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THE CORPORATE ENTITY CONCEPT (OR FICTION THEORY) AND THE MODERN BUSINESS ORGANIZATION

By Ke Chin Wang*

The corporate entity concept is generally accepted as the guiding principle in corporation law. But judges allow so many exceptions to it that we wonder whether such a theory is really adequate for the modern business organization. An examination of the cases will show there is the greatest confusion and uncertainty as to when the corporate entity will be disregarded.

Generally, the concept governs and the separate corporate entity is observed. In New York, Lake Erie & Western Railroad v. Nickals, the Court held that preferred stockholders were not entitled as of right to dividends when profits accrue to the company, but that dividends must be declared by the company through directors, at their discretion, even when owners of preferred stock were entitled by express agreement with the corporation to dividends at a certain yearly rate.

In Humphreys v. McKissock, several railroad companies combined to construct an elevator, to be connected with their respective roads, each to contribute an equal sum towards its costs, and each to receive corresponding certificates of stock in a corporation organized to take title to the elevator and to construct it.

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1 This inadequacy is further shown by the numerous legislative enactments which ignore the distinct entity and look through the corporation to the individual shareholders. E.g., Section 15, Federal Securities Act 1933, 12 U.S.C., Section 63, 1935.

2 Cases relating to taxation will be conclusively discussed in a later article.

3 (1886) 119 U. S. 296, 7 S. Ct. 209, 30 L. Ed. 363.

This arrangement was carried out. The Court held, first, that the interest of each company in it was that of a stockholder in the company which constructed it, second, that no company had an interest in the property itself which it could mortgage, third, that such stock would not pass to a mortgagee of one of the railroads under a general description as an appurtenance to the road.

Mr. Justice Field, delivering the opinion of the Court, said,

"That railway company (Wabash Company) had no interest which it could assign, the building belonged to the Union Elevator Company, and the railway company was entitled by its subscription, when paid, only to a certain proportion of its stock. Both the commissioner, and the Court, in confirming his report and entering the decree mentioned, seem to have confounded the ownership of stock in a corporation with ownership of its property. But nothing is more distinct than the two rights, the ownership of one confers no ownership of the other. The property of a corporation is not subject to the control of individual members, whether acting separately or jointly. They can neither encumber nor transfer that property, nor authorize others to do so. The corporation—the artificial being created—holds the property, and alone can mortgage or transfer it, and the corporation acts only through its officers, subject to the conditions prescribed by law."

The corporate entity concept is not always followed. An early exception was allowed by the United States Supreme Court in 1809.

In Bank of United States v. Deveaux, the headnote reads

"A corporate aggregate, composed of citizens of one state, may sue a citizen of another state in the circuit court of the United States. No right is conferred on the bank, by its act of incorporation, to sue in the federal courts. A corporation aggregate cannot, in its corporate capacity, be a citizen."

Marshall, C. J., however, allowed such a corporation to sue. "That invisible, intangible, and artificial being, that mere legal entity a corporation aggregate, is certainly not a citizen, and, consequently, cannot sue or be sued in the courts of the United States, unless the rights of the members, in this respect, can be exercised in their corporate name. (Here Marshall referred to the

4.1 (1891) 140 U. S. 304 at p. 312, 11 S. Ct. 779, 35 L. Ed. 473. The italics are added. In other quotations found later in this chapter italics will also be the writer's. See also Smith v. Hurd, (1847) 12 Met. (Mass.) 371, 46 Am. Dec. 687, Aiello v. Crampton, (C.C.A. 8th Cir. 1912) 201 Fed. 891, Donaldson v. Andresen, (1930) 300 Pa. St. 312, 150 Atd. 616.

5 (1809) 5 Cranch (U.S.) 61, 3 L. Ed. 38.
...English case of City of London v. Wood, 12 Mod.). In that case the objection, that a corporation was an invisible, intangible thing, a mere incorporeal entity, in which the characters of the individuals who composed it were completely merged, was urged and was considered. The judges unanimously declared that they could look beyond the corporate name, and notice the character of the individual.

"The court feels itself authorized by the case in 12 Mod. on a question of jurisdiction, to look to the character of the individuals who compose the corporation, and they think that the precedents of this court, though they were not decisions on argument, ought not to be absolutely disregarded."

Since this case there have been many others which disregarded the distinction between the corporation and its shareholders. Their examination will show that the courts have not yet fixed any definite rules for lifting the corporate veil.

I.

It is generally accepted that where the corporate device is used "to defeat public convenience, justify wrong, protect fraud, or defend crime," the theoretical distinctions between the corpo-
ration and its shareholders will be disregarded. This principle was relied upon in the decisions of several cases.

In *J J McCaskill Company v United States*, the headnote reads,

"The presumption that a corporation is, in law, an entity distinct from its stockholders and officers cannot be carried so far as to enable the corporation to become a means of fraud, and knowledge of fraud on the part of the officers, who are also the principal stockholders and whose interests are identical, is properly to be imputed to the corporation itself."

Mr. Justice McKenna delivered the judgment of the Court.

"Undoubtedly a corporation is, in law, a person or entity entirely distinct from its stockholders and officers. It may have interest distinct from theirs. Their interests, it may be conceived, may be adverse to its interest, and hence has arisen against the presumption that their knowledge is its knowledge, the counter presumption that in transactions with it when their interest is adverse their knowledge will not be attributed to it. *But while this presumption should be enforced to protect the corporation it should not be carried so far as to enable the corporation to become a means of fraud or a means to evade its responsibilities.*"

The purpose and intention of the corporators, then, will determine whether or not the corporate veil will be lifted. But since "the devil himself knows not the mind of man," such a test is difficult to apply and offers wide variations in interpretation.

In *Minifie v Rowley*, an individual, being indebted to a testator gave a renewal note in the name of a corporation. Afterwards he became executor of the testator, so that treating the debt as his, under Code Civil Procedure Sec. 1447, he would not be relieved of liability by the subsequent running of the statute, whereas treating it as the debt of the corporation it would have become barred by limitations. The Court decided to hold its obligations his. It was found that he had always been the owner and holder of all its stock, excepting enough shares to qualify others as directors, not exceeding one to each, had always con-

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*(1910) 216 U. S. 504, 30 S. Ct. 386, 54 L. Ed. 590.


*(1922) 187 Cal. 481, 202 Pac. 673.
trolled the board, and always been the representative of and the only person interested in the corporation.

Lennon, J. said.

"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 there is such a unity of interest and ownership that the individuality, or separateness, of the said person and corporation has ceased, second, that the facts are such that an adherence to the fiction of the separate existence of the corporation would, under the particular circumstances, sanction a fraud or promote injustice."

Already we find a variation from the tests laid down in the McCaskill Company Case. It is necessary that there be fraud plus identity of interest before the corporate entity can be disregarded. Moreover, the meaning of fraud is extended to include much more than active wrongdoing.

Lennon, J., continued,

"It is not necessary, as defendants contend, that the complaint allege actual fraud; it is sufficient if the facts set forth disclose that the dealings were in form with a corporation but in reality with an individual and that a refusal to recognize this fact will bring about inequitable results.

In the instant case the assumption of that form (corporate) will result in the avoidance of a legal obligation, unless equity intervenes to prevent this injustice. This equity does by penetrating the fiction of the independent existence of the corporation."

In Wenban Estate v. Hewlett, a corporation was organized for the sole purpose of owning and operating the owner's property. It was held that her acts and conduct when dealing with the director with reference to corporate bonds were the acts and conduct of the corporation, and the corporation was therefore estopped to complain that the bonds were not issued or delivered by the corporation, or that no consideration was received by it from the pledgees or transferees of such bonds. Again Lennon, J., said, "To disregard fiction of separate corporate entity it is unnecessary that actual fraud be shown, it being sufficient if a refusal to recog-
nize identity of corporation with that of the individual would bring about inequitable results.”

That the meaning of fraud has an extended interpretation when given as the reason for disregarding the corporate entity is further shown in the case of *Shapiro v Wilgus.* A debtor in Pennsylvania, where the law permits appointment of a receiver for the business of a corporation but not for that of an individual, caused a corporation to be formed in Delaware and conveyed to it all of his property in exchange for substantially all of its shares and its covenant to assume payment of his debts. Three days later, joined with a simple contract creditor, he sued the corporation in a federal court in Pennsylvania, invoking jurisdiction on the ground of diversity of citizenship, and, with the consent of the corporation, obtained on the same day a decree appointing receivers and enjoining executions and attachments. The Supreme Court held that the conveyance and receivership were fraudulent in law as against non-assenting creditors and the corporate entity will therefore be disregarded, notwithstanding that the purpose of the debtor was a laudable one, namely, to prevent disruption of his business by suits of hostile creditors and to cause the assets to be nursed for the benefit of all concerned.

To conclude this class of cases where the test is whether or not the corporate device is used “to defeat public convenience, justify wrong, protect fraud, or defend crime,” we can do no better than cite *Commercial Cable Staff’s Association v Robert Lehman et al.* to show the uncertainties of that test. For in this case involving parent and subsidiary companies, there was an intention to defeat creditors (fraudulent within the wider meaning of that word) yet the corporate entity was observed.

Proceedings were instituted under section 77B for the reorganization of two holding companies, one of which, the Postal Telegraph and Cable Company owned all the common and a substantial part of the preferred stock in the other, the “associated companies.” None of the other subsidiaries or affiliates in the extensive system of which the debtors formed a part had been technically in reorganization, nor had they at any time submitted themselves to the jurisdiction of the Court. The plan, however, provided for a thorough reshuffling of inter-company holdings and

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13 (1924) 193 Cal. 675, 227 Pac. 723, 732. See also headnote to the case.
15 (C.C.A. 2d Cir. 1939) 107 F. (2d) 917 The case is discussed in Note, (1940) 49 Yale L. J. 590-596.
properties, which was to be effected by votes cast by the debtor holding companies as stockholders in the subsidiaries. Cable Staff's Association, composed of the employees of one of the subsidiaries, sought to intervene in the reorganization proceedings on the plea that its interests were adversely affected by the proposed plan. It was interested in Commercial Cable Company, its employer, as a creditor only through certain pension claims, which in a large part depended upon the existence of profits, it asserted, inter alia (a principal feature of the plan was to transfer assets of Commercial Cable, a solvent subsidiary, to weaker parts of the system), that the plan would strip Commercial of all its liquid assets and thereby render insolvent the new company which was to succeed it and to assume the pension claims, thus constituting a conveyance which would be fraudulent as to the trade union. In the district court, the union lost on the merits. The Second Circuit, speaking through Judge Learned Hand, in a two-to-one decision, dismissed the appeal for want of jurisdiction on the ground that the union was not a “creditor” of either debtor subject to the jurisdiction of the Court, and hence should not have been allowed to intervene. He maintains that even though the stockholders of the parent may be identical with those of the subsidiary, nevertheless the latter's creditors have no interest in the parent's reorganization, because their rights are against different assets. The Court seems to argue that in a situation in which it is unnecessary for a subsidiary to be a party to the reorganization of the parent, there is no need to hear objections raised by adversely affected creditors of the subsidiary.26

II.

In many instances the test for disregarding the fiction of corporate entity appears to be whether or not the intention was to evade a statute. This test is also open to the same criticism as the text explained in Section I—it leaves too much to the discretion of the particular Court.27

In Northern Securities Company v. United States,18 stockholders of the Great Northern and Northern Pacific Railway Com-

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16See a detailed discussion of this case in (1940) 49 Yale L. J. pp. 590-596. Also (1940) 24 Minn. L. R. 998 et seq.
17Some cases decide that the intention of evading a statute is not enough. There must be evidence moreover that the new corporation is “a mere agent, or instrumentality or department” of another. See e.g. United States v. Reading Co., (1920) 253 U. S. 26, 40 S. Ct. 425, 64 L. Ed. 760, discussed under section 3 infra.
panies—corporations having competing and substantially parallel lines from the Great Lakes and the Mississippi River to the Pacific Ocean—combined and conceived the scheme of organizing a corporation, under the laws of New Jersey which should hold the shares of the stock of the constituent companies, such shareholders, in lieu of their shares in those companies, to receive, upon an agreed basis of value, shares in the holding corporation. Pursuant to such combination the Northern Securities Company was organized as the holding corporation through which the scheme should be executed, and under that scheme such holding corporation became the holder—more properly speaking, the custodian—of more than nine-tenths of the stock of the Northern Pacific, and more than three-fourths of the stock of the Great Northern, the stockholders of the companies, who delivered their stock, receiving, upon the agreed basis, shares of stock in the holding corporation.

Mr Justice Brewer disregarded the corporate entity. He found that the intention was to evade the statute (Act of July 2, 1890) forbidding restraint of trade. "A corporation, while by fiction of law recognized for some purposes as a person and for purposes of jurisdiction as a citizen, is not endowed with the inalienable rights of a natural person. It is an artificial person, created and existing only for the convenient transaction of business. In this case it was a mere instrumentality by which separate railroad properties were combined under one control. That combination is as direct a restraint of trade by destroying competition as the appointment of a committee to regulate rates. The transfer of stock to the Securities Company was a mere incident, the manner in which the combination to destroy competition and thus unlawfully restrain trade was carried out."

In Linn & Lane Lumber Company v United States, the owner of land under voidable patents transferred property to his one-man corporation and allowed the Government to sue him individually until the Statute of Limitations had run. Held, the purpose of his action being to evade the statute, the corporate entity would not be respected.

In Corker v Soper plaintiff formed a corporation for the express purpose of avoiding statutory double liability on bank stock.

20(1915) 236 U. S. 574, 35 S. Ct. 440, 59 L. Ed. 725.
21(C.C.A. 5th Cir. 1931) 53 F. (2d) 190.
to which he was going to subscribe. The Court, while asserting that the corporate fiction would not be disregarded, nevertheless held him liable. This appears self-contradictory. Hutcheson, Circuit Judge, said,

"Appellant's troubles do not arise from the fact that the corporate entity of the Laurens Company has been disregarded. The judgment of the court below fully recognized and gave effect to that entity. It is found that, though it did in fact exist, it existed as a mere creature organized and maintained for the purpose of holding, not really, but as agent for appellant, the stock which he caused to be put in its name, that appellant at all times remained the real owner of the shares, and that the law will look through the subterfuge of pretended ownership to fasten liability upon the shareholder to whom, in fact, the shares belong.

"The view which the court below took, and which we take, does not require, in fact, it prevents, the conclusion that the corporation in this case was a fiction, having no corporate existence. In this view, the judgment, thoroughly consistent with itself, stands upon the sound foundation on which alone a just disposition of this case may rest. It correctly gives effect to the general intent of appellant to create a corporation for the purpose of placing in its name his and his wife's stock in the bank, because what was done made that intent effectual. It with equal correctness denies effect to the particular intent which induced him to act as he did, to avoid liability on the stock, because the things done by appellant were not in accord, but wholly inconsistent, with that intent. For while the things done did place the certificates of stock in the name of the Laurens Company, they did not divest appellant of his beneficial ownership of them, but left him the real owner, and therefore liable to assessment..."

Either the corporation is distinct from its shareholders or it is not. If it is, then it cannot become the agent of another except through contract, express or implied. In this case the Court has failed to understand the essentials of corporate theory. It professes to adhere to the corporate entity concept while in fact disregarding it. There is a definite confusion of thought.

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22 U. S. C. A. 63. For its provisions, see Excursus. The Iowa Code, 1931, sec. 9251, says, "All stockholders of savings and state banks shall be individually liable to the creditors of such corporations of which they are stockholders over and above the amount of the stock held by them therein and any amount paid thereon, to an amount equal to their respective shares for all its liabilities accruing while they remained such stockholders." The Federal Statute is to the same effect.

23 Ibid., at page 192.
In *Barbour v Thomas*, the practical effect of organizing a holding company was to escape the statutory double liability of bank directors. The corporate entity was again disregarded to prevent this result.

Hayes, District Judge, said

"It is well settled now, after years of conflict and confusion, that the corporate concept cannot be employed to evade a statute or to defeat its intent. In such cases the Courts treat it as a mere sham, a device, and a dummy. It is utterly inconsistent with these laws (National Banking Laws) for a holding company to acquire all the stock of a national bank, and control it in the manner shown by the evidence in this record, except on the theory that it existed as an agency for the stockholders of the bank, who are, to all intents and purposes, still stockholders therein, and liable as such stockholders for any bank stock assessment.

"Prior to the organization of the holding company, the stockholders of this bank were individually liable for the stock assessment. They cannot destroy this liability and circumvent the statute by creating a holding company and conveying their stock to it.

"The law will unmask the apparent ownership of bank stock and fasten liability for the assessment on the ‘real’ owner. If the mask is a corporate device, it will be removed like any other sham."

Similarly, in *Metropolitan Holding Company v Snyder*, the Court held that the contingent liability on shares of stock in a national bank cannot be circumvented by the organization of a holding company, and directors of the bank who have organized such a company to purchase shares of stock, *even though in good faith*, will be held liable where the directors knew the bank was in a precarious position. Here the intention of the individual seems to have been subordinated to the practical result of his act in determining the circumstances for disregarding the corporate entity.

But, in *Pearson v All Borg*, the corporate entity was observed though the net result was to escape the statutory double liability. The Court held that an insolvent national bank’s stock-

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25 (C.C.A. 8th Cir. 1935) 79 F. (2d) 263.
holders, transferring their stock to a holding company, are not liable for assessment thereon, in the absence of showing in complaint of bank's receiver, suing to enforce such liability, that they transferred the stock for the purpose of evading liability or that transferee had no other assets or held stock merely as agent or trustee and distributed dividends thereon to assignors.

Holly, District Judge, declared, "One of the principal purposes of a corporation as distinguished from a partnership is to avoid individual responsibility for the debts of the enterprise. It is the contention of plaintiff that this rule does not apply to holding companies whose assets consist principally of national bank stocks, or stocks of national and other banking institutions. I do not think that the courts so hold. Whether the shareholders of the holding company shall be held responsible for an assessment levied upon bank stocks standing in the name of the corporation depends upon the circumstances of the particular case.

"If it appeared from the complaint that the shareholders of People's National Bank had transferred their stock to Bancorporation for the purpose of evading their statutory liability, if Bancorporation had no other assets than the stock of People's National Bank, if it appeared from facts stated in the complaint that Bancorporation was holding the stock merely as agent or trustee, if the dividends on People's National Bank stock when received by Bancorporation were distributed to the assignors of that stock, then, in my opinion, the assignors of the stock to Bancorporation might be held liable for the assessment against the holders of the stock which had been held by them respectively. But none of these facts appear, and I feel constrained to hold that they are not liable for the assessment plaintiff seeks to enforce."

Neither can other statutes be evaded through the scheme of incorporation. In National Labor Relations Board v. Hopwood Reinvesting Company, proceedings were instituted under the National Labor Relations Act (29 USCA Sec. 151 et seq.) to compel corporations to cease and desist from unfair labor practices.

27 The Banking Act, while permitting the ownership of a majority of stock in bank which is a member of the Federal Reserve System by a holding company, requires every such company whose charter does not preserve its stockholders' individual liability for assessment on bank stock held by it to possess other readily marketable assets in an amount of 25 per cent of par value of such stock.


29 (C.C.A. 2nd Cir. 1938) 98 F (2d) 97
The Court supported the Board’s finding that one of the corporations maintained an attitude of refusal to bargain with the unions as the proper representative of the employees, and, disregarding the corporate entity, decided that such a situation continued during the time of the lockout and after it discontinued its business in the state and transferred its machinery and business to the other corporation in another state.

The Commodities Clause of the Hepburn Act30 forbids railroads to carry commodities in which they have an interest.

The problem arises whether a railroad may carry articles owned by a corporation which is a subsidiary of the railroad. Will the corporate entity be disregarded? Earlier cases show that control through stock ownership alone is sufficient to bring the case within the statutory prohibition,31 but later cases seem to require something more. There must be evidence of direct control.32

Many states having usury statutes deny corporations the defense of usury33 Hence a borrower who is unable to secure capital otherwise may be advised to incorporate. The corporation is then loaned the money at what would be a usurious rate of interest were it loaned directly to the stockholder as an individual. Courts have held that the borrower is bound by his action and cannot set up the defense of usury, despite the fact that an avoidance of the effect of the statute was the sole purpose of incorporation.34

The large number of automobile accidents and judgment proof drivers has caused some states to pass statutes which suspend licenses while judgments resulting from automobile accidents remain unsatisfied, and which prevent a judgment debtor from licensing any car during that time. To escape this result, the judgment debtor transfers his automobile to a corporation formed by

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him. But the Court, without much hesitation, "ignores the entity" to prevent this modification of the effect of the statute.25

This concludes our examination of cases where the corporate entity was discarded or not upon the answer to the question, was the intention of the corporators to evade a statute or modify its effect.26

III.

Another test followed by many courts is the corporate entity will be disregarded when it is but an "instrumentality, adjunct, agent or alter ego" of an individual or another corporation. Being the vaguest of all tests, it is also the most unsatisfactory upon which judges could base their decision.27


In a later case, Inland Development Co. v. Comm'r, (C.C.A. 10th Cir. 1941) 120 F. (2d) 986, it was decided that where it could be shown that the true policy of a specific statute requires the disregard of a subsidiary's entity, the corporate concept will be overruled.

27Professor Fuller of Harvard says, "These terms are not, of course, self-defining their use is clearly part of a judicial technique, too often obscuring the real issues involved, employed to accomplish results which would not logically flow from a literal adherence to the conventional dogma that a corporation is a person separate and distinct from its shareholders." (1938) 51 Harv. L. R. 1373 at page 1378. Cf. also Latty, notes, Judicial Supervision of the One-man Corporation, (1932) 45 Harv. L. R. 1084, Corporate Entity—Its Limitations as a Useful Legal Conception, (1926) 36 Yale L. J. 254 et seq.

Professor Fuller gives a detailed account of the application of this test for one-man companies. Since these companies are necessarily controlled by one individual, it would seem that all such organizations are the "instrumentalities, etc." of another. Yet this is not the case. The true test, if there is one, cannot be discovered by examining the decisions. The law is extremely uncertain and Professor Fuller suggests that "The situation is one which calls for legislative action." See (1938) 51 Harv. L. R. 1373-1405.
It has been settled long ago that identity of stockholders, directors and other officers does not make one company the "instrumentality" of another company. Similarly, the ownership of all the stock in a company does not make that company the "alter ego" of the sole stockholders. Something more is required to disregard the corporate entity. The control must be more intimate.

*In Richmond & I Const. Co. v Richmond, Etc Ry. Co.*, 38

Lurton, Circuit Judge, said,

"It (the appellants) contends that under the evidence in this case the K company was, in legal effect, the railroad company and that engagements made by it were, in legal effect, engagements made by the railroad company. In support of this, appellant has endeavored to show that the stockholders in each corporation were the same, and that the K company dominated and controlled the railroad company. The K company was a legal corporation, wholly distinct and separate from the railroad company. The fact that the stockholders in each may have been the same persons does not operate to destroy the legal identity of either corporation. Neither does the fact that one corporation exercised a controlling influence over the other through the ownership of its stock or through the identity of stockholders, operate to make either the agent of the other, or to merge the two corporations into one." 39

*In Peterson v. Chicago, Rock Island and Pacific Railway Co.*, 10

Mr. Justice Day, delivering the opinion of the Court, said,

"It is true that the Pacific Company practically owns the controlling stock in the Gulf Company, and that both companies constitute elements of the Rock Island System. But the holding of the majority interest in the stock does not mean the control of the active officers and agents of the local company doing business in Texas. That fact gave the Pacific Company the power to control the road by the election of the directors of the Gulf Company, who could in turn elect officers or remove them from the places already held, but this power does not make it the company transacting the local business.

"The conduct and control of the business in Texas was entrusted to the Gulf Company. As the largest stockholder

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38 (C.C.A. 6th Cir. 1895) 68 Fed. 105.

39 Ibid., at page 108. In this case the appellant company had knowledge of the close relations of K company to the railroad company. It was not misled. This element probably had much to do with the outcome of the case. Cf. Trust Company v. Bridges, (C.C.A. 6th Cir. 1893) 57 Fed. 753. See also Pullman's Palace Car Company v. Missouri Pacific Railway Co., (1885) 115 U. S. 587 6 S. Ct. 194, 29 L. Ed. 499.

40 (1907) 205 U S. 364, 27 S. Ct. 513, 51 L. Ed. 841.
the Pacific Company had an interest in that business, but a separate corporation had been legally created in Texas, with authority to make contracts and control its own affairs and carry on its own business. This separate corporation had its own officers, a large amount of its own property, was responsible for its contracts and to persons with whom it dealt."

A Georgia statute treated as an employer "Any employing unit, which together with one or more other employing units, is owned or controlled (by legally enforceable means or otherwise) directly or indirectly by the same interests, and which, if treated as a single unit with such other employing units, would be an employer under Paragraph (1) of this subsection." The Court in Independent Gasoline Co. v. Bureau of Unemployment Compensation, held this invalid, on the grounds that a corporation retains its separate and independent character regardless of the ownership of its capital stock.

Duckworth, Justice, said, "The defendant is a corporation, and as such is an artificial person. This legal entity retains its separate and independent character regardless of the ownership of its capital stock, and as such it cannot be held liable for the obligations of a stockholder. Nor are the stockholders liable for the obligations of the corporation." The case of Benner-Coryell Lumber Company, Inc. v. Indiana Unemployment Compensation Board again decided that control through ownership of stock was not enough for disregarding the corporate entity. The relationship must be more intimate.

It called into question the validity of Section 2 g4 of the Indiana Unemployment Compensation Law, Acts of 1939, ch. 121, Sec. 1. This section provides that the term "employer" means "Any employing unit which together with one or more other employing units, is owned or controlled directly or indirectly by the same interests, or which owns and controls one or more other employing units, and which, if treated as a single unit with such other employing units or interests, or both, would be an employer under paragraph (1) of this subsection." The language used is to be construed in connection with sec. 2g1 of the Act, by

42(1940) 150 Ga. 613, 10 S. E. (2d) 35.
43Ibid., at pages 59-60.
44(1940) 218 Ind. 20, 29 N. E. (2d) 776.
which an employer is further defined as a unit having in its employ eight or more persons.

Shake, Judge, declared,

"The question which we are called upon to answer is therefore reduced to this: Do the owners of a majority of the stock of a corporation have such control thereof as to make their ownership or control the basis of classification for the purpose of imposing excise taxes on such corporations in the manner prescribed by the act under consideration? That a corporation is a legal entity separate and distinct from its stockholders, individually or collectively considered, is not open to debate. It is equally well established that a majority of the stockholders have the right to manage and control the corporation, under certain limitations.

"As has already been observed, the law regards a corporation as a distinct entity. This status is unaffected by the fact that a majority of its stock may or may not be controlled by the same interests."

He concludes,

"Regardless of the shades of meaning that may be attributed to the word ('control'), we are convinced that in the interpretation of the act before us, control of a corporation must be regarded as something more than that remote control that arises out of the fact that a majority of the holders of its voting stock may dictate who its directors shall be."

Before concluding this part of Section III which has attempted to point out that control through mere ownership of stock (in the case of one-man companies) or identity of directors and shareholders (in the case of parent and subsidiary or related companies) is not enough for the courts to disregard the corporate entity concept, several other cases should be noted. Corsican Bank v. Johnson, shows that in many instances even this 'indirect control' is sufficient.


46 See also Majestic Co. v. Orpheum Circuit, (C.C.A. 8th Cir. 1927) 21 F. (2d) 720; Owl Fumigating Corp. v. California Cyanide Co., Inc., (D. Del. 1928) 24 F. (2d) 718, In Re Adolf Jobel, Inc., (C.C.A. 2nd Cir. 1936) 80 F. (2d) 849. But the discussion of these two types of cases together is criticized by Hahn, Justice, in Vennerbeck & Chase Co. v. Juergens Jewelry Co., (1933) 33 R. I. 135, 164 Atl. 509 at page 510. "The decisions rendered in cases dealing with parent and subsidiary corporations, although they are in many ways similar to the instant case (a one-man company case), are to be confined in their application to that class of cases alone, being aimed at the evils in the financial structure of subsidiary corporation."

47 (1919) 251 U. S. 68, 40 S. Ct. 82, 64 L. Ed. 141.
Mr. Justice Pitney said, "Because the Bank and the loan company were distinct legal organizations, operating under separate charters derived from different sources, and possessing independent powers and privileges, we are constrained to hold that, notwithstanding the identity of stock ownership and their close affiliation in management, for some purposes they must be regarded as separate corporations, for instance, as being capable in law of contracting with each other. But in considering the practical effect of such inter-corporate dealings, especially as bearing upon the duties of the common directors and the authority of the stockholders to control them, we need not and ought not to overlook the identity of stock ownership. Thus, the transfer of the notes in February, 1908, from the Bank to the loan company, in consideration of their full face value ostensibly or actually paid by the company to the Bank, evidently could have no effect in relieving the stockholding interest from loss, since each stockholder of one corporation had a corresponding interest in the stock of the other, and any theoretical saving that accrued to him as a stockholder of the Bank was balanced by a corresponding loss sustained in his capacity as a stockholder of the company." 


But in other cases, although control is carried to extreme lengths, the separate entity of the subsidiary may be upheld by the Courts.

In *Interstate Transit Lines v Comm'r of Internal Revenue*\(^{49}\) the petitioner, Interstate Transit Lines, claimed in its income tax return for 1936 a deduction in the amount of $28,100.66 as a loss sustained by its wholly owned subsidiary, Union Pacific Stages of California, and absorbed by the petitioner under a contract. The deduction was refused.

The petitioner is a corporation created under the laws of Nebraska with its principal office at Omaha. For the purpose of augmenting its income by means of additional revenues derived from carrying California intrastate traffic, petitioner organized under the laws of California the wholly-owned subsidiary corporation.

There were two contracts.

The absorption agreement recited that all the capital stock of the subsidiary was owned by the petitioner, that the petitioner operated buses between various points but operated no buses in California, that the subsidiary operated buses in California that the subsidiary was maintained as an operating subsidiary for the sole benefit of the petitioner, and that to secure such benefits it was necessary that the schedules of the two corporations be coordinated. The agreement then provided that the subsidiary agreed to operate buses upon such routes and schedules and under such rules and regulations as may be directed by the petitioner. There was a further stipulation that petitioner would reimburse its subsidiary for any deficits incurred in its operations and that the subsidiary would pay over to the petitioner any profits resulting from its operations, payments to be made at the end of each calendar year.

Under an operating contract it was agreed that as the buses of each party crossed the state line they would pass into the custody of the other party, that as one party took possession of the buses of the other under this arrangement the owner should be designated lessor and the other party lessee, that expense of operations should be apportioned between the parties monthly.

These appear but superficial attempts to cover up what was in effect one and the same business. It was further found that there was no change in the conduct of the business after the par-

\(^{49}\) (C.C.A. 8th Cir. 1942) 130 F (2d) 136.
ties began operating. No additional expense was incurred other
than the cost to the principal of keeping the separate accounts
for the subsidiary. Both corporations had the same officers and
directors. Both contracts were executed for each party by the
same person as president of each company. The subsidiary had its
own accounting records, employees, buses, directors and cor-
porate minute book. Its accounting records were kept at the
offices of the principal by the employees who kept the principal's
records. The principal collected all the revenues of the subsidiary
and paid all of its bills. The subsidiary had no separate bank
account.

On the facts, the control exercised by the parent over its sub-
sidiary was complete. It went beyond mere identity of stock-
holders, directors and other officers. Nonetheless, the Court re-
 fused to disregard the corporate entity of the subsidiary.50

In Cintas v. American Car and Foundry Co.51 we find another
“border” case.

The defendant was organized under the laws of New Jersey.
It acquired or established several subsidiaries which were foreign
corporations as they were not incorporated under the laws of New
Jersey. All the stock of these companies was owned either by the
defendant or one of its other subsidiaries. The officers and direc-
tors of the subsidiaries were officers, directors or employees
of the defendant. In most instances the principal offices of these
companies were at the principal office of the defendant in New
York. The books, records and accounts of the subsidiaries were
kept by the auditing department of the defendant although sepa-
rate records and accounts were maintained by each subsidiary.

For the purpose of paying dividends, defendant kept its books

50The Columbia Law Review had this to say about the case: “At
times, the line of demarkation becomes rather blurred. Some courts will
allow the parent to disaffirm the entity of a subsidiary set up as a pure
formality for honest business convenience, while others reach contrary de-
cisions in hardly distinguishable situations, where the resulting ordinary
hardship is compensated by the business usefulness of the subsidiary.

“The instant case is one of conflicting equities. On one hand, the
requisite strict control was present. The subsidiary was a mere formality
and every transaction between it and petitioner was a purely bookkeeping
operation. On the other hand, the subsidiary was not a mere instru-
mentality of petitioner since it did things petitioner itself could not do, and
its cost was therefore justified by actual business advantage.”


In Armour and Company v. Bailey, (C.C.A. 5th Cir. 1942) 132 F
(2d) 386, the idea that retention of control of the property after it passed
into the hands of the corporation made it merely the “alter ego” of
Bailey was examined by the court and rejected.

51 (1942) 131 N. J. Eq. 419, 25 A. (2d) 418.
on a consolidated basis—that is, it computed dividends on the basis of the net earnings of the entire enterprise, the parent and subsidiaries combined.

Here, too, there was more than identity of stockholders, directors and other officers. It is evident that effective control was maintained by the parent over its subsidiaries and the whole enterprise was run as one business. Nonetheless, the Court held that the parent must be considered a distinct entity for the purpose of determining dividends, and that the earnings of the subsidiaries can inure to the benefit of the parent's preferred stockholders only at the time they are paid to the parent as dividends.

(ii) The above section shows that identity of stockholders, directors and other officers is not enough to make one corporation the "instrumentality, adjunct, agent or alter ego" of another. There must be other evidence of effective control. Just what constitutes that control is a difficult question and does not appear to have been defined by either judge or jury.

Sometimes that control is dependent on the purpose of the incorporator. If the court is reasonably satisfied that he had no intention to make the corporation his agent or instrumentality, then the corporate entity will be preserved. But any test which depends on mental elements becomes vague and uncertain.

In Chicago, Milwaukee and St. Paul R'y Co. v Minneapolis Civic and Commerce Assn., two railroad companies, between them owning all the stock and controlling completely the property and operations of a third company, which had legal title to terminal tracks, caused separate switching charges to be made in its name on traffic moved by them over those tracks, although for substantially the same service over terminals which each owned separately neither made any charge in addition to its line-haul rates. A state commission, finding that the practice discriminated against shippers on the third company's tracks, ordered that the separate charges be discontinued and that the tracks be operated as a part of the terminal properties of the other companies, in intrastate traffic. The United States Supreme Court held, inter alia, that upon examination of the findings and evidence, the commis-

52The case is noted in (1943) 56 Harvard Law Review 133. Its terse comment was, "the court's concern solely with the conceptualistic notion of whether to pierce the corporate entity seems highly artificial." This writer shares the view that the case is unsatisfactory. See also Mills v. Comm'r of Internal Revenue. (C.C.A. 1st Cir. 1943) 132 F. (2d) 753.
THE CORPORATE ENTITY CONCEPT

sion and the courts below were justified in holding the third company a mere agency or instrumentality of the other two.

Mr. Justice Clarke delivered the opinion of the Court.

"With the facts thus summarized, it is difficult to conceive of a plan for the control of a jointly owned company and for the operation of a jointly owned track more complete than this one is and it is sheer sophistry to argue that, because it is technically a separate legal entity, the Eastern Company is an independent public carrier, free in the conduct of its business from the control of the two companies which own it and therefore free to impose separate carrying charges upon the public. Much emphasis is laid upon statements made in various decisions of this court that ownership, alone, of capital stock in one corporation by another, does not create an identity of corporate interest between the two companies, or render the stockholding company the owner of the property of the other, or create the relation of principal and agent or representative between the two.

"While the statements of the law thus relied upon are satisfactory in the connection in which they were used, they have been plainly and repeatedly held not applicable where stock ownership has been resorted to, not for the purpose of participating in the affairs of a corporation in the normal and usual manner, but for the purpose, as in this case, of controlling a subsidiary company so that it may be used as a mere agency or instrumentality of the owning company or companies. In such a 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 substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require."54

Similarly, in United States v. Reading Company,55 the Court syllabus read in part,

"While the ownership by a railroad company of shares of the capital stock of a mining company does not necessarily create an identity of corporate interest between the two such as to render it unlawful under the commodities clause for the railroad company to transport in interstate commerce the products of such mining company, yet where such ownership of stock is resorted to, not for the purpose of participating in the affairs of the corporation in which it is held in a manner normal and usual with stockholders, but for the purpose of making it a mere agent, or instrumentality or department of another company, the courts

54Ibid., at pages 498-501.
55(1920) 253 U. S. 26, 40 S. Ct. 425, 64 L. Ed. 760.
will look through the forms to the relation between the companies as if the corporate entity did not exist and will deal with them as the justice of the case may require.

"Applying this rule, held, that the relation between the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, with the former owning eleven-twelfths of the capital stock of the latter and using the latter as the coal mining department of its organization, violates the commodities clause, and for that reason must be dissolved." 

In *Detroit Motor Appliance Co. v General Motors Corporation*, the Court found that the purpose of defendant corporation in forming subsidiaries was to make them its agents. Hence that corporation itself was in contempt of decree enjoining infringement of patents committed by them. The corporate entity was disregarded because control here was "direct."

Lindley, District Judge, declared

"This decision is in line with the general rule in such cases to the effect that where stock ownership control of a subsidiary corporation is resorted to, not for the purpose of participating in the affairs of the corporation in the normal and usual manner of a stockholder, but for the purpose of so controlling a subsidiary company that it becomes a mere agency of the owning company, the latter may not escape liability for the acts of the subsidiary.

"The control of General Motors Company over such subsidiaries is shown by the instructions of the parent company to the subsidiaries with regard to this case. After the contempt proceedings were instituted General Motors sent to its subsidiaries written directions that they 'must not offer for sale or sell either used cars or new cars of the above mentioned models.' Such is plain assumption of authority over the subsidiaries. It is not a request, but a demand." 

(iii) As has been pointed out, the purpose of a corporator is difficult to determine this test for disregarding the corporate entity is therefore a vague one. Courts in recent years have at-
tempted to make it more definite and concise. Where there is a failure to maintain a separate corporate organization, or to follow the ordinary routine of corporate procedure, then the courts will infer such intimate control as is required for identifying the corporation with its sole shareholder or its parent corporation. Such a test has the advantage of clarity, but to rely on the mere formalities of corporate machinery seems grossly inadequate as a basis of observing the entity theory.\footnote{Especially is this true in the case of one-man companies. See Fuller, The Incorporated Individual—A Study of the One-Man Company, (1938) 51 Harv. L. R. 1373-1405.}

A clear statement of the trend of authority is given in Fletcher's work on Corporations. "Section 42—Corporate agencies or affiliates of other corporations."

"Courts have pointed out that what is called the metaphor of agency tends to confuse thought, unless regard is given to the actual submergence of independent management of the subsidiary by its own directors by a direct management by the principal corporation, and the test of this is said to be rather in the form in which it is exercised than in the substance of control by stockholding. There may have been no actual consensual agency, but if there was actual dominance and direction by which the act was the act of the parent corporation it is responsible."

"Whether one is a mere agency or instrumentality or they are identical, is a question of fact to be proved by competent evidence. This question of fact depends on many circumstances overcoming or failing to overcome the indicia of separate entities, sameness of members, officers and objects, and the absence of distinct interests, being indicia of agency or identity, while differences in officers, objects or conduct are indicia of separate recognizable entities.\footnote{Fletcher's Corporations, Permanent Edition, Volume 1, Section 43, pages 154, 158. Passages cited with approval of Hamilton, Justice, in Wade and Wade v. Central Broadcasting Co., (1939) 227 Iowa 427, 288 N. W. 441 at page 443.}"

These conclusions are supported by the following cases.

In Commerce Trust Co. v. Woodbury,\footnote{(C.C.A. 8th Cir. 1935) 77 F (2d) 478.} Farris, Circuit Judge, said.

"Few questions of law are better settled than that a corporation is ordinarily a wholly separate entity from its stockholders, whether they be one or more. Likewise, we think it must be conceded that neither ownership of all of the stock of one corporation by another, nor the identity of officers in one with officers in another, creates a merger
of the two corporations into a single entity, or makes one either the principal or agent of the other.

"But, notwithstanding this, we are constrained by the uncontradicted facts to the conclusion that the sales company was, as it was controlled, and as it functioned, merely an agency or department of the lumber company. All of its assets were furnished, and all of its stock owned by the lumber company, its officers, directors, and its main office were the same as those of the lumber company, and its employees had, for the most part, formerly been employees of the lumber company. But the strongest undisputed facts constraining us to this conclusion are that the president of the lumber company had the power to vote all of the stock of the sales company, and aside from this power which was not of itself unusual, had the power to remove any officer or director of the sales company without cause or notice, and to dominate and control performance of its contracts. Moreover, the sales company did nothing not theretofore done by the lumber company which in forming it only split its business into a manufacturing department which it retained, and a sales department which it transferred to the sales company, but over which it retained thoroughgoing, ultimate control."

In Cannon Manufacturing Co. v Cudahy Packing Company,\textsuperscript{64} the machinery for independent corporation activity was maintained. External appearances convinced the Court of the existence of a separate corporate entity.

The defendant, a Maine corporation, marketed its products in North Carolina through a subsidiary, an Alabama corporation, which it completely dominated through stock ownership and otherwise. The Supreme Court held that the concentration of the Alabama corporation's stock in the defendant's single ownership and the legal consequences of this under the Alabama law did not have the effect of rendering its business in North Carolina the business of the defendant for purposes of jurisdiction.

Mr Justice Brandeis, delivering the judgment of the Court, said,

"The Alabama corporation, which has an office in North Carolina, is the instrumentality employed to market Cudahy products within the state, but it does not do so as defendant's agent. It buys from the defendant and sells to dealers. In fulfillment of such contracts to sell, goods packed by the defendant in Iowa are shipped direct to

\textsuperscript{63}Ibid., at page 487
\textsuperscript{64}(1925) 267 U. S. 333, 45 S. Ct. 250, 69 L. Ed. 634.
dealers, and from them the Alabama corporation collects the purchase price. Through ownership of the entire capital stock and otherwise, the defendant dominates the Alabama corporation, immediately and completely, and exerts its control both commercially and financially in substantially the same way, and mainly through the same individuals, as it does over those selling branches or departments of its business not separately incorporated which are established to market the Cudahy products in other states. The existence of the Alabama company as a distinct corporate entity is, however, in all respects observed. Its books are kept separate. All transactions between the two corporations are represented by appropriate entries in their respective books in the same way as if the two were wholly independent corporations. This corporate separation from the general Cudahy business was doubtless adopted solely to secure to the defendant some advantage under the local laws. The question is simply whether the corporate separation carefully maintained must be ignored in determining the existence of jurisdiction. In the case at bar, the identity of interest may have been more complete and the exercise of control over the subsidiary more intimate than in the three cases cited, but that fact has, in the absence of an applicable statute, no legal significance. The corporate separation, though perhaps merely formal, was real. It was not pure fiction.

In American Package Corporation v. Com'r of Internal Revenue, taxpayer was incorporated pursuant to a reorganization which was effected by an agreement that taxpayer should issue its stock for stock of four corporations which became taxpayer's subsidiaries. Held, dividends which subsidiaries declared and paid to taxpayer in tax year were in fact and in law "dividends" rather than "income" received by the taxpayer.

Soper, Circuit Judge, drew some fine lines in deciding that here there was a sufficiently separate corporate organization. The criteria seem highly artificial.

"More particularly it is pointed out with respect to each subsidiary corporation that the parent corporation designates the officers and employees, discharges and fixes the salaries of all employees except common laborers, that it


67(C.C.A. 4th Cir. 1942) 125 F. (2d) 413.
arranges all financing for the business as a whole, allocating the money among the subsidiaries as it deems proper, that it buys all the raw materials, distributes them amongst the subsidiaries and directs the kind of product to be manufactured and the improvements and repairs to be made by each, that it controls the accounting and consolidates the accounts of all the subsidiaries into one general accounting system. In practical effect, the parent corporation is the controlling head and the subsidiaries are the departments or branches of a single business.

"On the other hand, it should be noted that each subsidiary has title to its own assets and operates its own plant subject to the parental control."

In some cases, even when all the formalities of a separate corporate organization are observed the Courts will disregard the corporate entity. To show this anomaly, the following cases are in point.

In *The Willem Van Driel, Sr.* a railroad company owned all the stock of an elevator company, except a few shares necessary to qualify the latter's officers, and leased the elevator to another railroad company (Penn. Ry. Co.) for 999 years, the latter assuming liability for damages. Separate corporate organizations were maintained. The lessee was held liable for the loss to vessels by fire communicated on account of negligence in the operation of the elevator.

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68 Page 415.

The instant case is compared with *U. S. v. Brager Building and Land Corporation*, (C.C.A. 4th Cir. 1941) 124 F. (2d) 349, where the corporate separateness of a subsidiary was ignored since it existed merely to hold title to real estate and had no other function or activity. Cf. note 36, also *Inland Development Co. v. Comm'r*, discussed supra, where the corporate entity was ignored. At page 989 the Court said, "This taxpayer owned all of the stock of the several subsidiaries. Each subsidiary owned no assets whatever except the one lease transferred to it in the manner indicated. The subsidiary in each instance executed the contract under which the well was drilled, but the taxpayer paid all the costs and expenses of drilling and operation, and it received directly all of the income arising from the sale of royalty oil. The subsidiaries had no employees, the work on the leasehold estates being done by employees of the taxpayer, no offices, no books, except those kept by employees of the taxpayer in its offices, and no bank account. They did not buy, acquire, manage, control, sell, receive, or pay out anything. The taxpayer did all that, without voice on the part of the subsidiaries." Cf. also *Interstate Transit Lines v. Comm'r* of Internal Revenue, discussed supra, where separate accounting records, though kept at the offices of the principal by the same employees who kept the principal's records, appeared to have been an important factor in the court's opinion for retaining the corporate entity concept.


69 (C.C.A. 4th Cir. 1918) 252 Fed. 35.
Woods, Circuit Judge, said, "The inquiry remains whether the Pennsylvania Railroad is liable as a participant in the operation of the elevators by reason of its control of the elevator company. This depends upon the question of fact whether the elevator company, although in name and organization a distinct corporation, was in substance a mere corporate agent or instrumentality of the Pennsylvania Railroad Company.

"It is true that the elevator company and its stockholders and directors held meetings, but in all essential particulars their action was dictated and controlled by the railroad company. It would be impossible to imagine a relationship between corporations where the subsidiary corporation was more completely under the control of the dominant corporation. The elevators were constructed and operated merely as a facility to the business of the railroad company. Applying the language of Judge Wallace in Lehigh Valley Railroad Co. v. Dupont, the potential and ultimate control of all its property and business affairs of the elevator company was lodged in the railroad company, and this control was exercised as completely and as directly as the machinery of corporate organisms would permit. Such complete dominance and control by the railroad company made the elevator company its mere puppet.

Insufficiency of assets is sometimes given as the reason for disregarding the corporate entity, though the machinery for corporate activity is maintained.

In Dixie Mining and Manufacturing Company v. Williams, an action was brought against the sole shareholder to recover for the negligent death of plaintiff's decedent. The company for which the decedent was working at the time of his death was bankrupt and admitted liability. This company was one of several which the defendant owned and which he had formed to carry on different phases of his business. The assets with which the company employing the decedent commenced business apparently were relatively insignificant, although there was no suggestion that the statutory requirement for the payment into the company of $1,000 in capital had not been complied with. Personal liability was imposed upon the sole shareholder upon the ground that his company was a mere simulacrum formed for the dual purpose of avoiding personal liability and of reserving to his own use and benefit the profits which might arise from the business.

Ibid., at page 38.
L(1930) 221 Ala. 331, 128 So. 799. This case is discussed in Professor Fuller's article on one-man companies, (1938) 51 Harv. L. R. 1373-1405.
In *Mosher v Salt River Valley Water Users' Assn.*, a sole shareholder was held personally responsible for corporate obligations, the fact being stressed that the corporation was without assets.

The requirements of assets goes to the very heart of the problem and represents an attempt to enforce the policy of the law. This idea appears to be recognized in the Federal Banking Act of 1933. It provides that stock in banks belonging to the Federal Reserve System may be owned by holding companies but requires that the holding companies invest in marketable assets, if the stockholders of the holding company are not to be subject to assessments made upon the stock, marketable assets up to 25% of the aggregate par value of the bank stock must be acquired if the stockholders are to be subject to assessment, a lesser amount of reserve is required.

In *Centmont Corporation v Marsch*, and *Brusselback v Cago Corporation*, the stockholders took special care that the corporate activities were conducted through the proper corporate channels. Nevertheless, the court overlooked these formalities and disregarded the corporate entity.

We can conclude by saying that this third test—the corporate entity will be disregarded when it is but “instrumentality, adjunct, agent or alter ego” of an individual or another corporation—is also vague and uncertain.

IV

Another test often resorted to by the Courts is based upon general principles of equity applied in its widest sense. The corporate entity will be disregarded when not to do so would produce an inequitable result. This test furnishes a convenient excuse for judges to disregard theory and look at facts in deciding cases. Again, it tends to make the law uncertain in its application.

In *Grotheer v Meyer Rosenberg*, an attempt to evade a legal obligation failed. The defendant in the case organized a corporation a few days prior to the commencement of a creditors' action against him. The Court held the corporation liable for his debts.

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72 (1932) 39 Ariz. 567 8 P (2d) 1077.
74 (C.C.A. 1st Cir. 1933) 68 F (2d) 460.
76 (1936) 11 Cal. (2d) 268, 53 P (2d) 996.
Knight, Justice, declared.

"The separateness of the person and the corporation would of course be recognized if no inequitable results would follow. But, where, as here, an inequitable result would follow, the two should be considered as one." 177

An early case where the corporate entity was disregarded to avoid an inequitable result is *Bank of United States v. Deveaux.* 18 Although a corporation itself is not a citizen, yet when it is composed of citizens of one State, it may sue a citizen of another State in the circuit court of the United States.

Marshall, C. J., said,

"That corporations composed of citizens are considered by the legislature as citizens, under certain circumstances, is to be strongly inferred from the registering act. It never could be intended that an American registered vessel, abandoned to an insurance company composed of citizens should lose her character as an American vessel, and yet this would be the consequence of declaring that the members of the corporation were, to every intent and purpose, out of view, and merged in the corporation."

Sometimes after a testator has organized a corporation and has transferred property to it, he would forget the transfer and give such property away in his will as if it was still his own. The Courts will often disregard the corporate entity to effectuate the intention of such person when no adverse interests are affected. The result is an equitable one.

*In re Turley's Estate,* 80 T purchased the home where his widow now resided and title was taken in the name of a newly organized company called the "Judicial Realty Company, Inc." Since that time T, the wife, and the children have resided there. T executed a contract to purchase the property in his own name, but had the title taken in the name of the Realty Company which was organized on May 27, 1922. On June 6, 1922, a resolution of the Board of Directors was adopted authorizing the purchase of the decedent's (T's) interest in the same contract. All the money which went into the purchase of this home was furnished by decedent. After T's death, it was learned that no certificates of stock had been issued to anyone. The stock certificates were never taken out of

18(1809) 5 Cranch (U.S.) 61, 3 L. Ed. 38.
179(1809) 5 Cranch (U.S.) 61, at page 90, 3 L. Ed. 38.
80(1936) 160 Misc. 190, 289 N. Y. S. 704.
the stock certificate book. The infant, appearing by special guardian, brought a petition to show cause why the stock of the Judicial Realty Company, Inc., should not be transferred to the widow Slater, Surrogate, said,

"On legal principle the title is in the corporation as a legal entity and artificial personality. The courts, however have pierced the veil of corporate entity to sustain a gift and, if need be, to impress a trust upon the real property standing in the name of the corporation. There are no intervening interests. Here the decedent was the equitable owner of the property. He supplied the consideration for its purchase. In order to effectuate the intention of a person, the doctrine of corporate entity may be disregarded. The testimony reveals that the corporation was used as a mere dummy or name for James A. Turley. The corporate entity will be charged with the knowledge which its real owner possessed pertaining to the matter of the decedent's treatment of the title." 81

The same result was reached in Matter of Busch. 82 Testator was the sole owner of the shares of a corporation which he had formed as a convenience in carrying on his financial operations. He bequeathed shares of another company owned by his company to a designated beneficiary. It was contended that the gift failed as the shares were the property of the corporation and not of the testator. After the testator's death the corporation was dissolved. The bequest was sustained.

But in two other cases the intention of the testator was not enough to disregard the corporate entity.

In Fidelity Union Trust Co. v Vander Roest 83 the syllabus of the Court reads as follows:

"Testator gave his estate to a trustee to pay the income to his son for ten years, then the principal, over if the son dies within ten years. By codicil he devised to the son certain real property title to which was in a corporation of which the testator owned all the capital stock. Held, a, the corporate fiction may not be disregarded and the legal title does not pass by the codicil, b, the trustee will effectuate the testator's intention by causing the corporation to convey the property."

Backes, Vice Chancellor, said,

"Nor can the devise be given effect upon the theory..." 84

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81 Ibid., at pages 706-707.
82 (1925) 124 Misc. 674, 209 N. Y. S. 776.
83 (1933) 113 N. J. Eq. 368, 166 Atl. 918.
advanced by the devisee that the equitable title was in the testator by virtue of possessing all the capital stock of the company. Absolute ownership is in the corporation, for the ultimate beneficial use of stockholders, in a sense as trustee for them, but stockholders have neither legal nor equitable estate in the property of the corporation. The corporation alone can convey. Neither a majority nor all the stockholders can divest it of title. They may accomplish but themselves cannot do it. The corporation is their instrument, they the instrumentalities by which it functions extra-ordinarily, and through their appointees, the board of directors, ordinarily.

In Crane v. Horton, testator under will gave his son undertaking business and bank deposit and directed executors to divide proceeds of real estate among his wife, son, and daughter. The residue, including bills receivable, was also given to them. The testator had organized a corporation which owned the undertaking business, bank deposits, bills receivable, and some real estate. The Court held that the property must be equally divided among residuary legatees.

Rugg, Chief Justice, declared,

"The testator was president and treasurer of the corporation until his death and he conducted its business of undertaking much as he would conduct his own business, without directors' meetings or much other strictly corporate activity. But the business was conducted in the corporate name. Purchases and bills were made in the corporate name. The stationery and bill heads were in the corporate name or in the name of H. R. Crane & Company. The bank account was in the name of H. R. Crane & Company. Certificates of condition were filed with the Commissioner of Corporations from 1926 to 1931, inclusive. These certificates recited the holding of stockholders' meetings in each year from 1926 to 1930.

"The corporation is not a party to these proceedings. It has not been and could not well be argued that this is a case where the corporate entity can be disregarded and the testator treated as the sole owner of all its property."

This was a particularly hard decision. The intention of the testator should have been carried out by disregarding the corporate entity for equitable reasons and for the reason that formalities of corporate existence were only loosely adhered to.

84Ibid., at page 920.
86Ibid., at page 392.
Again in *Gallagher v. Germania Brewing Company*, although disregarding the corporate entity would have brought an equitable result, the Court refused to do so.

Plaintiff, as assignee of Westphal under general assignment for benefit of creditors, brought the action to recover for goods sold and delivered by his assignor to the defendant corporation. B and V H intervened, and set up in their complaint that they owned, and for nearly two years had owned, (each half), all the capital stock of the defendant, no other person but themselves having any interest in the stock or property of the corporation, that each of them had a valid and unsatisfied judgment against Westphal upon a cause of action which accrued before the assignment to the plaintiff that Westphal was, and for over two years had been, utterly insolvent. The relief sought was that their claims against Westphal might be allowed, in equal amounts, as equitable set-offs to the claim of the plaintiff against the defendant corporation. This was not granted.

Mitchell, Justice. though admitting that to disregard the corporate entity here would bring about a more equitable result, nevertheless decided against doing so.

"The facts of the present case appeal to a natural sense of justice, for while, by fiction of law a corporation is a distinct entity, yet in reality it is an association of persons who are in fact the beneficial owners of all the corporate property. Hence, if interveners cannot set off their claims, the practical result is that Westphal's estate will collect its entire claim out of what is really their property while the estate is at the same time indebted to them on claims of greater amount, which they will wholly lose because of Westphal's insolvency. But, as has been often said, hard cases are liable to make bad law. If the rights or liabilities of a corporation could be affected by the acts of the stockholders, except when acting in the corporate name, or if shareholders could set up their several equities against persons having claims against the corporations, or, conversely, if claims in favor of the corporation could be set off against claims against individual stockholders, it can easily be seen into what confusion and chaos corporate affairs would inevitably fall. Inasmuch as the two interveners own all the stock of this corporation, the facts of this case seem comparatively free from embarrassments, and the contention of respondent quite plausible. But, suppose there were fifty other stockholders, (which would not alter the principle), what would be the result? Could interveners then

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87 (1893) 53 Minn. 214, 54 N. W. 1115.
interpose their claims as set-offs, and, if so, could they do so to the full amount of their claims, or only in the proportion which their shares bore to the whole capital stock? And, if the former, would they have a claim for the excess against the corporation, or a right to call on the other stockholders for contribution? These are good reasons. They could very well apply to those cases where the entity is disregarded.

It is not always true that the observance of corporate entity will bring about an inequitable result, even when the intention of the corporators was to provide a means of insulation. On the contrary, in most instances such observance works an injustice to no one.

In *Donnell v. Herring-Hall-Marvin Safe Co.*, the Supreme Court held that a stockholder, even though he was also an officer of a corporation bearing his family name, does not necessarily lose his right to carry on this business of manufacturing the same commodity under his own name because that corporation sold its good will, trade name, etc., and as a stockholder and officer he participated in the sale.

Mr. Justice Holmes delivered judgment.

"Philosophy may have gained by the attempts in recent years to look through the fiction to the fact and to generalize corporations, partnerships and other groups into a single conception. But to generalize is to omit, and in this instance to omit one characteristic of the complete corporation, as called into being under modern statutes, that is most important in business and law. A leading purpose of such statutes and of those who act under them is to interpose a non-conductor, through which in matters of contract it is impossible to see the men behind. However it might be with a partnership, when this corporation sold its rights everybody had notice and knew in fact that it was not selling the rights personal to its members, even if, as always, they really received the consideration, or, as usual, they all assented to its act. That it contracted for such assent, if it did, by its undertaking to dissolve, does not make the con-
tract theirs. But the case does not stop there. The purchasing company had the possibility of competition from the Halls before its mind and gave the measure of its expectations and demands by the personal contracts that it required. Those contracts were limited in time and scope and have been discharged.

The italics are added to show how important was the fact that no one had been misled by the fiction of corporate entity. There was no inequitable result.

Similarly in Gillis v Jenkins Petroleum Process Co., a corporation which organized a subsidiary which obtained licenses for use of patents, and guaranteed payment for use, was held not to be a "licensee" by virtue of the close relationship between it and the subsidiary so as to impose liability upon the corporation's receiver who purchased the subsidiary's assets. Licensor was not damaged by alleged belief that the subsidiary was instrumentality of the corporation, and the close relationship was not enough to make the subsidiary a mere agency.

Denman, Circuit Judge, said

"We think it well settled law that the organization of one company by another, or the ownership of all the stock of one company by another, or common officers and directors, or all of these elements combined, are not sufficient to defeat separate corporate entity.

"There are, of course, situations calling for disregard of the corporate entity. Some of them are instances where too close a relationship between two or more corporations offends a statute or circumvents public policy. No such question is involved here. Apart from the public aspect of the problem, corporate entity will be disregarded when necessary to prevent fraud upon a private party or when one company is, in fact, nothing but an agent of another. Neither such situation obtains here. There is no assertion that Jenkins was in the slightest measure misled into thinking that the relationship between Western and Petrolgas was other than it was, and not the slightest evidence that Jenkins was in any way damaged even if it had been so misled."

It is not improper to consider here two cases on organization proceedings under Section 77B of the Bankruptcy Act. In both

90Ibid., at pages 273 to 274.

The italics are added to show how important was the fact that no one had been misled by the fiction of corporate entity. There was no inequitable result.

91(C.C.A. 9th Cir. 1936) 84 F (2d) 74.

92Ibid., at pages 79-80.
the corporate entity was disregarded to bring about a more equitable result.

In *Taylor v. Standard Gas & Electric Company*, a parent corporation with complete control of a subsidiary grossly mismanaged its affairs through many years, and, according to the accounts between them, became its creditor in an enormous sum. The preferred stockholders of the subsidiary had no voice in its management because the charter demed them voting power so long as dividends were paid them, and because the dominant corporation caused the subsidiary, notwithstanding its precarious condition, to pay such dividends when due.

In a reorganization proceeding under Section 77B of the Bankruptcy Act, the Court approved a compromise of the parent company's claim, and on that basis approved a plan of reorganization involving formation of a new successor corporation, discharge of other obligations, and satisfaction of the compromised claim by awarding to the parent company a large majority of the new company's common stock, thus continuing its complete control, but allowing only a minority of such stock to the old preferred stockholders.

Mr. Justice Roberts, in delivering judgment for the Supreme Court, looked behind the curtain of corporate entity to allow an equitable solution. The parent cannot be allowed to control the subsidiary to such an extent as before. If a reorganization is effected, the amount at which the parent company's claim is allowed is not important if it is to be represented by stock in the new company, provided the stock to be awarded it is subordinate to that awarded preferred stockholders of the bankrupt.

In *First National Bank of Herkiner v. Poland Union*, the Court looked at realities throughout to effect an equitable result. Debtor was a cooperative country store organized as a partnership but operating as a company with shares of stock, officers and directors. No certificate for business organization of any kind had been filed. A bankruptcy petition under Section 77B and its successor, Chapter X, which did not extend to the reorganization of individuals and general partnerships, was allowed on the grounds that the debtor was more of a joint stock company than a partnership. For purposes of discharge, however,

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94 See pages 315-324 of the case.
95 See pages 315-324 of the case.
97 52 Stat. 883 et seq. 11 U. S. C., Secs. 509-676. (Supp. 1938)
individual members were not freed from liability for the debts of the company.\footnote{In joint stock companies, members are generally subject to unlimited individual liability. This case is discussed in Note, (1940) 49 Yale L. J. 1331-1335.}

This concludes our examination of cases where corporate entity was disregarded to effect an equitable result. We can say that this test, like the others, is a vague and a much too uncertain one to be satisfactory.\footnote{For other cases, see further, United States v. Milwaukee Refrigerator Transit Co., (E.D. Wis. 1905) 142 Fed. 247, Gallagher v. Germania Brewing Co., (1893) 53 Minn. 214, 54 N. W. 1115, Minifie v. Rowley, (1922) 187 Cal. 481, 202 Pac. 673, Wenban Estate v. Hewlett, (1924) 193 Cal. 675, 227 Pac. 723.}

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We have now completed our examination of cases falling under our general classes where the corporate entity is disregarded. It must be understood, however, that not all Courts accept even this wide classification, which classification is wholly arbitrary, being devised by the writer only to indicate the trend of the decisions, and to show the lack of agreement among the judges as to when the corporate entity will be disregarded.