that is the juristic creation of a foreign jurisdiction, as they will a corporation organized under local laws.[12]

§ 476. Some Courts Hold That the Organization of a Corporation Under the Laws of One State Expressly For the Purpose of Doing Business in Another Is Itself a Fraud

Some courts have gone to the extent of holding that the organization of a corporation under the laws of one state for the express purpose of doing business in another constitutes a

[11] Cincinnati Second National Bank vs. Lovell, 13 Ohio Dec. (Reprint) 972; 2 Cin. Super. 397; Myatt vs. Ponca City Land & Improvement Co., 14 Okla. 189; 78 Pac. 185; 68 L. R. A. 810; Van Steuben vs. Central Ry. Co., 178 Pa. 367; 35 Atl. 992; 34 L. R. A. 577; Owen vs. Shepard, 59 Fed. 746; 8 C. C. A. 244; Hill vs. Beach, 12 N. J. Eq. 31; see also 14a C. J. 1219, 1220.

[12] Demarest vs. Flack, 32 N. Y. St. 675; 128 N. Y. 205; 28 N. E. 645; 13 L. R. A. 854; 16 Daly 337; 11 N. Y. S. 83; sometimes styled as Demarest vs. Grant; Montgomery vs. Forbes, 148 Mass. 249; 19 N. E. 342; Empire Mills vs. Alston Grocery, 4 Tex. Civ. Cas. (Willson) sec.

fraud upon the jurisdiction of the state where it is proposed to do business.[13] However, the better rule seems to be that the organization of a corporation solely for the purpose and with the intention of doing business within another jurisdiction does not in and of itself constitute a fraud upon either jurisdiction and that it will be recognized as a corporation with all of the rights and privileges of such juristic existence.[14] Some cases stress the point that if the corporation maintains an office in the state of its creation that that is a distinct feature and strengthens the position of the right of the corporation in doing business, except in maintenance of such office in another jurisdiction.[15]

§ 477. Corporation Doing Business in a State Other Than That of Its Creation Without Compliance With Laws, Stockholders Liable As Partners

It is a well established principle of law that a corporation

221; 15 S. W. 200-505; 12 L. R. A. 366; State vs. Topeka Water Co., 61 Kan. 547; 60 Pac. 337; Land Grant Ry. & Trust Co. vs. Coffey, 6 Kan. 245; Myatt vs. Ponca City Land & Improvement Co., 14 Okla. 189; 68 L. R. A. 810; 78 Pac. 185; see sec. 439, supra.

[13] Land Grant R. & Trust Co. vs. Coffey, 6 Kan. 149; Taylor vs. Branham, 17 Southern 552; 35 Fla. 297; 48 A. S. R. 249; 39 L. R. A. 362; Empire Mills vs. Alston Gro., 4 Tex. Civ. Cas. (Willson) 221; 15 S. W. 200-505; 12 L. R. A. 366; Cleaton vs. Emery, 49 Mo. App. 345; Hill vs. Beach, 12 N. J. Eq. 31.

[14] Troy & N. C. Gold Mining Co. vs. Snow Lbr. Co., 173 N. C. 593; 92 S. E. 494; 1917E L. R. A. 892; Moxie Nerve Food Co. vs. Baumbach, 32 Fed. 205; Cumberland Telegraph & Telephone Co. vs. Louisville Home Telephone Co., 114 Ky. 892; 24 Ky. L. R. 1676; 72 S. W. 4; Oakdale Mfg. Co. vs. Garst, 18 R. I. 484; 23 L. R. A. 639; 49 A. S. R. 784; 28 Atl. 973; Demarest vs. Flack, 128 N. Y. 205; 32 N. Y. St. 675; 13 L. R. A. 854; 28 N. E. 645; 16 Daly 337; 11 N. Y. S. 83; Mo. Lead Mining & Smelting Co. vs. Reinhard, 114 Mo. 218; 35 A. S. R. 746; 21 S. W. 488; Merrick vs. Van Santvoord, 34 N. Y. 208; Lancaster vs. Amsterdam Improvement Co., 140 N. Y. 576; 24 L. R. A. 322; 35 N. E. 964; 72 Hun. 18; 25 N. Y. S. 309; 55 N. Y. St. Rep. 69. In Troy & N. C. Gold Mining Co. vs. Snow Lbr. Co., supra, the court illustrated a point involved by instancing the way the Union Pacific Railroad Co. did business and pointed out that it operated a line of railroad from Kansas City to Ogden, Utah, and that it was chartered under the laws of Kentucky, in which state it had no track.

[15] Second National Bank vs. Lovell, 13 Ohio Dec. (Reprint) 972;

can have no legal existence out of the boundaries of the sovereignty by which it is created. It exists only in contemplation of law and by force of law and where that law ceases to operate and is no longer obligatory, the corporation can have no existence. It must dwell in the place of its creation and cannot migrate to another sovereignty.[16] Of course, it is understood that a corporation may do business in another state by virtue of comity.[17] The better reasoned and modern rule seems to be that where a corporation enters another state and does business therein without complying with the conditions imposed by law upon foreign corporations coming into such state, its stockholders are liable as partners; and it is submitted that this rule is sound and the situation simply amounts to this, that so far as the jurisdiction is concerned, where the corporation is found to be doing business, though organized under the laws of another state, the stockholders having merely united together and assuming a fictitious name and transacting business thereunder, what reason could be urged as to why they should not be held as partners it is difficult to understand.[18] It is interesting to contemplate just what the effect of holding the stockholders of such corporation as partners, would be. It is readily seen that it is perfectly just and proper to hold such stockholders as partners in the suit of a creditor, but on the other hand may such stock-

2 Cinn. R. 397; Second National Bank vs. Hall, 35 Ohio State 158; Stabler vs. El Dora Oil Co., 27 Cal. App. 516; 150 Pac. 643.

[16] Bank of Augusta vs. Earle, 38 U. S. 518; 10 L. Ed. 274; Miller vs. Ewer, 27 Me. 509; 46 A. D. 619; Freeman vs. Machias Water Power & M. C., 38 Me. 343; Taylor vs. Branham, 35 Fla. 297; 17 Southern 552; 48 A. S. R. 249; 39 L. R. A. 362; Duke vs. Taylor, 37 Fla. 64; 31 L. R. A. 484; 53 A. S. R. 232; 19 Southern 172.

[17] See sec. 471.

[18] Cunnyngham vs. Shelby, 136 Tenn. 176; 188 S. W. 1147; 1917B L. R. A. 572; Taylor vs. Branham, supra; Montgomery vs. Forbes, 148 Mass. 249; 19 N. E. 342; Davidson vs. Hobson, 59 Mo. App. 130; Cleaton vs. Emery, 49 Mo. App. 345; Empire Mills vs. Alston Grocery Co., 4 Tex. Civ. Cas. (Wilson) Sec. 221; Equitable Trust Co. vs. Central Trust Co., 145 Tenn. 148; 239 S. W. 171; Crouch vs. Gray, 290 S. W. 391; 50 A. L. R. 1023; 154 Tenn. 521; Campbell-Moss-Johnson vs. Lupton, 290 S. W. 992; 51 A. L. R. 372; 155 Tenn. 93; 1 S. W. (2d) 783; see sec. 49, supra.

holders assume unto themselves the relationship that the law has provided for them and assert rights as partners, and as such partners may they bring suits upon contracts that have been entered into in the name of the corporation organized under the laws of another state? It is thought that when the situation is properly analyzed, the status of partners is fixed upon the stockholders of such corporation, when it is sought to make them respond to a liability attaching to the transaction of the business in such state without complying with its laws relating to foreign corporations, but it is a status they may not claim for their own advantage. To hold otherwise would allow a foreign corporation to come into a jurisdiction and there transact business as such corporation until its right so to do were questioned and then it would discard its corporate suit of armor and assume to assert rights in an entirely different capacity than that in which it had been carrying on its business. Some states have statutes declaring that foreign corporations doing business therein, in violation or fraud of its laws, the stockholders will be liable as partners.[19] Moreover, in the absence of such statute, it is recognized that a corporation found beyond the confines of the jurisdiction of its creation, has no existence, and by the forcible reasoning of the Supreme Court of Tennessee,[20] there being no corporation to be bound, those participating, whether stockholders, officers or other agents, doing the business which gives rise to the demand, are liable. Of course, it could make no difference in so far as liability of stockholders is concerned, that the foreign corporation doing business in violation of the law of another state has one stockholder or more than one. If such foreign corporation has but one stockholder, he would be none the less liable for its acts or the acts of its agents in such state. His liability would be the same as an individual doing business under an assumed name.[21]

[19] Meir vs. Crossley, 305 Mo. 206; 244 S. W. 882; 35 A. L. R. 611. Concurring opinion of Judge Ragland.
[20] Campbell-Moss-Johnson vs. Lupton, supra.
[21] See sec. 480, infra.

§ 478. It Seems That the Liability Attaching to Stockholders of a Foreign Corporation Doing Business Without Compliance With Law, Is the Same Whether It Is a Tort or Contract

It does not make any difference, in so far as the liability attaching to stockholders of a noncomplying corporation doing business within a state, whether that liability arises *ex contractu* or *ex delicto*. When a foreign corporation is found doing business in a state without having complied with laws thereof, the status of partners is fastened thereby upon its stockholders, officers and agents and as a corollary of such status attendant liabilities attach. So it is readily seen that such liability is the same without regard to whether it arises from contractual obligations or tortious acts.[22]

§ 479. Foreign Corporation Doing Business in a State Without Compliance With Law, No Defense to Criminal Prosecution For Embezzlement

It seems well established, by the adjudicated cases, where the question has been made that when an agent or employee of a foreign corporation is doing business within a state without having complied with the laws thereof, such agent may not embezzle the corporate funds and defend against a criminal prosecution upon the ground that such corporation had not complied with the laws of the state.[23] While there is no dissent among the decisions on the proposition that the noncompliance of a foreign corporation with the laws of the state in which it is found doing business is no defense to the charge of embezzlement preferred against an officer or agent of it, criminally appropriating its money, yet it is a little difficult

[22] Rowden vs. Daniell, 151 Mo. App. 15; 132 S. W. 23; see sec. 49, supra.

[23] State vs. O'Brien, 94 Tenn. 79; 26 L. R. A. 252; 28 S. W. 311; People vs. Hawkins, 106 Mich. 479; 64 N. W. 736; Commonwealth vs. Shober, 14 Lanc. Law Rev. 158; 3 Pa. Super. Ct. 554; State vs. Hopkins, 56 Vt. 250; State vs. Tunney, 81 Ind. 559.

to understand how it can be charged that the funds of a corporation have been appropriated by the defendant and that that very corporation has no legally recognized existence at the hands of the state. The position of the state in holding on the one hand there is no corporation, and on the other there is, to say the least of it, an antinomy. It would seem far more satisfactory from the logical point of view, to charge that the embezzlement was of the funds of a partnership.

An interesting situation could arise in such case where a foreign corporation doing business in a state, without complying with its laws respecting foreign corporations, in the course of its business receives a check and it turns out that the drawer of that check has no funds or credit with the bank to meet the same, and there being a statute in the particular jurisdiction punishing as criminal the giving of a check without funds in or credit with the drawee bank, to meet the same, could such a prosecution be sustained? It is respectfully submitted that it could not, for the reason that the corporation could not enforce the civil liability represented by such check and then manifestly if it could not enforce the civil liability, it ought not be permitted to prosecute upon an obligation that had no validity, or was at least voidable as an obligation. Also it would seem, as we have remarked above, that the state could not charge that a corporation as such had been defrauded by the giving of such check when the state itself accorded no recognition to such corporation.

§ 480. An Individual Engaged in Business Who Thereafter Organizes a Foreign Corporation and Attempts to Continue the Business in the Name Thereof Without Compliance With Local Law, Is Liable

An individual who is engaged in business in a state and during the time of such engagement organized a foreign corporation and continued the same business in the name of the purported corporation, he being in charge thereof, under such

state of facts he will be held personally liable for the contractual obligations and tortious acts of such foreign corporation. His liability is predicated upon the ground that by reason of such noncompliance, the corporation had no recognition or existence within the state.[24]

§ 481. Corporate Entity Will Be Ignored in the Construction of Treaty Provisions

At the close of the Revolutionary War, the treaty between Great Britain and the United States of America provided that there should be no further confiscations made nor any prosecution commenced against any *person* or *persons* for or by reason of the part which *he* or *they* may have taken in the Revolutionary War, and that no *person* shall in that act suffer any further loss or damage either in his person, liberty or property. After rendering that treaty effective on behalf of the respective governments, it was contended by the state of Vermont that it had the right to forfeit and put an end to the title of a British corporation and to appropriate to itself lands within the jurisdiction of Vermont. But this contention on the part of the State of Vermont was held untenable and the corporation, by reason of its members being British subjects, was given the full protection of that treaty provision. The court dealt with the members as such and put aside any view of the legal entity.[25] If the corporate form had been kept in view perhaps the contention of Vermont was well founded.

§ 482. Trustees of a Will May Not Organize a Corporation Under the Laws of a Foreign Jurisdiction and Buy Trust Property in Its Name and Avoid Inheritance Taxes

The courts will so far ignore corporate forms as to go be-

[24] Rowden vs. Daniell, 151 Mo. App. 15; 132 S. W. 23; see sec. 477, supra.

[25] Society for the Propagation of the Gospel in Foreign Parts vs.

hind the fictional idea of a corporation existing separate and apart from its stockholders as to hold the trustees under a will, cannot by the organizing of a corporation under the laws of another jurisdiction and placing the property therein, avoid the payment of inheritance or succession tax. In such case, on the death of the beneficiary, the funds being placed by the trustee in the hands of the foreign corporation, the court will ignore the corporate forms and treat it the same as the trustees, and accordingly taxes will properly accrue as on inheritance or succession.[25a]

§ 483. Corporate Entity Disregarded to Carry Out Intent of Testator

A testator purporting to give shares of stock in a corporation will be given effect although the shares so attempted to be bequeathed were issued in the name of a corporation, all of the stock of which belonged to the testator. In other words, the corporate entity will be brushed aside and the testator allowed to make effective his gift of stock that stands in the name of his corporation.[26] So, where a testator makes a gift of both real and personalty, his intent will be carried out notwithstanding the fact that the legal title to that property is vested in a close corporation, all of the stock of which being owned by the testator.[27] So, where a testatrix had, prior to the execution of her will, conveyed certain real estate to a corporation and had taken stock in payment therefor, which stock was an asset of her estate, it was held that in order to effectuate the intent of the testatrix, the corporate entity would be ignored and the substance of the gift would be considered and mere form disregarded.[28]

The Town of New Haven, 8 Wheat. 464; 5 L. Ed. 662; see sec. 422, supra.

[25a] Gardiner vs. Burrill, 225 Mass. 355; 114 N. E. 617; see sec. 412-414, supra.

[26] In re Bush's Estate, 124 Misc. 674; 209 N. Y. S. 776.

[27] In re Friedman, 177 App. Div. 755; 164 N. Y. S. 893.

[28] Matter of Cartledge, 118 Misc. 131; 192 N. Y. S. 838; 203 App. Div. 899; 197 N. Y. S. 902; 236 N. Y. 515; 142 N. E. 265; in re Man-

§ 484. Corporation Succeeding Another May Not Sue For Fraud Perpetrated by One of Its Officers

It seems that a corporation succeeding another is not permitted to maintain an action for fraud alleged to have been perpetrated, against one of its officers. The theory advanced by the court denying such recovery was that such cause of action for fraud is not assignable and such succeeding corporation had no standing in court in its attempt to enforce the same.[29] It seems hardly necessary that the court should place its decision upon the ground that a cause of action for fraud was not assignable. It would seem that a far more satisfactory reason as a basis for such conclusion would be that a corporation, the stockholders of which have changed, cannot maintain an action against its officers for mismanagement occurring prior to the change.[30] If there had been no change in stockholders, but if the only change was of entity —the fiction—then it would be logical to hold such action could be maintained. This position gives effect to substance.

§ 485. Corporation Cannot Sue Directors for Mismanagement, Stockholders Having Changed

The courts will so far dissipate the corporate entity that it seems to be well settled that a corporation may not sue for mismanagement on the part of its directors where there has been a change in the stock ownership personnel and such alleged mismanagement has occurred at a time antedating the change. Neither may subsequent stockholders maintain an action in their own name or direct the corporation to sue

ning's Will, 196 App. Div. 575; 186 N. Y. S. 472; 232 N. Y. 512; 134 N. E. 551; in re Moran's Will, 53 Misc. 169; 104 N. Y. S. 478. This is in accord with the view that the only stockholder or all of the stockholders of a corporation may convey the corporate property. See sec. 85, supra.

[29] American Woolen Co. vs. Old Colony Trust Co., 160 N. E. 816; 263 Mass. 321. For general rule of law relating to assignments of causes of action for fraud, see 5 C. J. 891.

[30] See secs. 323a, supra, 485, infra.

for such mismanagement.[31] Some cases go upon the theory that such recovery is not permitted as it would be in effect, disregarding the corporate entity, allowing the stockholders to recover the consideration that they had paid for their stock,[32] while others go on the basis that the purchasing stockholder cannot maintain a suit against the malfeasant for the reason that he stands in the shoes of his immediate vendor and such vendor had consented to such mismanagement.[33]

§ 486. Corporate Entity Set Aside to Allow Sublessee Right of Rental

A lessee subletting a portion of the premises and providing for a continuance of such sublease for the additional period that is granted by the original lease in renewal of it, will inure

[31] Hawes vs. Contra Costa Water Co. City of Oakland, 104 U. S. 450; 26 L. Ed. 827; Foote vs. Cunard Min. Co., 5 McCrary 251; 17 Fed. 46; Whittemore vs. Amoskeag National Bank, 26 Fed. 819; 134 U. S. 527; 33 L. Ed. 1002; 10 S. Ct. 592; Church vs. Citizens St. Ry. Co., 78 Fed. 526; Robinson vs. West Virginia Loan Co., 90 Fed. 770; Bimber vs. Calivada Colonization Co., 110 Fed. 58; Venner vs. Great Northern Ry. Co., 153 Fed. 408; Boldenweck vs. Bullis, 40 Colo. 253; 90 Pac. 634; Alexander vs. Searcy, 81 Ga. 536; 12 A. S. R. 337; 8 S. E. 630; Clark vs. American Coal Co., 86 Iowa 436; 17 L. R. A. 557; 53 N. W. 291; Schilling & S. Brewing Co. vs. Schneider, 110 Mo. 83; 19 S. W. 67; Home Fire Ins. Co. vs. Barber, 67 Neb. 644; 60 L. R. A. 927; 108 A. S. R. 716; 93 N. W. 1024; Rankin vs. Southwestern Brewery & Ice Co., 12 N. Mex. 54; 73 Pac. 612; Moore vs. Silver Valley Min. Co., 104 N. C. 534; 10 S. E. 679.

[32] Home Fire Ins. Co. vs. Barber, 67 Neb. 644; 108 A. S. R. 716; 93 N. W. 1024; 60 L. R. A. 927; Babcock vs. Farwell, 245 Ill. 14; 91 N. E. 683; 19 A. C. 74; Hawes vs. Contra Costa Water Co., 104 U. S. 450; 26 L. Ed. 827; Dimpfel vs. Ohio & M. R. Co., 110 U. S. 209; 28 L. Ed. 121; 3 S. Ct. 573; Taylor vs. Holmes, 127 U. S. 489; 32 L. Ed. 179; 8 S. Ct. 1192; Southwest Natural Gas Co. vs. Fayette Fuel Co., 145 Pa. 13; 23 Atl. 224; Alexander vs. Searcy, 81 Ga. 536; 8 S. E. 630; 12 A. S. R. 337; Clark vs. American Coal Co., 86 Iowa 436; 17 L. R. A. 557; 53 N. W. 291; United Electric Securities Co. vs. Louisiana Elec. Light Co., 68 Fed. 673; Venner vs. Atchison Topeka & S. F. R. Co., 28 Fed. 581; Heath vs. Erie Ry. Co., 8 Blatchf. 347; Fed. Cas. No. 6306; Dannmeyer vs. Coleman, 8 Sawy. 51; 11 Fed. 97; Pa. Tack Works vs. Sowers, 2 Walk (Pa.) 416; Tompkins vs. Sperry Jones & Co., 96 Md. 560; 54 Atl. 254; Matthews vs. Headley Chocolate Co., 100 Atl. 645; 130 Md. 523; Ulmer vs. Maine R. E. Co., 93 Me. 324; 45 Atl. 40; Bimber vs. Calivada Co., 110 Fed. 58; Woods vs. Corry Water Co., 44 Fed. 146; 12 L. R. A. 168. But see Mason vs. Carrothers, 105 Me. 392; 74 Atl. 1030, where it is held the rule

to the benefit of the sublessee, and this may not be defeated by the president and principal stockholder of the original lessee, renewing the lease in his name.[34] In such case, the court will ignore the corporate entity and treat the president and principal stockholder thereof as one and the same with such corporation.[35]

§ 487. Owner of Property Making Conveyance of All Land Owned by Him in a State to a Corporation Owned by Him Will Be Ineffectual Against Creditors Within the State

An individual owning all of the stock in a corporation and seeking to evade the payment of his debts makes a conveyance of all his property within the state to such corporation, taking the corporation's note for the consideration for such conveyance and realizing on said note and paying creditors outside of the state, such transaction will be deemed fraudulent as to resident creditors of the state. It is held under such circumstances that the grant or conveying of the title to the property from himself, personally, to himself garbed in the robes of the corporate formation, such conveyance comes within the purview of the statute in the state that intent to defraud on the part of the grantor is necessary but that conveyance may not be attacked as against the grantee for a valuable consideration, who had no knowledge of the grantor's fraudulent intent, it being held that the guilty knowledge of the grantor in making the fraudulent conveyance to his corporation is imputable to the legal entity and the erection of the juristic personality of the corporate fiction in the path of the course of justice will not avail and the corporation and its owner will be treated as identical.[36]

stated in the text does not apply to promoters. See also Just vs. Idaho Canal & Impr. Co., 16 Idaho 650; 133 A. S. R. 140; 102 Pac. 381.

[33] Home Fire Ins. Co. vs. Barber, supra; Clark vs. Am. Coal Co., supra; Babcock vs. Farwell, supra; see sec. 323a.

[34] Winestine vs. Rose Cloak-Suit Co., 107 Atl. 500; 93 Conn. 633.

[35] Ibid. See secs. 368, 407, supra.

[36] James vs. Stokes, 203 Ky. 127; 261 S. W. 868.

§ 488. Sale of Property to Corporation by Stockholder, There Being No Creditors, Cannot Be Fraudulent

Stockholders and the corporate entity are so far regarded as one that a sale of property by the stockholders to their own corporation, there being no creditor's rights prejudiced and no rights of third parties involved, cannot, by reason of overvaluation of the property transferred to the corporation, be declared fraudulent, and neither the corporation nor its stockholders may successfully attack such transfer.[37] Individuals transferring property to their corporation at excessive valuation, being the only stockholders of the corporate body, no action will lie in favor of the corporation or a stockholder against one under such circumstances receiving an excessive amount of stock.[38] So, too, where under a plan to consolidate several corporations and concentrate the property of all in a single corporate entity, there is an overvaluation of the property that is thus put in the consolidated corporation and stock issued therefor, cannot be fraudulent unless the rights of creditors intervene or the interests of third parties are prejudiced.[39] The theory underlying the holdings in such cases is, that while the technical form of the transaction is a sale by the stockholders to the corporation, its substance is merely a change in the manner of holding the sellers are the buyers, they sell as individuals and buy as a corporation, and no one else having any interest in the question of price or terms of sale, no complaint can be made, they being the vendors on one hand and dealing with themselves in the corporate capacity on the other, they are the sole beneficiaries to be affected and cannot defraud themselves. The abstract of the corporate entity should never be allowed to bar out and prevent the real and obvious truth. Whatever price is charged for property thus

[37] Seymour vs. Spring Forest Cemetery Ass'n, 144 N. Y. 333; 39 N. E. 365; 26 L. R. A. 859; 4 App. Div. 359; 74 N. Y. St. R. 245; 38 N. Y. S. 726; Blum vs. Whitney, 185 N. Y. 232; 77 N. E. 1159; Flanagan vs. Lyon, 54 Misc. Rep. 372; 105 N. Y. S. 1049.

[38] Flanagan vs. Lyon, supra.

[39] Blum vs. Whitney, supra.

turned over to the corporation, no one is wronged and can wrong no one, and can be nothing except to fix a primary limit to the anticipated profits. This is true whether the sale is from stockholders to a corporation formed by them or a sale involving more or less the matter of consolidation among different corporate entities. In any such case the entities will be brushed aside and the parties dealt with as such.[40] It seems immaterial whether stockholders in transferring property to their corporation, pay themselves in stock or in bonds.[41]

§ 489. Corporation Cannot Hold on to Property and Plead Ultra Vires Against Its Purchase Price

A corporation that attempts to hold on to property and at the same time plead *ultra vires* when called upon to pay the purchase price, has no standing in court. In other words, the doctrine of *ultra vires* will not avail the corporation so long as it holds on to the property for which the obligation is owing that it is called upon to pay.[42]

§ 490. Locaters of Mining Claims Transferring Same to Corporation, Relocating and Transferring to a New Corporation, Former Corporation May Recover

Where a number of parties locate mining claims upon government lands, pursuant to federal statutes in such case providing therefor, and thereafter transferring the same to a corporation and then relocating the claims in their own names

[40] Blum vs. Whitney, supra; Seymour vs. Spring Forest Cemetery Ass'n, supra; Barr vs. N. Y. L. E. & W. Ry. Co., 125 N. Y. 263; 26 N. E. 145; in re Ambrose Lake Tin & Copper Co., 14 Ch. Div. 390; Foster vs. Seymour, 23 Fed. 65; 23 Blatchf. 107; in re Seamless Box Co., 17 Ch. Div. 46. It seems the rule that stockholders selling property to a corporation—there being no creditors or other interested third parties—cannot be fraudulent, does not apply to promoters of the corporation. Mason vs. Carrothers, 105 Me. 392; 74 Atl. 1030.

[41] Seymour vs. Spring Forest Cemetery Ass'n, supra.

[42] Seymour vs. Spring Forest Cemetery Ass'n, supra; Whitney Arms Co. vs. Barlow, 63 N. Y. 62; 20 A. R. 504; Duncomb vs. N. Y. H. & N. R. Co., 84 N. Y. 190; Woodruff vs. Erie Ry. Co., 93 N. Y. 609.

and not that of the corporation, causing it to pay the expenses thereof, and thereafter transferring the same claims as thus relocated to a second corporation of their organization, the first corporation can recover from the second. In such case the corporate entities will be brushed aside and the stockholders treated as the real substantial beneficiaries in the corporate property of the second corporation.[43] The knowledge of the stockholders, in relocating the claims and transferring them to the second corporation of their organization, is imputed to it and it cannot assume the position of an innocent purchaser. It is generally true that knowledge and notice of incorporators constitute knowledge and notice to the corporation that they create.[44]

§ 491. Property Standing in the Name of a Corporation, and the Corporation Owned by a Deceased Person, the Property of the Corporation Will Be Regarded As That of the Decedent

Property standing in the name of a corporation and in turn the corporation is owned by a single individual or substantially so, on his decease the property standing in the name of the corporate entity will be treated as his individual property in determining the assets of his estate, and so, where a property owner transferred it to a corporation formed by him, the stockholders of which being himself, his wife and children, the wife and children paying no consideration for the stock issued to them and which property was subsequently transferred to a second corporation that was likewise formed under such circumstances, in the administration of an estate, the property in the name of the second corporation will be regarded as his, and will be subject to all of the rights and bene-

[43] Utah Black Marble Co. vs. Am. Marble & Onyx Co., 43 Utah 68; 133 Pac. 472.

[44] Utah Black Marble Co. vs. Am. Marble & Onyx Co., supra; Simmons Creek Coal vs. Doran, 142 U. S. 417; 12 S. Ct. 239; 35 L. Ed. 1063; National Conduit Mfg. Co. vs. Conn. Pipe Mfg. Co., 73 Fed. 491; see sec. 341, supra.

erty that is in fact that of her husband stands in the name of a corporate fiction, is going too far, in view of the enlightened authority now generally holding that corporate entities will not be apotheosized. If the corporate form is real rather than simulated, then of course, the corporate property should not be impressed with the burden of dower, but if a corporation is a mere cloak for the defeating of the wife's right, then a different question is presented. There is no more reason why the corporate form should not be brushed aside to grant a wife her rights of dower than there is to override it to allow creditors to have just relief. It is thought that in view of the well considered and increasing holdings that the corporate form will be disregarded in the interest of justice, the better rule is and the one certainly in consonance with sound principles of modern authority, that the corporate fiction will be ignored and wife granted dower, where it is merely a screen to defeat and deny her that right.

Poillon vs. Poillon is of such doubtful soundness that it seems that there could hardly be claimed for it the weight of modern authority. In that case a husband, who clearly sought to defeat and destroy his wife's rights to dower, organized a corporation purely for that purpose. He owned the corporation. He bought in a mortgage against a piece of property that had been theretofore conveyed to him subject thereto, but he did not assume the mortgage. The husband's corporation purchased the mortgage; the husband's corporation foreclosed the mortgage and became the purchaser of the property at the sale thereof. The lower court sustained the wife's dower right in this property. This equitable and manifestly just result was attained by discarding the corporate fiction.[54] The appellate division in the State of New York reversed the lower court, and sustained the husband's scheme to defeat the wife's dower right. However, the appellate division contented itself with a reversal of the judgment of the lower court, and did not attempt to answer its dialectics.

[54] Poillon vs. Poillon, 37 Misc. 729; 76 N. Y. S. 488.

Manifestly it was easier to merely reverse the trial court than to answer its ratiocination sustained on principle, and fortified by justice and equity.[55] It is hardly necessary to add that what has been said with respect to the dower rights of the wife would be equally applicable to the right of the husband to curtesy.

§ 492. Corporate Entity Disregarded in the Interest of a Conditional Seller's Rights, the Contract Not Being Recorded

Where property is bought on a conditional sales contract—which under the laws of the particular jurisdiction was required to be recorded—by a partnership, which partnership subsequently organized itself into a corporation and the property transferred to it, it will still be subject to the rights of the conditional vendor for the reason that the court will disregard or ignore the corporate entity and treat the corporation as standing in no better position than the partnership out of which it was organized. In fine, the rule is that corporate entities will be ignored to avoid the claim of an innocent purchaser on the part of the corporation, that it is an innocent purchaser that has been sold property, under an unrecorded conditional sales contract, the corporation being composed of partners having knowledge of the existence of such conditional sales contract and as to them recording is unnecessary.[56]

[55] 90 App. Div. 71; 85 N. Y. S. 689. Unfortunately, Poillon vs. Poillon was not carried to the Appellate Court; had it been, surely the position of the trial court would have been upheld. See also sec. 446, supra, where wife's rights in a separate agreement were protected and the corporate entity was overridden to attain that end. The better rule seems to be where one owns or substantially owns a corporation, on his decease, the property standing in the corporate name will be treated the same as if it were in such owner's name. Then if this be true, no reason appears why, in a proper case, it might not be subject to dower and in case the wife is owner of such corporation, the property would be subject to curtesy—the husband being otherwise entitled thereto. See sec. 491, supra.

[56] York Mfg. Co. vs. Brewster, 174 Fed. 566.

§ 493. A Merchant Taking in a Partner and Thereafter Incorporating and an Involuntary Petition of Bankruptcy Filed Against the Corporation, the Prior Debts Against the Merchant Not Considered

A merchant being indebted, but yet solvent, in the sense of that term as defined by the federal bankruptcy statute, taking in a partner and transferring to the partner a one-half interest in the business, but the partner assuming no part of the existing indebtedness against such merchant, and thereafter the partners incorporate and an involuntary petition of bankruptcy is filed against the corporation by its creditors, in casting up the assets and liabilities to ascertain the solvency or insolvency of the corporation, the entity will not be ignored so as to include in the liabilities the creditors holding indebtedness against the merchant prior to the formation of such partnership.[57]

§ 494. Corporate Entity Will Be Disregarded to Determine the True Ownership and Proper Application of a Fund Paid Into Bankruptcy Court

Where a party contracts with a corporation to build a house for such party and agrees, in consideration for the building of such house upon certain property in the name of the corporation, that such party will transfer to the corporation certain other real property and pay the difference in cash, and such party thereupon later enters into a second contract with a new corporation formed by the stockholders of the former contracting corporation, and such original contracting corporation is adjudged a bankrupt, on application of the party contracting therewith for the building of such house, the bankruptcy court will decree that the balance of the price for the building of such house be paid into bankruptcy court and the trustees of the bankrupt corporation be required to transfer the title to the premises upon which said house is located to

[57] In re C. W. Aschenbach Co., 174 Fed. 396.

such contracting party; and likewise a holder of a claim for materials furnished going into said house, although the contract for the furnishing of such materials is with the second corporation composed of the same stockholders as the former, is entitled to have the claim for materials satisfied out of the deposit paid to the bankruptcy court, and to accomplish these equitable results, the corporate entity may not be intercalated in the way of the court doing full, complete and substantial justice.[58]

§ 495. Insolvent Bank Not Permitted to Pay Obligations to a Corporation Owned by Its Officers

An insolvent bank cannot pay the obligations due a corporation owned by one of its officers, and if in so doing a preference results, the corporate entities will be brushed aside and such officer and the corporation he owns will be treated as one, and the knowledge that such officer of the bank has by virtue of his connection with the bank, will be imputed to his corporation and accordingly legal results attaching to such knowledge will follow.[58a] The rule thus enunciated in the first portion of this section is not confined to banking institutions but will apply with like force and effect where an officer or director of two different corporations so uses his knowledge or position for the betterment of one of the corporations, the entities will be ignored and parties dealt with in their individual capacity.[59]

§ 496. Corporation Cannot Be Organized or Used After Organization For the Perpetration of Fraud

It is the general rule, well established and abundantly sustained by the almost unanimous modern authority, that a corporation cannot be organized for the purpose of perpetrating fraud. Neither can corporate entity be used for shielding

[58] A. B. Newbury Co. vs. Tennant, 113 Atl. 486; 92 N. J. 493.
[58a] James Clark Co. vs. Colton, 91 Md. 195; 46 Atl. 386; 49 L. R. A. 698; Finch Mfg. Co. vs. Stirling Co., 41 Atl. 294; 187 Pa. St. 596.
[59] Finch Mfg. Co. vs. Stirling Co., supra.

or covering up fraudulent transactions.[59a] So, where a corporation has been organized as an instrumentality for the effectual perpetration of fraudulent designs, as where an individual has incorporated himself in order to hinder and if possible defraud his creditors, courts will go as far as necessary, in disregarding the corporate fiction, in order to reach the proper ends and accomplish justice. Such a corporation is a mere parasitic growth, a mass of fungus, which will be lopped off clean whenever necessary to attain proper results.[60]

§ 497. Under Statutes Providing That Directors Are Statutory Trustees on Dissolution of Corporations, the Only Stockholder Who Is a Trustee May Sue For Corporate Property

Statutes are now generally found in the different states, that provide in general terms that upon a dissolution of a corporation or a forfeiture of its charter for the nonpayment of license tax, or for other reasons, the directors become statutory trustees and may maintain and defend suits for and on behalf of the corporation and hold its property for the benefit of stockholders and creditors. So, under such statutes, the only stockholder of a corporation, who is also a trustee or was such at the time of the dissolution of the corporation or forfeiture of its charter, may under such circumstances bring an action to assert rights for the corporation, and to recover its property and such action may be maintained in his own name.[61]

§ 498. Under Statute Making Directors Trustees on Corporation Going Defunct, Sole Stockholder May Convey Property

In a number of states there are found statutory provisions

[59a] Matchan vs. Phoenix Land Investment Co., 159 Minn. 132; 198 N. W. 417; Rice vs. Sanger Bros., 27 Ariz. 15; 229 Pac. 397.
[60] Matchan vs. Phoenix Land Investment Co., supra.
[61] Soderberg vs. McRae, 70 Wash. 235; 126 Pac. 538.

generally providing that when a corporation goes defunct for the nonpayment of its license tax, or for any other reason the charter is forfeited, the directors of such corporation, at the date of the effectiveness of its going defunct, become statutory trustees and as such are possessed of its property and of all of the rights of the corporation. In other words, such statutory trustees succeed the corporation and stand in its shoes. Under such a statute, where there is but a single stockholder, he may, if the corporation has gone defunct, convey the corporate property and no one can complain of this except existing creditors at the time of such conveyance who are affected thereby.[62] This holding harmonizes with the rule prevailing to the effect that the stockholders of a corporation are the equitable owners of its property, and as such may convey it, or encumber it.[63] It is readily understood that the statutory trustees represent, in a fiduciary capacity, the continuance of the corporate entity, and so to hold that the stockholder could convey the property instead of such technical representatives of the corporate entity is in consonance with the rule that such stockholder could convey the property of the corporation of which he is the sole owner, even though technically the corporation is in existence.

§ 498a. A Joint Stock Company Succeeding to the Property Rights of a Corporation Likewise Will Be Held Responsible For Its Obligations

We have seen that a corporation succeeding to the property rights of an individual will be held for his debts,[64] and a partnership converted into a corporation will be required to respond for the partnership undertakings,[65] and a corporation reorganizing itself into another corporation and transferring its property thereto impliedly, at least, will be held to have

[62] Ginaca vs. Peterson, 262 Fed. 904.
[63] Secs. 85, 379, supra.
[64] See secs. 248-251, supra.
[65] Sec. 275, supra.

assumed the obligations of the former organization.[66] So, it seems true that where a joint stock company succeeds to all of the property rights of a former corporate organization or that a corporation is reorganized into a joint stock company, such successor to the corporation takes the property burdened with the rights of creditors of the former organization.[67] It seems clear enough that no good reason is apparent or can be suggested why the converse of the proposition that a corporation succeeding an individual, partnership, or other corporation is liable for the debts of its predecessor, should not be true and that an individual, partnership, joint stock company, Massachusetts Trust or other formation should not be liable for the debts of the corporation that is succeeded by such.

[66] See sec. 168, supra.

[67] Livingston Co. Agricultural Society vs. Hunter, 110 Ill. 155. So, too, where a corporation turns over its property to one under an uncompleted sale of stock to him the corporation is liable for debts contracted by him in the apparent scope of his authority. Albany Mill Co. vs. Huff Bros., 24 Ky. L. R. 2037; 72 S. W. 820.

CHAPTER XXVII

PROCEDURE IN CONNECTION WITH THE DISREGARD OF CORPORATE ENTITY

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§ 499. Character of Action to Enforce Liability of Succeeding Corporation

In the kaleidoscopic questions that grow out of multifarious situations arising in corporations succeeding other corporations or the organization of one corporation into another, or the converting of a partnership into a corporate formation, or an individual organizing his business into a jural personality, give rise to a great deal of difficulty in determining the character and form of an action that has for its purpose to assert the liability of such successor, much laborious effort and lucubration are often required in order to determine the proper course to pursue. However, it is thought that the weight of authority establishes the fact that the liability of such successor may be asserted directly against it by an action in form *ex contractu* and that it is not even necessary that the predecessor of such corporate formation should be made a nominal party to the record.[1] Some courts make the distinction that before an action can be brought directly against a succeeding corporation, it must be made to appear that it is but a continuation of the former corporate entity, but the broader ground upon which the liability of the succeeding corporation is predicated seems to be where the new corporate formation is in its essence but a continuation of the activities and interests of the old, the old retaining simply its franchise as

[1] Stanford Hotel Co. vs. M. Schwind Co., 180 Cal. 348; 181 Pac. 780; Tecumseh National Bank vs. Best, 50 Neb. 518; 70 N. W. 41; Western Union Railway Co. vs. Smith, 75 Ill. 496; Central Electric Co. vs. Sprague Electric Co., 57 C. C. A. 197; 120 Fed. 925; Okmulgee Window Glass Co. vs. Frink, 260 Fed. 159; 171 C. C. A. 195; 251 U. S. 563; 64 L. Ed. 415; 40 S. Ct. 342. See also secs. 131, 132, 133, 145, 222, supra.

a corporation, becoming practically extinct as an active entity, direct recovery against the succeeding corporation under such circumstances is permitted.[2] Consideration will also be given to the fact that if it can in advance be seen that a judgment against the old corporation would require further proceedings against the new to secure any satisfaction equity—as it has always been its purpose seeking to avoid useless multiplicity of suits and circuity of action—will permit a direct proceeding against the new corporation.[3] So, also, if the predecessor corporation has been dissolved, or it is otherwise not conveniently possible to serve it, the courts will not require any proceedings against it before allowing the action directly against the successor. If to deny a direct action against the successor would be to deny all remedies, equity will not give its sanction to such a course of proceeding.[4] It would seem that in principle, there could be no difference in the character of proceeding against a succeeding corporation, whether it is a successor of another corporation, joint stock company, Massachusetts Trust or voluntary association, or partnership, or an individual. Indeed to hold that a different rule would apply in any one of the cases instanced above would seem to be an antinomy.

§ 500. Common Counts Will Lie to Hold a Succeeding Corporation on an Obligation of Its Predecessor

Common counts will lie to hold a corporation that is suc-

[2] Central of Georgia Railway Co. vs. Paul, 93 Fed. 878; 35 C. C. A. 639; Hibernia Ins. Co. vs. St. Louis and N. O. Transportation Co., 10 Fed. 596; 13 Fed. 516; Brum vs. Merchants Mutual Ins. Co., 16 Fed. 140; 4 Woods 156; Harrison vs. U. P. Railway Co., 13 Fed. 522; Altoona vs. Richardson Gas & Oil Co., 81 Kan. 717; 106 Pac. 1025; 26 L. R. A. N. S. 651; Douglas Printing Co. vs. Over, 69 Neb. 320; 95 N. W. 656; Friedenwald & Co. vs. Asheville Tobacco Works, 117 N. C. 544; 23 S. E. 490; Morrison vs. American Snuff Co., 79 Miss. 330; 30 Southern 723; 89 A. S. R. 598; Howe vs. Robinson, 20 Fla. 352; Okmulgee Window Glass Co. vs. Frink, supra.

[3] Central Improvement Co. vs. Cambria Steel Co., 210 Fed. 696; 127 C. C. A. 184; Okmulgee Window Glass Co. vs. Frink, supra.

[4] Okmulgee Window Glass Co. vs. Frink, supra. See secs. 131, 132, 133, 145, 222, supra.

ceeding to the interest of a partnership, under such circumstances as to raise an implication of its liability on the part of a creditor of such partnership against the corporation. In such case it is not necessary for the plaintiff's pleading to set out his claim on a special contract that the corporation made, either in fact or raised by implication of law, whereby it succeeds the partnership.[5] The principle underlying the rule that common counts would lie for recovery against the succeeding corporation, is that it is not necessary to set out the special contract, for although there may be a special contract, if by the breach of it the plaintiff becomes entitled to recover a sum in numero or which can, by mere calculation, be rendered certain, a recovery may be had on the common counts.[6]

§ 501. Assumpsit, Action of, May Be Resorted to For Recovery After Disregard of Corporate Entity

In harmony with the rule announced by the last preceding section, it may be stated generally that common counts will lie against the responsible party, after the corporate entity has been brushed aside, in dealing with the individuals composing it. So it has been held that assumpsit is the proper remedy to assert liability against the defendant who has received plaintiff's money and used it for his own private purposes and has sought to cover up the use thereof by delivery to plaintiff securities wholly worthless, issued by a corporation which was organized and is wholly controlled by the defendant for the transaction of his own private business and which is wholly under his own control.[7] So where the common-law system of pleading has been supplanted by the simplified method adopted by the codes, the pleading analogous to assumpsit, could

[5] Motor Sales Co. vs. Birmingham Electric Battery Co., 97 Southern 907.

[6] Motor Sales Co. vs. Birmingham Electric Battery Co., supra; Holloway vs. Talbot, 70 Ala. 389.

[7] Donovan vs. Purtell, 216 Ill. 629; 75 N. E. 334; 1 L. R. A. N. S. 176.

well be adopted, when it is sought to hold the individuals composing a corporation liable for a purported corporate act. It is manifest that when the corporate entity is abrogated a direct proceeding against the individuals composing it is proper. In such case the individuals are treated as if the corporation did not exist.

§ 502. Necessary Parties in Action to Hold a Succeeding Corporation

In cases where a corporation is organized by an individual and his business is turned to it, or a partnership is converted into the corporate form, or Massachusetts Trust, joint stock company or other association is reorganized into jural personality, if there is a reorganization of the predecessor, or reincarnation of a corporation, the only indispensable party in an action seeking to hold such succeeding corporation liable for the obligations and liabilities of its predecessor, is the succeeding corporation. In short, it is not necessary in asserting rights against such succeeding corporation, to make the predecessor of such corporation a party defendant.[8]

§ 503. Sufficiency of a Plaintiff's Pleading to Hold Two Banks

The plaintiff's pleading alleging that a named bank went into liquidation, that the defendant bank was organized as a corporation and came into possession of and received as the successor of the first mentioned bank for the plaintiff in such action, a sum of money deposited in the former bank by the plaintiff, states a cause of action against a succeeding bank for recovery of a deposit in the hands of its predecessors.[9]

§ 504. Insufficiency of Plaintiff's Pleading to Hold One Corporation For Judgment Against Another

In a case where it was sought to hold one corporation as a

[8] Stanford Hotel Co. vs. M. Schwind Co., 180 Cal. 348; 181 Pac. 780.
[9] Eans' Administrator vs. Exchange Bank, 79 Mo. 182.

mere instrumentality of another and the pertinent portion of a plaintiff's pleading upon which it was sought to predicate a judgment debtor of one corporation as an instrumentality of another, it was alleged in paragraphs 19, 20, 21, and 22:

"(19) Petitioner further alleges that he is informed and believes and does charge on information and belief that the mortgage of $25,000 which the Birmingham Realty Company claimed to hold as security for a loan of $25,000 to the Norwood Transportation Company, was not a mortgage to secure a *bona fide* loan or *bona fide* indebtedness. On the contrary, complainant charges that any sum of $25,000, if ever actually advanced or paid, was so paid or expended by the Birmingham Realty Company under its direction and complete control for the purpose of improving the transportation system which the Birmingham Realty Company was operating in the name of its adjunct for the purpose of furthering the Birmingham Realty Company's development scheme in Norwood and Chestnut Hills. Complainant further charges that it was not an honest *bona fide* loan from one corporation to another corporation, but was in reality a purported or pretended loan by the Birmingham Realty Company, which was simply a device in the guise of a loan whereby the Birmingham Realty Company might invest and did invest money in a transportation scheme to carry people to and from its lots in Norwood and Chestnut Hills, as a part of its real-estate development scheme in those two places so that, among other results, through the enforcement and collection of this purported loan and mortgage the Birmingham Realty Company could intervene and claim the assets of the Norwood Transportation Company in the event any liability was incurred by the operation of said transportation system by the realty company, which obligation said realty company did not want to pay.

"(20) Petitioner further alleges that the rich and timorous Birmingham Realty Company, not being satisfied with the hoped-for protection afforded it by the fraudulent incorpora-

tion of its dummy, Norwood Transportation Company, became alarmed in February, 1919, when your petitioner's case for damages was tried in the Circuit Court of Jefferson County, Ala., and resulted in a mistrial on, to-wit, February 4, and did in that same month cause to be executed the mortgage from its dummy, the Norwood Transportation Company, to it, in the sum of $25,000 in furtherance of the fraudulent scheme to escape its just obligations as herein above set forth, which mortgage is hereto attached and made a part hereof as Exhibit A. And petitioner further alleges that at the time of said mortgage other people had also been injured by the busses of the Norwood Transportation Company, and had suits for damages pending against the Norwood Transportation Company in the Circuit Court of Jefferson County, Ala., on one or more of which suits judgments have also been rendered in substantial amounts against the Norwood Transportation Company.

"(21) Petitioner further alleges that this $25,000 mortgage by this $5,000 corporation was made but a short time after the representative of the dummy, Norwood Transportation Company, had told the attorney of your petitioner that the dummy was thoroughly solvent. Petitioner further shows that on execution levied no assets were found belonging to the dummy, Norwood Transportation Company, other than those it mortgaged after the mistrial in February to the respondent herein.

"(22) Petitioner further alleges that, by reason of the legal guise in which the corporate organization of the Norwood Transportation Company was effected, and the legal guise of the loan and mortgage, petitioner herein has no adequate remedy at law for the redress of the wrongs which he has suffered by reason of the scheme whereby the Birmingham Realty Company was actually in equity and good conscience operating the busses, one of which injured your petitioner."

Upon consideration of the whole pleading of the plaintiff, it was held that it was not sufficient to sustain a case declaring

one corporation but an instrumentality of another.[10] Palpably the plaintiff's pleading in this case is subject to the strictures that it is barren of direct allegations of positive fact. It seems that the pleader essayed to substitute recitals for allegations of fact. But it is submitted, that even though the pleading was recitals instead of allegations of fact, yet it is doubtful if the decision holding it insufficient is sound.

§ 505. Creditor's Pleading Alleging the Formation of a Corporation Out of a Partnership With Fraudulent Designs Sufficient

A partnership converting itself into a corporation and transferring thereto the partnership property, taking stock in payment, the corporation will be declared liable for the partnership indebtedness. A creditor's pleading being filed by creditors for themselves and other creditors in like situation. The substantial averments of plaintiff's pleading were to the effect that certain persons named as defendants in the pleading had been doing business under a firm name, and in such firm name had incurred indebtedness which had become the basis of judgments held by the complainants; that the members of the partnership conducted an extensive business and had a large stock of goods and other assets subject to execution, and with the intention of hindering, delaying and defrauding complainants and other creditors attempted to form a corporation with a capital stock of a stated amount; that the members of the partnership, put into said corporation, as its only capital stock, the goods, wares and other assets of the partnership and receiving in payment thereof stock of the corporation and issuing certificates for various amounts thereof in favor of the copartners and the members of their families; that the property put into the corporation consisted of substantially all of the property belonging to the firm and to the respective members thereof; then the pleading concluded with a prayer for an injunction to restrain the defendants

[10] Birmingham Realty Co. vs. Crossett, 98 Southern 895.

from disposing, transferring or encumbering any property referred to in the pleading, and that a receiver be appointed of the property of the corporation and that the court decree that the formation of the corporation was fraudulent and void as to the complainant in this pleading. A demurrer was interposed and it was overruled by the lower court and thereupon was appealed.

Such a complaint by judgment creditors seeks the aid of a court of equity to remove obstacles or hindrances to the enforcement of judgments which the judgment debtors had fraudulently interposed and a corporation may not be formed by partners, they, thereafter investing it with the legal title to all of their property and rights of property to the detriment of creditors and parceling out the stock of the corporation to the debtors and their wives. Such a pleading states a cause of action against the debtors and the corporation and such a scheme with fraudulent designs, authorizes the court to go behind the corporate formation and deal with the individual partners in the same manner as if the corporation had not been formed.[11] Indeed it may be said in the light of modern authority that such a conveyance or transfer would not be upheld even though free from fraud on the theory generally prevailing in the neoteric adjudications that the corporate entity will be disregarded, or upon the theory of assumption of the indebtedness by the corporation, raised by implication of law from receipt of the partnership assets.[12]

§ 506. Sufficiency of Plaintiff's Pleading to Hold Successor Corporation For Personal Injuries

A corporation organized under the laws of one state and engaged in a line of business, is thereafter reorganized under the laws of another state, having practically the same officers as the former and substantially the same stockholders, stock

[11] Metcalf vs. Arnold, 110 Ala. 108; 20 Southern 301; 55 A. S R. 24.

[12] See sec. 167, supra.

of the preceding corporation having been exchanged for stock of the reorganized corporation, an employee injured before the reorganization may maintain an action against the succeeding corporation. The plaintiff's pleading is sufficient in an action for personal injuries, although it did not allege that the succeeding corporation was the successor of its predecessor of the same name, incorporated in another state, the plaintiff being employed by the predecessor when injured. Neither did it allege that the reorganized corporation had taken over the assets and assumed the liabilities of such predecessor, but notwithstanding this lack of allegations the issue was properly submitted to the jury, where the case was tried on the theory that such corporation was a successor of the former. The pleading in this case proceeded upon the theory that there had been no change, but the defendant made the point that it was not the employer at the time of the injury and was not even in existence at that time and raised the question of its liability by merely having succeeded to the rights of its predecessor.[13]

§ 507. In an Action For Fraud of the Substantial Owner of a Corporation to Hold It Thereby, Plaintiff's Pleading Sufficient When

A complaint in an action against a corporation for fraudulent misrepresentation, made by the president who owns 98% of the corporation, which alleges that such president is the owner of 98% of the corporation and controls the remaining 2% and that such president is the director of the corporation, it is unnecessary to allege any agency or representative of such individual to act for and on behalf of the corporation and under the allegations, it is made to appear that the individual, when the fictional corporate existence is ignored, is in reality the corporation itself, is sufficient.[14]

[13] Zachra vs. American Manufacturing Co., 179 Mo. App. 683; 162 S. W. 1077.

[14] Cawthra vs. Stewart, 59 Misc. 38; 109 N. Y. S. 770.

In Cawthra vs. Stewart,[15] it was urged on behalf of the defendant corporation, by demurrer, that it was not a party to the misconduct of its president, that such individual was not its agent and that the corporate entity had no part in the fraud. In other words, that the individual was one person and that the corporation is an entirely separate, distinct and legal entity and is not bound by or liable for any acts or omissions of the individual, but in view of the fact that the plaintiff's pleading alleged the ownership of 98% of the stock of the corporation by such individual, that is sufficient to establish, so far as the pleading is concerned, that the individual was in reality the corporation itself.

§ 507a. Sufficiency of Plaintiff's Pleading Under a Statute Requiring Pro Rata Distribution of Assets of Dissolved Corporation, Among Creditors

Creditor's pleading must allege that his claim has been ascertained in equity or that he is the only creditor. The Missouri statute relating to the distribution of the assets of dissolved corporation provides:

"Upon the dissolution of any corporation, . . . the president and directors or managers of the affairs, of said corporation at the time of its dissolution, by whatever name they may be known in law, shall be trustees of such corporation, with full powers to settle the affairs, collect the outstanding debts, and divide the monies and other property among the stockholders, after paying the debts due and owing by such corporation, at the time of its dissolution, as far as such money and property will enable them; to sue for and recover such debts and property by the name of trustees of such corporation, describing it by the corporation name, and may be sued by the same; and such trustees shall be jointly and severally responsible to the creditors and stock-

[15] Supra.

holders of such corporation to the extent of its property and effects that shall have come into their hands.

"Under this statute—in order for a creditor to maintain an action against the president and directors of a dissolved corporation who have divided its assets among the stockholders or for appropriating the same to their own use and thus having denuded the corporation of its property and debt or debts remain unpaid—it has been held that an action cannot be sustained against such president and directors unless the pleading discloses by affirmative allegations, that the amount due such complaining creditors has or have been previously ascertained in a proceeding in equity; or that the demand or demands, that serve as a basis for the cause of action is, or are, the only one or ones which exists against the corporation at the time of the effectiveness of the dissolution; and the assets received by the president and directors equalled or exceeded the amount of the claim or claims sued for. In the absence of a complaint with one or the other of these conditions alleged it will be vulnerable to the assault of a demurrer."[16]

§ 508. Property Transferred From an Existing Corporation to a New in Consideration of Issuance of Stock and Assumption of Mortgaged Indebtedness Sufficiency of Complaint to Hold New Corporation

Where a corporation has been reorganized and the former has conveyed all of its property to the reorganized company and the only consideration paid therefor being the issuance of stock and assumption of mortgaged indebtedness, a bill in equity, by creditors of the old corporation, against the new alleging substantially that the new corporation was organized to take a conveyance from former of all of its corporate property; that the only consideration paid therefor was the issuance of shares of capital stock in the new corporation to

[16] Horner vs. Carter, 11 Fed. 362.

the individual stockholders and directors of the old; that in addition thereto an agreement on the part of a new corporation to assume certain mortgaged indebtedness of the old corporation set forth, and that the value of the property so conveyed and transferred to the new corporation by the old amounted to considerable more than the mortgaged indebtedness so assumed, and which bill seeks to subject such property so conveyed to a satisfaction of a judgment indebtedness of such old corporation, is not demurrable for lack of equity upon the face of the bill.[17]

§ 509. A Complaint Against Stockholders and Succeeding Corporation Which Did Not Allege That They Assumed the Debts Nor That Any of the Assets of the Former Corporation Had Come Into Their Hands, Insufficient in Equity but Sufficient at Law

A complaint against stockholders, and a succeeding corporation, which fails to allege that the stockholders and such succeeding corporation had assumed the indebtedness of the predecessor corporation, and which also failed to allege that any of the assets of the predecessor had gone into the hands of the successors, was held to be insufficient to state a cause of action in equity, but the complaint did allege that the successor corporation had been reorganized for the purpose of doing the business of the predecessor company. This was held to be sufficient at law.[18] It is difficult to understand why the pleading in the case cited in the footnotes should be sufficient at law and insufficient in equity. In this connection it ought to be borne in mind that the rules of pleading prevailing in courts at law are more exacting and technical than those obtaining in courts of chancery or in equity. It is doubtful that a complaint that merely alleges that one cor-

[17] J. I. Kelley Co. vs. Pollock and Bernheimer, 57 Fla. 459; 49 S. 934; 131 A. S. R. 1101.

[18] Meeks vs. Arkansas Light & Power Co., 147 Ark. 232; 227 S. W. 405.

poration is a reorganization of another would be sufficient either at law or in equity for the manifest reason that such allegations of reorganization would be merely a conclusion of the pleader, and the absence of facts from which legal rights flow, would seem to require that such pleading be held insufficient.

§ 510. A Complaint Held Insufficient For Lack of Allegations of Fraud Being Alleged, That Partnership Put Money Arising From Insurance, in Corporation

Plaintiff's pleading alleged the corporate capacity of the defendant; that plaintiff sold and delivered goods to a partnership; that the members of which were defendants to the action; that such partners gave plaintiff their promissory note due one day after date; that judgment was recovered upon the note; that execution was issued and had been returned unsatisfied; that said partnership was and is insolvent; that said partners caused to be organized a corporation—the defendant —of which corporation one of the partners was president and the other was treasurer and a brother-in-law of one of the partners secretary; to which corporation the defendant partnership transferred the proceeds of a certain policy of insurance against fire, written upon partnership property and upon which loss had accrued and the insurance money had been paid; that said corporation received the proceeds of said fire policy and mingled the same with its assets and used the same in its business; that said corporation did not pay the partnership any consideration for the transfer of such insurance, except the issuance of stock; that aside from the partners and the issuance of stock for the insurance money to them the only remaining stockholder of said defendant corporation was a brother-in-law, who contributed one-third of the total capital that went into said corporation; that the only assets of said firm at the time of the organization of the corporation, aside from the insurance, were book accounts,

which one of the partners collected a portion of and applied to his use; that after the incorporation, one of the former partners pledged his stock to his wife for payment of an alleged indebtedness to her from the partnership; that the wife contributed a sum of money thereafter into the corporation in supposed part payment of the stock that had been pledged to her; that the other partner transferred his stock to his wife, upon an alleged indebtedness due from the firm and an indebtedness due from such partner individually to his wife; that the indebtedness from the partnership to the wives of the partners was fraudulent and void; that there were transfers of stock from one of the wives to the other; that said corporation took the assets of said firm, including the insurance policy with full notice and knowledge of insolvency of said partnership, unpaid indebtedness to creditors; that such assets were received without a valuable consideration except the issuance of stock; that the corporation converted to its own use the proceeds of the insurance referred to. The complaint concluded with appropriate prayer. This complaint, by the court, was held insufficient upon the ground that it did not allege fraud.[19] It is submitted, however, that the court went too far in its insistence that there should be allegations of fraud, as it is highly questionable whether or not an allegation of fraud is essential in order to hold a succeeding corporation.[20] It is of little importance that the partnership property had been burned and the insurance funds put into the succeeding corporation, instead of the property itself. The complaint, however, it must be confessed is inartificially drawn, in not alleging positively that the corporation was but the partnership in another form.[21] In other words, it seems that it occurred neither to court nor counsel that a corporate entity will be dispelled in order to get at the real facts of the case and had this been done, in the

[19] Byrne & Hammer Dry Goods Co. vs. Willie Dunn Co., 23 S. D. 221; 29 L. R. A. N. S. 589; 121 N. W. 620.
[20] See sec. 167, supra.
[21] Andres vs. Morgan, 62 Ohio St. 236; 56 N. E. 875; 78 A. S. R. 712.

case cited in the footnotes, the difficulties presented thereby would have disappeared, for, if the corporation was but another form of the partnership, then there is no necessity of averring fraud—liability would follow without.

§ 511. Complaint to Disregard a Corporate Entity and Hold It As One With Its Owner Alleging Unity of Interest and Adherence to the Corporate Fiction Would Sanction Fraud

It has been laid down as a rule that the complaint of plaintiff's pleading in a case, to disregard the corporate entity and hold the corporation as one with its owner, must show by pertinent allegations so that the court can see that if the allegations of the complaint are true, the corporation is not only influenced and governed by its owner but that there is such a unity of interest and ownership that the individuality or separateness of the said person and corporation has ceased, and in addition thereto that the facts are such that an adherence to the fact of the separate existence of the corporation would under the particular circumstances, sanction a fraud or promote injustice.[22] It is believed however, that if the complaint contains pertinent allegations, showing that the corporation and its owner are identical, that alone would be sufficient, and that this is the position of the modern adjudications on this subject. It is well understood that a corporation may be its owner's double, and that where a corporation is a mere simulacrum of its owner or where it is a mere instrumentality in the hands of its owners and the like situations, the corporation and its owner or owners will be treated as one.[23] If that is true then why the necessity of alleging facts to show fraud or the workings of injustice? If the corporation is a mere *alter ego* of its owner it is submitted, nothing more need appear from the allegations of a complaint to make it sufficient.

[22] Minifie vs. Rowley, 202 Pac. 673; 187 Cal. 481.
[23] See secs. 71, 78, 237, 247, supra.

§ 512. Complaint Held Insufficient For Failing to Allege the Assumption of Indebtedness by Succeeding Corporation or Fraud

In a complaint it was alleged that the defendant was incorporated under the laws of the state and then succeeded to the property of a corporation organized under the laws of another state; that the property was sufficient to pay the liabilities of the preceding corporation; that the assets and business of the preceding corporation had become merged into and consolidated with the defendant company; that the defendant company paid for the assets of its predecessor in stock to the stockholders of that company; that the stockholders of predecessor and the defendant corporation were practically the same; that the predecessor after it had transferred all of its property to the defendant had ceased to do business; that the defendant conducted the business of the predecessor; and concluded with an allegation that the defendant was liable for the obligations of its predecessor. The court concluded that such complaint did not state a cause of action in that it did not allege an assumption of the liability of the predecessor, nor fraud. This holding lays down the rule that before the defendant could be held, it must be alleged that there was a consolidation, or there was a promise express or implied by the succeeding corporation to assume the obligations of the old, or that the defendant was a mere continuation of its predecessor or that the transaction was fraudulent.[24] It is respectfully submitted that this decision is contrary to the great weight of modern authority.[25] Undoubtedly, the better rule, and the one in consonance with neoteric adjudications, is, that if it appears that the corporation is continuing the same business and is composed of substantially the same parties and that the corporation paid its predecessor or the stockholders thereof or parties in interest

[24] Swing vs. Empire Lumber Co., 105 Minn. 356; 117 N. W. 467.
[25] Blumenthal vs. Schneider, 186 Wis. 588; 203 N. W. 393; Ziemer vs. C. G. Bretting Manufacturing Co., 147 Wis. 252; 133 N. W. 139; 1912D A. C. 1275; see secs. 144, 156, 157, 174, 226, supra.

in stock, this will be sufficient to give rise to the presumption that the succeeding corporation assumed the liabilities of its predecessor.[26]

§ 513. Sufficiency of Complaint to Set Aside Conveyances to a Corporation Organized Out of a Partnership

Plaintiff's pleading, in substance, averred that the plaintiffs were creditors prior to the making of conveyances, which were attached for fraud. That the partners named composed a partnership, that partners were engaged in the banking business; that same partners composed another firm under a different name; that at the time of making the conveyances the partners as individuals and as such partners were insolvent; that the defendant corporation (which was organized out of one of the partnerships) became incorporated at the time of conveyance of some real estate to it; that the partners or individual members owned a large majority of the stock of the corporation succeeding such partnership; that such corporation had no assets other than the lands conveyed to it by the insolvent debtors; that all of the remaining stockholders of the corporation were brothers or sisters of the partners; that such remaining stockholders had knowledge of the insolvent condition of the partners or had notice of facts which were sufficient to put them on inquiry and if followed up would have led to information; that the consideration expressed on the face of the conveyance was the sum of $192,000, but that no money was paid or if any, a very small sum; that the purpose of the corporation and the conveyance to it was a mere scheme to hinder, delay, and defraud creditors, that the corporation succeeding the partnership was insolvent; that all of the partners were insolvent at the time of making the conveyance; that the debts of the plaintiffs were contracted and due prior to the making of such conveyances. This plead-

[26] Swing vs. American Glucose Co., 123 Ill. App. 156.

ing was attacked by demurrer but upon due consideration of the same it was overruled.[27]

§ 513a. Sufficiency of Complaint to Hold Practically the Sole Stockholder For Goods Sold and Delivered to His Corporation

The plaintiff's pleading alleged substantially that practically the sole stockholder of a corporation requested the creditor to bill the goods to said corporation and carry the account in that name, which was done for convenience; that such request was made by such stockholder, as a ruse in anticipation of defeating the creditor's claim against him personally for liability on account of goods sold and delivered to the corporation; that said corporation was composed of such stockholder, his wife and sister and has been inactive as a corporation for several years—no meeting of stockholders having been held or officers appointed and no authorization given to such stockholder as the self-styled president of the corporation to engage in the particular line of business out of which the indebtedness grew; that the particular line of business was carried on directly and simply for the benefit of such stockholder individually; that such stockholder used all of the sums received from the sales in the particular line of business derived for his sole and exclusive benefit, and is therefore personally responsible to the plaintiff for the amount due, on account for goods sold and delivered to the corporation. The pleading concluded with appropriate prayer for judgment against such stockholder. It was insisted by such stockholder that the plaintiff had no right of action against him, but this contention was denied and the pleading held sufficient.[28]

[27] Steiner Land & Lumber Co. vs. King, 118 Ala. 546; 24 Southern 35.

[28] French Market Ice Mfg. Co. vs. Dalton, 130 Southern (La.) 122. While the pleading involved in the last cited case contained an averment that the supposed owner personally contracted the debt in suit, it is submitted that such pleading would have been sufficient without such allegation, that to have charged that he was the corporation, taking its proceeds, applying and using same as he saw fit and that the corporate form was but a shell, would have rendered the pleading invulnerable to assailment.

§ 514. Sufficiency of Complaint For Dissolution of a Copartnership, Accounting and Receiver on Theory That the Corporation Is a Mere Shell Thrown Around Partnership Operations

In an action where it is sought to dissolve as a partnership, a corporation, that is contended to be a mere shell thrown around the partnership operations, and for an accounting and appointment of receiver, in order to sustain the plaintiff's contention that in theory the parties were copartners and that the corporation was a mere shell thrown around the partnership operations, it is incumbent upon the plaintiff to allege that there are no creditors of such shell of a corporation, whose rights will be jeopardized, and in addition thereto, some reason must be alleged why a dissolution of the corporation, if a cause of action exists therefor, should not be had in accordance with the statutory method prescribed in such cases.[29] It would seem to follow, as a corollary of such holding, that if a legal reason could be alleged why a dissolution could not be had according to the statutory method prescribed, and that there were no creditors whose rights would be jeopardized, that the complaint would be sufficient to sustain an accounting, appointment of receiver and ultimately a dissolution of the corporation. Safe pleading would seem to require that the complaint should also allege that there were no intervening rights of any third parties in addition to the allegation that there were no creditors.

§ 515. To Fix Responsibility of One Corporation For Acts of Another

In a plaintiff's pleading it was alleged that the contract relied on and upon which the suit was predicated was not made or entered into by the defendant corporation, but with an-

[29] Thomashefsky vs. Edelstein, 192 App. Div. 368; 182 N. Y. S. 707; see sec. 525, infra.

other entirely separate and distinct corporation, seeking to hold such other corporation by alleging that the same persons were stockholders in the two companies and that, therefore, the contract made by the one was in legal contemplation, the same as if entered by the other. Such complaint states no cause of action whatever against such other corporation, in absence of some other ground to hold it upon the contract that is not made by it or in fraud.[80] Even the most radical abolitionist of the corporate entity has never made bold to assert the mere fact that two separate and distinct corporations have the same stockholders is sufficient to dispel the separate corporate existences. It takes something more than the mere ownership of stock or having the same stockholders to invoke the rule that the courts will brush aside the corporate entity in proper cases.[81]

§ 516. Plaintiff's Pleading Sufficient to Hold Stockholders As Partners in a Corporation Doing Business in a State Without Compliance With Law

Plaintiff's pleading alleging the organization of a corporation by citizens of a state under the laws of another state and the opening up of an office within the state of which the stockholders were citizens, the sale of stock and the entering into of contracts in the furtherance of the operation of its property in a different state is sufficient statement of cause of action to hold the stockholders as partners for fraudulent sales of stock, under a statute providing that if it be made to appear that a corporation was organized under the laws of a foreign state by citizens and residents of the state where the statute is enacted, for the purpose of evading the laws of such state, the pretended incorporators shall be liable as partners for the debts of the corporation.[82] While the case cited

[80] Waycross Air Line Railway Co. vs. Offerman and W. R. Co., 109 Ga. 827; 35 S. E. 275.

[81] See secs. 19, 69, supra.

[82] Booth vs. Scott, 276 Mo. 1; 205 S. W. 633; Meir vs. Crossley, 305 Mo. 206; 264 S. W. 882; 35 A. L. R. 611.

in the footnote is decided under the Missouri statute, nevertheless, that statute is merely declaration of a principle of common law. It would seem to be a corollary of such holding that a complaint good under the statute would likewise be good in the absence of the statute, for it is thought to be the general rule that a foreign corporation doing business in a state without compliance with the law thereof pertaining to corporations, its stockholders or members are liable as partners.[33]

§ 517. In an Action to Set Aside Corporate Entity, in the Nature of a Creditor's Bill, the Plaintiff Acquires a Lien Upon the Tangible Property of the Corporation

It seems that where an action is filed to set aside the corporate entity and to reach property thereby, by the filing of an action in the nature of creditor's suit, the plaintiff thereby impresses rights in the nature of a lien upon the tangible property of the corporation, and especially where the property, by means of resort to the corporate entity, has been put beyond the reach of an execution.[34] Undoubtedly the property would not be impressed with a lien in such case unless the filing of a suit in the nature of a creditor's bill impresses the property of defendant with a lien generally, in the particular jurisdiction. In other words, where in a jurisdiction the filing of a creditor's bill or an action in the nature thereof, subjects property to a lien for the benefit of the complaining creditor, in such action it is not a rule peculiarly applicable in cases that call for a disregard of the corporate entity, but it is an application of the rule prevailing in actions in the nature of creditor's suits generally, and incidentally involving the subject of the disregard of the corporate entity and reaching of property concealed thereby.

[33] See secs. 477, 478, 480, supra.

[34] Keating vs. Hammerstein, 209 N. Y. S. 769; 125 Misc. 334; Knower vs. Central National Bank, 124 N. Y. 552; 27 N. E. 247; 21 A. S. R. 700.

§ 518. A Complaint in the Nature of a Bill of Discovery in Jurisdictions Where Bills of Discovery Are Permissible, Will Lie to Uncover the Organization of a Corporation Out of a Partnership

It seems that in those jurisdictions where bills of discovery are permissible, such an action may be resorted to to discover the manner and means of the organization of a corporation out of a partnership and that when such a bill is filed, the corporate entities will be disregarded or dispelled in order to require proper answers to the interrogatories submitted therewith. It is permissible in such proceedings to inquire into the object, the connection of, two organizations and the circumstances under which a corporation is created, and the number of its shares and the distribution of the same between or among the partners and others.[35] It is undoubtedly true that the rule announced in this section is but another application of the doctrine, that in the interest of procedural matters, the court will dispel corporate entities.[36]

§ 519. In an Action by Receiver of a Corporation Against a Debtor Thereof, a Plea of Set-Off Against the Only Stockholder of the Corporation Will Be Allowed, If It Sets Forth That the Corporation Has Otherwise Sufficient Assets to Pay Its Creditors

In an action where a receiver of a corporation is plaintiff and seeks the collection of an alleged debt from an individual corporate debtor, a plea by such debtor, that an individual owns all of the capital stock of the corporation; that the net proceeds of the action would go to the sole stockholder, there being no other creditors; that such stockholder is indebted to the corporate debtor—the defendant—in the action, in a sum in excess of the amount sought to be recovered in the action; that the sole stockholder has no other assets than the proceeds

[35] Gormully vs. Jeffery Mfg. Co., 64 Fed. 612.
[36] See sec. 103, supra.

of the action and property of the corporation; that such stockholder procured the appointment of a receiver for the express purpose of defrauding the defendant and for the purpose of preventing the defendant from collecting his debt from such stockholder; that such sole stockholder is undertaking, under the disguise of a receiver, to cheat and defraud the defendant —the debtor—by claiming that the corporation and not the sole stockholder is seeking the recovery; that such sole stockholder is the real party in interest in the action; that the defendant has no adequate remedy at law, other than the equitable set-off; that this remedy and equitable set-off would avoid circuity of action in the matter of enforcing the rights of the debtor—the defendant; this pleading is sufficient as a plea of set-off and as such will be sustained by the courts.[87] This is but an application of the principle that the plea of set-off may be made against a corporation where the principal or only stockholder is indebted to the defendant or where the plea of set-off may likewise be made against a stockholder who is the principal or only stockholder in a corporation and the corporation is indebted to the defendant.[88]

§ 520. Under Statutes Making the Directors Statutory Trustees at the Time a Corporation Goes Defunct, For the Purpose of Winding Up Its Business, There Being Only Two of Such, One May Sue the Other For Malfeasance

In a number of states there are statutes that provide in effect that upon a corporation going defunct, the directors of such corporation at such time automatically become trustees or liquidating trustees, and under such enactments, there being only two of such trustees at the date of the corporation's going defunct, one of them may maintain an action against the other for malfeasance in office as such director for the benefit

[87] Knight vs. Burns, 22 Ohio App. 482; 154 N. E. 345.
[88] See secs. 20, 237, 317, 439, 450, supra.

of creditors and stockholders of a corporation, and it is not necessary to demand that the other trustee join, and he is not a necessary party plaintiff in his capacity as a liquidating trustee or otherwise, notwithstanding the fact that he is sued individually for such malfeasance, it being sufficient that he is made a party defendant in his individual capacity. Neither is the corporation under such circumstances a necessary party to the action.[89]

§ 521. Sufficiency of Doing Business Through Subsidiary As Warranting Service on Foreign Corporation

The P Company, a domestic corporation, engaged in a retail business within the state, was subjected to involuntary bankruptcy and thereafter a foreign corporation, which was a creditor of the P Company, effected a composition with creditors advancing the money for that purpose, which the foreign corporation had borrowed from a local bank; thereupon, the trustee in bankruptcy, pursuant to authority, transferred and made a bill of sale of the assets of the P Company—the domestic corporation, the secretary of the foreign corporation entering the state where the P Company was located and negotiating the composition and arranging for the loan. Such foreign corporation thereafter, through local sales agents, put on a sale of the assets that it had acquired and such agent was directed to pay the proceeds arising from such sale in liquidation of the loan from the local bank. There was no evidence that the sales agent had any other business within the state, the evidence establishing that the foreign corporation had continued the sale through its agents. The foreign corporation financed and controlled the business during the time the sale was being conducted. Such agent sold a portion of the assets that were turned over by the foreign corporation and applied the proceeds arising therefrom in partial liquidation of the loan. During the time that the sale was being conducted, the foreign corporation purchased goods

[89] Peeples vs. Hornik, 146 S. E. 680; 149 S. C. 40.

amounting to a number of thousand dollars for the purpose of replenishing the stock of merchandise and such sales agent at different times made small outside purchases for the same purpose. Thereafter the remaining goods left on hand for some time after the prosecution of said sale were redelivered to the P Company, a domestic corporation, and such delivery to the P Company, the domestic corporation, was with the understanding that it was to act as selling agent only and was in turn to apply the proceeds arising from sales made by it in liquidation of said loan. During all of the time after the acquisition of the assets of the domestic corporation, the same were insured in the name of the foreign corporation and premiums thereon were paid by it. For several months thereafter the business was conducted through the domestic corporation. It was claimed that the goods were sold to the domestic corporation, but the only consideration given therefor was the domestic corporation's note, but no bill of sale or written contract was entered into at the time of giving such note. Thereafter, over a period of months, the foreign corporation delivered different shipments of goods to the domestic corporation, aggregating in value several thousand dollars. These were placed in the stock of goods on hand and the proceeds arising from the prosecution of the business, were applied in the same way. At a later time the domestic corporation was reorganized and one of its former officers was made president and manager and a local attorney of the foreign corporation was made secretary. The president of the foreign corporation held 498 shares of the capital stock of the reorganized domestic corporation—there being 500 issued—and the former officer of the domestic corporation, now president and manager of the reorganized corporation, and the local attorney of the foreign corporation, each held one share. Thereafter the reorganized corporation went into voluntary bankruptcy and a firm that had sold goods to the reorganized corporation brought an action seeking to hold the foreign corporation for the purchase price of such goods. The

statutes in the state provide that service on a foreign corporation doing business within the state could be made by delivery to any agent, cashier or secretary thereof. The foreign corporation's president was within the state at the time the service of summons was attempted to be made upon it, and was made by serving him. Under these facts it was held that the foreign corporation was doing business within the state within the meaning of the statutes and that the service by that means was good. The court further held that corporate entities would be disregarded in order to sustain the service of the summons.[40] However, it must be borne in mind that a foreign corporation organized to engage in the manufacturing business and also authorized to hold capital stock in another corporation, in like or similar lines of business is not, by reason of the acquisition of the capital stock of a local or domestic corporation, subjected to the local jurisdiction authorizing service of summons on its president. In other words, the mere ownership of stock is not sufficient, as doing business within the state, as will warrant service of process from the courts located therein. The general rule, undoubtedly, is that such business must be of a nature warranting an inference that the corporation has subjected itself to the local jurisdiction, and is by its duly authorized officers or agents present within the state or district where service is attempted.[41] It may be further stated as a general proposition, and one that has been fairly well established by decisions in accord, that jurisdiction may not be obtained of foreign corporation by serving process on a subsidiary within the state, even though the subsidiary be completely dominated by the parent or holding corporation.[42]

[40] Spokane Merchants Ass'n vs. Clere Clothing Co., 84 Wash. 616; 147 Pac. 414.

[41] Selbert vs. Lancaster Chocolate & Caramel Co., 23 Fed. (2d) 233; Peoples Tobacco Co. vs. American Tobacco Co., 246 U. S. 79; 38 S. Ct. 233; 62 L. Ed. 587; 1918C A. C. 537.

[42] Philadelphia & R. R. Co. vs. McKibben, 243 U. S. 264; 61 L. Ed. 710; 37 S. Ct. 280; Atchison T. & S. F. R. Co. vs. Weeks, 248 Fed. 970; see, however, 39 S. C. 102; 166 C. C. A. 71; 249 U. S. 602; 254 Fed. 513; 63 L. Ed. 797; Peterson vs. Chicago R. I. & P. R. Co., 205

§ 522. Corporation Organized Under the Laws of One State, Owning and Controlling a Corporation Organized Under the Laws of Another, May Not Be Held in a Suit on Its Own Obligation by Serving the Subsidiary

A corporation organized under the laws of one state and engaged in the fabrication of merchandise, organizes a corporation under the laws of another state which is owned and controlled by the former corporation, and the subsidiary corporation engages in business in a third state, the business that it is engaged in being that of selling the products of the parent corporation, but the business is carried on as separate and distinct and the separate entities are kept up, separate sets of books are kept, the funds of each corporation are kept separately, and in short the separateness of the corporation is maintained with clarifying lines of demarcation. Under such circumstances a party holding an obligation against the parent corporation, growing out of contractual relations existing between the parent corporation and such obligee, and with which the subsidiary corporation had no connection, may not maintain a suit in the third state where the subsidiary corporation is found doing business against the parent corporation, and sustain that suit by service of process upon such subsidiary corporation.[48] The touchstone by which it may be

U. S. 364; 51 L. Ed. 841; 27 S. Ct. 513; Robert Dollar Co. vs. Canadian Car & Foundry Co., 100 Misc. 564; 166 Miss. 34; 180 App. Div. 895; 167 N. Y. S. 1124; Cannon Mfg. Co. vs. Cudahy Packing Co., 292 Fed. 169; 267 U. S. 333; 69 L. Ed. 634; 45 S. Ct. 250.

[48] Cannon Mfg. Co. vs. Cudahy Packing Co., 292 Fed. 169; 267 U. S. 333; 69 L. Ed. 634; 45 S. Ct. 250. This case is clearly distinguishable from Spokane Merchants Ass'n vs. Clere Clothing Co., 84 Wash. 616; 147 Pac. 414; and discussed in Sec. 521, supra, for there the foreign corporation had taken more or less of an active part in the conduct of the business within the local jurisdiction, and had manifested itself and in exhibition of its activities to such an extent as clearly establishing that it was doing such business of the nature warranting the inference that the corporation had subjected itself to the local jurisdiction and was by its duly authorized officers and agents present within the state, exercising the functions conferred upon it by its charter of incorporation, while in the case of Cannon Mfg.

determined whether or not the parent corporation is subject to service within a local jurisdiction, is whether it is sought to enforce an obligation arising from the acts or conduct of the parent itself as contradistinguishing from those cases where it is sought to fasten liability upon the parent by reason of contracts, acts or conduct of the parent through the subcorporation. If the suit or claim of liability is predicated upon a contract, act or conduct of the parent, in which the subsidiary corporation has in no manner intervened, it seems that the parent may not be reached through the instrumentality of its subcorporation, but, if on the other hand it is sought to reach and fasten liability upon the parent for a contract, an act or conduct of it, through and by the instrumentality of the subcorporation, that the means thereby of reaching the parent will be efficacious.[44] So, where a foreign corporation owns the stock of a number of other corporations within the local jurisdiction and dominates and controls them and such corporations within the local jurisdiction infringe the patent rights of another, the parent corporation may therefore be reached through and by the instrumentality of the service of process upon such subsidiary corporation within the local jurisdiction.[45]

§ 523. A Kansas Corporation Authorized to Do Business in Nebraska, Thereafter Absorbed by a Missouri Corporation, Which in Turn Consolidated With a Utah Corporation, Neither of the Latter Being Authorized to Do Business in Kansas, Service May Be Had in Nebraska by Serving Kansas Corporation

A corporation organized under the laws of the State of

Co. vs. Cudahy Packing Co., supra, the parent corporation was not within the state at all unless it was by the stockownership in the subsidiary corporation that was in turn a foreign corporation in so far as the local jurisdiction was concerned.

[44] Cannon Mfg. Co. vs. Cudahy Packing Co., supra; Industrial Research Corporation vs. General Motors Corp., 29 Fed. (2d) 623.

[45] Industrial Research Corp. vs. General Motors Corp., supra.

Kansas and thereafter migrating to and becoming qualified under the laws of Nebraska, doing business therein, having duly appointed an agent upon whom process might be served, which said Kansas corporation subsequently merged with a Missouri corporation and the Missouri corporation absorbing the name and identity of the Kansas body politic, and the Missouri corporation thereafter consolidated with a corporation organized and existing under the laws of the State of Utah, and the Missouri corporation, not the consolidation thereof with the Kansas corporation, was authorized to transact business in Nebraska, and likewise the Utah and the consolidated company arising from its combining with the Missouri corporation, were not authorized to transact business in Nebraska, will sustain a judgment obtained in Nebraska by the serving of the statutory agent of the original corporation which will be binding upon the subsequently consolidated corporate organization, they having grown up from the nucleus of the Kansas corporation.[46]

§ 524. Corporate Entity Disregarded, Notice Given to Parent Corporation Claiming Lien on Property in the Name of Subsidiary, Sufficient

A party entitled to assert a mechanic's lien against certain property, giving notice thereof in accordance with law by serving the same on the parent corporation, where the legal title to the property was in the subsidiary, the statute in the particular state prescribing that the notice must be served on the owners, when it was intended to foreclose the lien, it was contended that the subsidiary was the owner of the property. The facts were that the subsidiary was owned by the parent except five shares that were held in the name of five stockholders for the purpose of making up the corporate organization of the subsidiary. The five stockholders, each owning one share, were likewise stockholders of the parent corporation and the

[46] Lincoln Safe Deposit Co. vs. Continental Life Ins. Co., 213 Mo. App. 561; 249 S. W. 677; see sec. 523, supra.

same individual was president, general manager, and attorney-in-fact for both corporations. During all of the time the same officers were in charge of both corporations. The parent was engaged in the operation of its business upon leased lands in the name of the subsidiary. Under such circumstances the corporate entity will be overridden and ignored and both corporations treated as one, and the notice to the parent where the legal title to the property in question is in the subsidiary, will be sufficient to impress the property with the mechanic's lien. Such notice, when form is ignored and substance considered, complies with the statute which prescribes that the notice must be given to the owner.[47]

§ 525. Where a Corporation Is Equally Owned by Two Stockholders and They Are Deadlocked the Court Will Appoint a Receiver Thereof As If They Were Partners, Even Though a Corporation Is Solvent

Where a corporation is owned in equal proportions by two stockholders and they are deadlocked and one of them is in charge of the corporate property, the court will appoint a receiver of such corporation for the purpose of winding up its affairs, even though the corporation is solvent. In so doing, the court assumes the attitude that such stockholders are substantially partners and will apply like principles as would be applied in dealing with partnership property. Courts of chancery are organized for the purpose of doing justice and affording relief, when in good conscience it should be awarded. With this principle in view, a court of equity will, in the furtherance of justice, be justified in directing the appointment of a receiver over the corporation. Under such circumstances, even though it is solvent, courts of equity will decline to turn a litigant out of court, to the end that the existing conditions will continue indefinitely. The appointment of a receiver in such case comes within a statutory enactment,

[47] Doss vs. Gulf Smokeless Coal Co., 135 S. E. 575; 102 W. Va. 470.

which in substance provides that when in the discretion of the court it may be necessary to do complete justice to the parties, receivers may be appointed. Briefly stated, the rule in such case is, that the corporate entity will be ignored and the substantial owners of the corporate property—the two contending stockholders—will be treated as partners, and substantial justice will be done by the setting aside of mere corporate forms.[48]

§ 526. In an Action Against a Corporation Having Succeeded a Partnership, Attachment Will Lie Against the Corporation Under Arizona Statute

The Arizona statute with respect to attachments, provides substantially, that the plaintiff at the time of filing his complaint or at any time afterward may have the property of the defendant attached as security for the satisfaction of any judgment that may be recovered against the defendant, unless the defendant gives security to pay such judgment, as provided by law in the following case: When any suit be pending for damages and the defendant is about to dispose of or remove his property beyond the jurisdiction of the court, in which the action is pending, for the purpose of defeating the collection of the judgment. Under this statute the attempt to organize a partnership into a corporation and appropriate the partnership property for the corporate benefits, attachment will lie and such cause of action is embraced within the term "damages."[49]

[48] Boothe vs. Summit Coal Mining Co., 55 Wash. 167; 104 Pac. 207; 19 A. C. 1255; see sec. 514, supra.

[49] Rice vs. Sanger Bros., 27 Ariz. 15; 229 Pac. 397. The court in this case adopts the definition of damages found in Bouvier's dictionary to the effect that damages are the indemnity recovered by a person who has sustained an injury either to his person, property, or relative rights through the act or default of another.

It must be submitted, however, that if the corporate entity that is organized out of the partnership is regarded as one and the same with the partnership or as the partnership continuing in another form, it is a little difficult to understand how the court could hold

§ 527. Attachment Will Lie Against Succeeding Corporation, Under a Statute Providing That an Attachment May Issue in an Action Upon a Contract Express or Implied For the Direct Payment of Money

The California statute, with respect to attachments, provides in substance, that an attachment will lie in any action upon a contract express or implied for the direct payment of money. Under this statute, where one corporation has been organized into another, even though they are organized under the laws of different jurisdictions, an attachment will lie against the succeeding corporation upon a contractual obligation of its predecessor. The theory upon which attachment is supported in such case is, that the succeeding corporation is but a continuance of the former corporate entity and that the obligation sought to be collected is a contract—the contract of the predecessor corporation and the succeeding corporation being the same, it is its contract and for that reason the claimant may make an affidavit couched in the verbiage of the statute and that will sustain the impounding of the succeeding corporation's property for the satisfaction of the judgment.[50] So, where a single individual owns a corporation organized under the laws of one state and a corporation identical in name, is organized under the laws of another and an obliga-

that such act amounted to "about to dispose of or remove his property beyond the jurisdiction of the court," as provided in the statute. The situation under the Arizona statute with respect to attachment is very similar to the question arising as to whether or not the organization of a corporation out of a partnership or of the combining of the business of an individual of the corporation formation violates the bulk sales law. See sec. 128, supra.

[50] Stanford Hotel Co. vs. M. Schwind Co., 180 Cal. 348; 181 Pac. 780. See also Goldmark vs. Magnolia Metal Co., 28 App. Div. 264; 51 N. Y. S. 68; Weintraub vs. Superior Court, 267 Pac. 733; 91 Cal. App. 763. It seems that attachment would lie against a succeeding corporation under the attachment statutes following. Rev. Codes of Mont. sec. 9257; Alaska Comp. Laws sec. 967; Comp. Laws of Utah sec. 6706; Conn. Gen. Sts. sec. 5869; Rev. Laws of Hawaii C 162; Mass. (Acts 1925) C 170; Public Laws of N. H. 1926, C 330, sec. 4; Idaho Comp. Sts. sec. 6780. This would seem to be true under Ariz. statute, Rev. Sts. of Ariz. secs. 1385, et seq. (1913); but see sec. 526, supra.

tion has been incurred by either the individual or one of the corporations or by all three jointly, attachment under such statute will lie upon an affidavit that the defendants are indebted to the plaintiff upon a contract express or implied for the direct payment of money and may be levied upon the property standing in the name of either corporation or their owner.[51] It is readily apparent that the attachment in the case of the owner of two corporations is sustained upon the theory that such individual and the two corporate formations are all identical.

§ 528. Where an Individual Owns Two Corporations, an Attachment Will Issue Against Such Owner and the Corporation, Mandamus Will Lie to Prevent Dissolution Thereof

An individual owning two corporations, one organized under the laws of one state and the other under the laws of another, and obligations have been contracted in the name of one of the corporations, the names of both being identical, the creditor may in such case maintain suit and obtain attachment against the property of both corporations and their owner, and in such case, where a lower court is about to dissolve the attachment, an appellate court will stay the hand of the lower court by mandamus to prevent the dissolution of the attachment, under such circumstances.[52]

§ 529. Not Necessary to Reduce Claim to Judgment Before Proceeding Against Corporation Organized by Individual

The law is that where an individual engaged in business converts that business into a corporate formation, it is unnecessary to reduce a creditor's claim to judgment before

[51] Weintraub vs. Superior Court, supra.
[52] Weintraub vs. Superior Court, 267 Pac. 733; 91 Cal. App. 763.

proceeding against the corporation.[53] The rule that a creditor need not reduce his claim to judgment against the predecessor of a corporation taking over the business of another corporation, partnership or individual, before proceeding against the successor, is in accord with the further well established rule that a creditor seeking to hold a succeeding corporation may proceed directly against such, and that the predecessor need not even be made a party to the proceedings.[54] It is readily perceived that the rule could not be otherwise than stated in the foregoing, when the true situation is kept in mind. The position established at this time, is under the authority of the neoteric adjudications of the courts, that in such case the creditor is not proceeding against a third party, but is merely seeking to hold his obligor, who has been transformed into the jural personality of a body politic and there exists and continues, in so far as substance is concerned, in the same manner as before the change took place.[55]

§ 530. The Question of Whether or Not One Corporation Succeeding Another Is the Same, Is a Question of Fact, Unless There Is No Dispute, Then a Question of Law

It is a recognized principle of law that there is no interdiction that inhibits persons from being interested in joint corporations, and this is true even though the stockholders in two or more corporations are substantially the same, and as a result of this rule of law there is no prohibition against the transfer of property from one of such corporations to another, and when a transfer has taken place between two corporations under such circumstances as to raise a question as to their separateness or whether or not the corporate entities are mere fraudulent devices, having for their purpose the evasion of

[53] Bennett vs. Minott, 28 Ore. 339; 44 Pac. 288; 39 Pac. 997.
[54] See secs. 131, 132, 133, 145, 199, 222, 499, supra.
[55] Andres vs. Morgan, 62 Ohio St. 236; 56 N. E. 875; 78 A. S. R. 712; First National Bank vs. Trebein, 59 Ohio St. 316; 52 N. E. 834; Stanford Hotel Co. vs. M. Schwind Co., 180 Cal. 348; 181 Pac. 780.

the claims of creditors, is largely a question of fact,[56] but if the facts are admitted or there is no dispute as to what the facts are, then whether or not a corporation is the same as another corporation or whether one is a mere continuance of another, becomes a question of law for the determination of the court without the intervention of a jury.[57] It would seem to follow as a result of these adjudications that in every case where the issue is the identity or separateness of two corporations and the separate existence of a corporation from its owner or owners is involved, if there is a dispute as to the facts then it would be determined by the jury or by the court deciding such issue, governed of course, by proper principles of law, but if the facts are not disputed then the question is resolved into one of law and is determined by the court in all cases.

§ 531. Burden of Proof on the Issue of the Identity of Corporation With Other Corporation or Individual

It seems to be the position of some courts, where the question has arisen, that the party asserting that two corporations are identical or that the corporation is identical with its owner or owners is on the party holding the affirmative,[58] but it would seem that the better rule is that if the particular facts upon which the identity or separateness of such body politic and their owner or owners and other corporations are within the peculiar knowledge of the parties against whom such allegation is made, the burden of proof would rest upon the party possessing the facts pertaining thereto. It has been held that as to the dealings between a parent and subsidiary corporation, when called into question, the parent has the burden of proof of explaining. It is submitted that this

[56] Chesapeake Stone Co. vs. Holbrook, 168 Ky. 128; 181 S. W. 953; 1916 D L. R. A. 311; Atkinson vs. Development Syndicate, 150 Pac. 360; 170 Cal. 503.

[57] Henry Waterhouse Trust Co. vs. Home Ins. Co. of Hawaii, 27 Haw. 572; see sec. 178, supra.

[58] Henry Waterhouse Trust Co. vs. Home Ins. Co. of Hawaii, 27 Haw. 572.

is a salutary rule and the one sustained by the better reasoning.[59] In consonance with the principle that the succeeding corporation is in possession of the facts and that the burden should rest upon it, as to its separateness or identity with another corporation or its owners, it has accordingly been held that if a succeeding corporation would defeat its liability upon a claim against its predecessor, it is encumbent upon such succeeding corporation to show that the assets that it received from such predecessor were insufficient to liquidate the claims in full. This position is predicated upon the principle that the evidence tending to prove or disprove such matters was peculiarly within the knowledge of the new corporation and that the burden rested upon it, in its defense, to show what was the fact in this behalf.[60]

§ 532. Sufficiency of Evidence to Hold Succeeding Corporation

Where it is shown that there was but a reincorporation of an existing company, although that reincorporation ensued after a forfeiture of charter for nonpayment of license tax, and that there was a transfer from the former corporation or its statutory trustee to the reincorporated company of all of the assets of the original corporation, nothing else appearing, this is sufficient upon which to fasten liability upon the succeeding corporation for the demands of the creditors of the old corporation.[61] So, also, where a debtor corporation transfers

[59] Brown vs. Pa. Canal Co., 229 Fed. 444; 235 Fed. 669; 149 C. C. A. 89; see sec. 152, n. 61, supra.

[60] Strahm vs. Fraser, 32 Cal. App. 447; 163 Pac. 680; see secs. 210, 373, supra.

[61] Strahm vs. Fraser, 32 Cal. App. 447; 183 Pac. 680. However, the court in this case fell into the error of subscribing to the fallacious doctrine that the reincorporated company was only liable to the extent of the assets received by it and at the same time holding that the succeeding corporation was but a continuance of the former corporation. Such a position, to say the least of it, is an antinomy. It is indeed not readily perceived, however, that the mere change of corporate names and assumption of a new charter, can make the new corporation, which is but a continuance of the old, liable to only the

all of its property to a new corporate organization organized for that purpose, and such succeeding corporation continues the same business with the assets of its predecessor, no provision being made for the liquidation of the debts and liabilities of the preceding corporation, such facts warrant the conclusion, on the part of the court, that the succeeding corporate organization is but a continuance of the old and sufficient to fix liability upon it for the obligations of the old, the substantial stockholders in both corporations being the same.[62] It is not sufficient, however, upon asserting the liability of the succeeding corporation to merely show that it is a successor of a former corporation in order to fasten liability upon the successor; but in addition thereto, there must be a showing that some of the funds or property of the predecessor passed into the hands of or under the control of the succeeding company.[63] Usually a case of liability against the succeeding corporation is strengthened very materially by the fact that the successor pays for the assets of the former in stock, thus making the stockholders in the old corporate formation, stockholders in the new.[64] When the point is reached where it has been established that the stockholders of the old corporation are beneficially interested in the new corporation, then the case rests upon the assumption that the real parties in interest are responsible when the corporate fictions are ignored.

§ 533. Parol Evidence May Be Received to Show That a Contract Entered Into in the Name of the Stockholder or Officer of a Corporation Is Corporate Contract

It is a well settled rule, at least in some states, that parol evidence may be invoked to hold a corporation upon a con-

extent of the assets received from the old. It would be just as reasonable to hold that the very corporation was liable to only the amount of assets that it held. See sec. 184, supra. See also, as sustaining the text, Quinlan vs. Alimini Co., 191 Ill. App. 568; Luce Furniture Co. vs. Alimini Co., 192 Ill. App. 386.

[63] Douglas Printing Co. vs. Over, 69 Neb. 320; 95 N. W. 656. In this case it was attempted to resort to the subterfuge of turning over

tract entered into by its president or manager in his own name, if it was intended for and inured to the benefit of the corporation. Of course, if there is something on the face of the instrument showing that it was made for the benefit of the corporation, then, the position that it is a corporate contract is strengthened materially.[65] Likewise, it may be shown by parol evidence that a contract entered into by officers or stockholders in the interest of the corporation is in fact a corporate contract when such stockholder or on his decease, his representative, seeks to lay claim thereto as an individual asset.[66] Indeed it seems that a corporation may adopt as many names as it chooses and that it will be bound upon obligations and contracts made therein, and that parol evidence is admissible to assert liability for or against a corporation upon a contract signed in the name of its officers or agents or in a name other than its own.[67]

§ 534. Corporation Succeeding Partnership and Taking Over the Property Thereof Parol Evidence Permissible

A corporation organized for the purpose of purchasing the assets and property of a partnership which had theretofore been operated by such partners, but the purchase and transfer by the partnership to the corporation were under a

the assets to a creditor of the old corporation that had a mortgage thereon, and then upon the organization of the new corporation the assets were delivered to it and a new mortgage given to the creditor of the old corporation therefor.

[65] Hopper vs. Moore & Co., 42 Iowa 563.

[66] See secs. 144, 156, 157, 174, 226, supra.

[67] Swartz vs. Burr, 43 Cal. App. 442; 185 Pac. 411; Southern Pacific Co. vs. Von Schmidt Dredge Co., 118 Cal. 368; 50 Pac. 650; Escondido Oil &, etc., Co. vs. Glaser, 144 Cal. 494; 77 Pac. 1040; Bean vs. Pioneer Mining Co., 66 Cal. 451; 6 Pac. 86; 56 A. R. 106; Mechanics Bank vs. Bank of Columbia, 5 L. Ed. 100; 5 Wheat. 326; Metcalf vs. Williams, 104 U. S. 93; 26 L. Ed. 665; Janes vs. Citizens Bank, 9 Okla. 546; 60 Pac. 290.

[68] Watton vs. Colonial Amusement Syndicate, 228 Pac. 42; 67 Cal. App. 654.

[69] Milledge vs. Boston Iron Co., 5 Cush. 158; 51 A. D. 59; Fuller vs. Hooper, 3 Gray 334; Walker vs. Popper, 2 Utah 96.

written contract, notwithstanding such written contract, it is competent to show by parol evidence that the real consideration for the transaction was the assumption of the partnership liabilities, by the succeeding corporation.[68]

§ 535. Corporation Succeeding to a Partnership and Taking Its Assets Is Estopped to Deny Assumption of Debts

Where a corporation takes over a partnership business, such business being within the scope of the corporate powers, and took possession of all of the assets of the partnership which had theretofore been operated by such partners, there being no other consideration for the purchase and transfer by the partners to the corporation made to appear, such corporation is estopped to deny that it assumed the partnership debts as the consideration of the purchase.[69]

§ 536. Evidence Insufficient to Hold That Two Corporations Are the Same Where One Had Actually Loaned Money to the Other, the Lender Being a Majority Stockholder of the Other

Where the evidence establishes that a corporation was organized to handle the property of a decedent and such decedent and such corporation, after the death of the decedent, had loaned to another corporation a large sum of money and the lending corporation had thereafter taken a trust deed and chattel mortgage upon the property of the borrowing corporation to secure the same, it appearing that the lending corporation was a majority stockholder in the borrowing company, such fact will be insufficient to warrant the court in holding that in reality the borrowing corporation is a mere *alter ego* of the lending company; it appearing to the satisfaction of the court, that the loans were made at different

[68] Leckie vs. Bennett, 160 Mo. App. 145; 141 S. W. 706.
[69] Leckie vs. Bennett, 160 Mo. App. 145; 141 S. W. 706.

times; were *bona fide*, and in perfect good faith.[70] Doubtless the court proceeded upon the theory that as the lending company did not own all of the stock of the borrowing company, no other facts appearing, would not warrant the court in adjudicating that the corporations were the same.

§ 537. Insufficiency of the Evidence to Hold a Succeeding Corporation on Obligations of Another Corporation, Partnership or Individual

The authorities seem to establish the proposition that the plaintiff's case is insufficient in seeking to hold a corporation succeeding another corporation, partnership or individual, where it consists merely of showing that the succeeding corporation received a portion of its predecessor's assets, something more than that must be shown. If it merely appears that the corporation is organized, having substantially the same personnel as its predecessor and the only other evidence to fix liability upon such corporation is the introduction of documentary evidence establishing the taking of a portion of the partnership assets of other predecessor, by the succeeding corporation to the business, would not be sufficient to hold it on the liabilities of its predecessor.[71]

§ 538. Corporation Continuing Same Business at the Same Place and Being Composed of Substantially the Same Parties

It has already been observed that a corporation succeeding to a partnership and taking its assets, the doctrine of estoppel will be resorted to to prevent it from disputing that it assumed the debts of a partnership.[72] The same result is reached by the operation of largely the same principle, in cases where a

[70] Woods Estate Co. vs. Chanslor, 286 Pac. 1001.
[71] See secs. 29, 159, 214, 293, supra.
[72] Sec. 535, supra.

sole trader incorporates, and the corporation takes over all his assets, continuing the same business at the same place, with substantially the same name and in the last analysis under substantially the same ownership equitably, such circumstances are sufficient to raise an inference that the corporation has assumed the liability of such sole trader.[73] Likewise where copartners, or other joint owners, of a solvent going business transformed themselves into a corporation to which the joint property is transferred in exchange for shares of stock; such facts are sufficient to raise by implication, that the liabilities of the predecessor are assumed. However, the assumption in such case may be express or implied, and may be established by any competent evidence as will establish it, either direct or circumstantial.[74] On the other hand it has been held that where a business is conducted by partners and thereafter one of them withdraws and the other continued to carry on the business, and later still the continuing partner in conjunction with another re-formed a partnership and continued the business, and later yet the partners, in conjunction with the wife of one of them, secured a charter from the state under identically the same name as the partnership and took over the tangible assets of the concern, was insufficient to hold the succeeding corporation. The court proceeded upon the theory that it did not appear that the corporation failed to pay full value for the assets.[75] Burt vs. Modern Dye and Rug Works[76] is so manifestly out of line with the great weight of authority generally prevailing that it cannot be sustained as a sound rule. In the first place the facts are manifestly sufficient to raise the implication that the corporation had assumed the liabilities of the partnership;[77] in the second place the better

[73] Blumenthal vs. Schneider, 186 Wis. 588; 203 N. W. 393; Pratt vs. Oshkosh Match Co., 89 Wis. 406; 62 N. W. 84; Ziemer vs. C. G. Bretting Manufacturing Co., 147 Wis. 252; 133 N. W. 139; 1912 D A. C. 1275.

[74] Ziemer vs. C. G. Bretting Manufacturing Co., supra.

[75] Burt vs. Modern Dye & Rug Works (R. I.), 139 Atl. 312.

[76] Ibid.

[77] Blumenthal vs. Schneider, supra; Ziemer vs. Bretting Manufac-

rule, and the one sustained on principle and authority, is that the burden of proof in such cases, where it is sought to brush aside the corporate entity, and examine into the transaction and ascertain the real parties in interest, rests on the parties peculiarly possessing the knowledge of the facts surrounding such transaction.[78]

§ 539. Insurance Companies Sued Upon a Policy, Issued in Favor of a Corporation, May Show by Competent Evidence in Defense That the Property Was Burned by the Stockholders of the Assured

In an action where it is sought to hold an insurance company upon a policy of insurance issued in favor of a corporation, it is permissible for the insurance company to defend upon the ground that the corporate property was burned by the stockholders of such corporation and competent evidence going to establish this defense should be received by the court.[79] It would seem that the correct procedure in such case, when the defense that the corporate property has been burned by the stockholder is interposed, would be to disregard the corporate entity on the basis of such plea, and then if the issue is determined in favor of the insurance company, that the stockholders committed the incendiary act, that recovery should be denied. It is submitted, however, that such defense would not be available, if the guilty stockholder owned only a negligible interest in the corporation. It ought, in all fair-

turing Co., supra; Andres vs. Morgan, 62 Ohio St. 236; 56 N. E. 875; 78 A. S. R. 712; Hall vs. Herter Bros., 90 Hun. 280; 35 N. Y. S. 769; 157 N. Y. 694; 51 N. E. 1091; Reed Bros. Co. vs. First National Bank, 46 Neb. 168; 64 N. W. 701; Modern Dairy, etc., Co. vs. Blank & Hauck Supply Co., 116 S. W. Tex. 153; Du Vivier vs. Gallice, 149 Fed. 118; 80 C. C. A. 556; Haslett vs. Wotherspoon, 1 Strob Eq. (S. C.) 209; Tex. Loan Agency vs. Hunter, 13 Tex. Civ. App. 402; 35 S. W. 399; Sheffield vs. Mitchell, 31 App. Div. 266; 52 N. Y. S. 925.

[78] See secs. 210, 373, 531, supra.

[79] D. I. Felsenthall Co. vs. Northern Assurance Co., 284 Ill. 343; 120 N. E. 268; 1 A. L. R. 602; Meily vs. London & L. F. Ins. Co., 142 Fed. 873; 79 C. C. A. 454; 148 Fed. 683; Kirkpatrick vs. Allemannia Fire Ins. Co., 102 App. Div. 327; 92 N. Y. S. 466; 184 N. Y. 546; 76 N. E. 1098.

ness, be made to appear that the stockholder guilty of the culpable act was a substantial one. Any other rule would lead to injustice.

§ 540. Corporate Entity Disregarded in Proceedings For Discovery of Books and Records

A corporation, being a holding company against which complainant takes action on behalf of stockholders, and such holding company owning the stock of seven or eight other corporations engaged in the same business which the holding company financed and all of the directors in a number of such corporations being directors in the holding corporation and a majority of the directors in the other corporations being directors in the holding company, and the president of the holding company being president of all of the subsidiaries, in such suit by the minority stockholders against the holding corporation, in which it is alleged that there is mismanagement in the conduct of the affairs of the corporation, by appropriate proceedings the court will compel the holding corporation to produce the books of its subcompanies, for the purpose of permitting a discovery as to whether or not the holding corporation is guilty of fraud in the mismanagement of the corporate affairs. In order to accomplish this end the subcorporations will be regarded by a court of equity as mere instrumentalities in the hands of the holding corporation and it will be compelled—the entities being disregarded—to produce the books of such corporations for discovery as well as its own books and records. In such case the interest of justice requires that, in order that the injuries alleged to have been perpetrated by the holding company be righted, the legal fiction of the distinct corporate entities will be disregarded, the subsidiary corporations being so organized and controlled and their affairs being so conducted as to make them mere adjuncts of the dominant corporation. It is but a step further to regard the books and records of the allied companies as the books and records of the holding corporation, or at least to be under

its control, to such an extent that it will be compelled to produce them for the purpose of discovery.[80]

§ 541. Where Partners Are in Failing Circumstances and Organize Themselves Into a Corporation With Their Wives, Upon Adjudication of the Partners Bankrupt, the Court Will Order the Inspection of the Corporate Books

Two partners, in failing circumstances, organized a corporation and by that means engaged in the prosecution of the same business, the corporation being composed of themselves and their wives and one other party, the stock being issued in the name of the wives, but they contributed no value for it, the husbands were elected officers of the corporation and had active charge of its affairs, managed its business and appropriated unto themselves the money earned in the corporate venture. The other stockholders, besides such former partners' wives, received nothing from the corporate earnings. The partnership as such was adjudged a bankrupt and thereupon the creditors of the partnership claimed the right to examine the books of the corporation. In such case the corporate fiction will be ignored if its assets are, to all intents and purposes, the assets of the two partner-stockholders—and when the fiction is ignored the situation amounts to this, that the creditors of the partnership—the partners being stockholders in the corporation—demand an examination and discovery of the partnership books. The fiction aside, no reason can be urged why this should not be permitted.[81]

§ 542. The Corporate Entity Will Be Ignored to Ascertain Whether or Not a Bankrupt Is Using It to Conceal His Property in His Application For Discharge

An individual engaged in business and within the period of

[80] Martin vs. D. B. Martin Co., 10 Del. Ch. 211; 88 Atl. 612; 102 Atl. 373.

[81] In re Horgan, 39 C. C. A. 118; 97 Fed. 319; 98 Fed. 414; Tripp vs. Childs, 14 Barb. 85.

four months prior to his adjudication, organized a corporation, the shares being taken mainly by himself and his wife and relatives, the wife and relatives being people without any means, to which corporation he contributed a small amount of capital and then retook such for himself and thereafter transferred the stock to supposed creditors. In such case the court will ignore the corporate form as a mere device to enable the bankrupt to continue his business in his own interest, principally with the assets belonging to his creditors and to their exclusion, not having mentioned the assets of the corporation in his schedule, to admit evidence of concealment thereof, the same will be treated as his property.[82]

§ 543. Evidence Held Sufficient to Hold One Corporation Liable For Personal Injuries of Employee of Another

An injured employee was employed by the Highland Stone Company, but worked in a quarry that the evidence didn't disclose whether in reality it belonged to the Highland Stone Company or the Chesapeake Stone Company, both corporations being owned by the same parties. It was established that the former owner of both corporations operated the quarry through the Chesapeake Stone Company, having done that for the purpose of protecting himself and the stockholders from suits and liabilities, such former owner caused to be organized the Highland Stone Company with a nominal capital stock; that it was organized solely for the purpose of protecting the Chesapeake Stone Company against liability and the Chesapeake Stone Company, thereupon, leased the quarry to the Highland Stone Company, at such high rental that no profit could ever be made by the Highland Stone Company; that after operating the quarry in this fashion for a few years, such former owner sold both companies to the parties who owned them at the time that the personal injury took place, and at the time of such sale advised such purchaser of why the

[82] In re Bullwinkle, 111 Fed. 364.

Highland Stone had been organized. The former owner of said companies testified that about the time that the injury resulted, he purchased from the Chesapeake Stone Company some crushed stone manufactured in this very quarry, and paid the Chesapeake Stone Company for it and that he also purchased other merchandise from the Chesapeake Stone Company that came from the same premises; such evidence was held admissible, it being presumed that the parties succeeding the former owner used the Highland Stone Company for the same purpose he had used it; both companies were sued in the action for injuries and the jury resolved the issue in favor of the plaintiff and the appellate court affirmed the judgment.[83] Likewise it has been held where a foreign railroad company extending its lines into another state, through the instrumentality of a corporation chartered therein, entered into an agreement with such domestic corporation to establish connecting lines through to all points on the railroads that were owned by both corporations, and the whole of the railroads in the name of both corporations were operated as if owned by a single corporation. The companies contracted with each other with respect to transportation of freight and prorated the revenues arising from the transportation of freight on a mileage basis. The corporations were privileged to inspect each other's books, and the foreign corporation furnished all equipment and rolling stock and received therefor the usual charge in such cases. The agreement between the two corporations provided for duration for 999 years. The domestic corporation owned no rolling stock or equipment. The foreign corporation owned a majority of the local company's stock and bonds and the local company was officered by the general attorney and other employees of the foreign corporation. The local corporation operated no trains that would not pass over the lines of the foreign corporation and the local company's agents and employees were considered as agents and employees of the foreign corporation when they passed without the state

[83] Chesapeake Stone Co. vs. Holbrook, 168 Ky. 128; 181 S. W. 953; 1916D L. R. A. 311.

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