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CORPORATIONS—DE FACTO EXISTENCE—NECESSITY OF GOOD FAITH ATTEMPT TO INCORPORATE UNDER AND OF COLORABLE COMPLIANCE WITH INCORPORATION STATUTE—Defendant, a purported holding corporation, was organized in 1922 before the enactment of a state statute authorizing such corporations. The articles of incorporation stated that the purpose of the corporation was “to acquire, own and hold” shares of stock in a realty company. There was actual user of corporate power by the defendant under this attempted incorporation until the time of this suit in 1954. The legislature in 1941 amended the incorporation statute to authorize incorporation of a holding company, but no action was taken by the defendant pursuant to this amended statute. In an action for a declaratory judgment, the minority stockholders of

the realty company challenged the corporate existence of the defendant. The district court sustained a demurrer to the petition. On appeal, *held*, the defendant became a de facto corporation at the time of amendment of the incorporation statute in 1941 and its corporate existence was not now subject to collateral attack. Reversed on other grounds. *Baum v. Baum Holding Co.*, (Neb. 1954) 62 N.W. (2d) 864.

In a typical incorporation law, the legislature sets forth certain conditions precedent to acquiring the privileges of corporate existence. That a de facto corporation is recognized at all by the courts where these conditions have not been substantially met must be attributed to judicial legislation.¹ When, as in the present case, the doctrine of de facto corporations is used to bridge a legal gap in favor of the party who has usurped corporate privileges, the courts should naturally be hesitant.² In general it is held that four requirements must have been met to establish the existence of a de facto corporation. There must have been: (a) a statute authorizing incorporation, (b) a good faith attempt to incorporate under this statute, (c) colorable compliance with the mandatory provisions of the statute, and (d) some user of corporate powers pursuant to the attempted incorporation.³ The doctrine of de facto corporations, as distinct from corporations by estoppel,⁴ is founded upon two main considerations of public policy: (1) the merits of the controversy will seldom be affected by the corporate existence of a party to the suit where the four requirements above have been met, and (2) if any rights and franchises have been usurped they are rights and franchises of the state, and the state alone can object.⁵ For these reasons no collateral attack on the corporate existence of a de facto corporation is allowed.⁶ The present decision raises the question—has the Nebraska court done away with requirements (b) and (c) above, so that statutory authority plus user of corporate powers are now sufficient to

¹For a discussion of this judicial function, see Warren, "Collateral Attacks on Incorporation," 20 HARV. L. REV. 456 (1907); Carpenter, "De Facto Corporations," 25 HARV. L. REV. 623 (1912).

²Due to this element of "fairness" in the decisions, the same defect or omission in the process of incorporation may or may not result in de facto status under different fact situations. Cases on this subject are collected in 84 UNIV. PA. L. REV. 514 (1936).

³Since a good faith attempt to incorporate will in most cases include a colorable compliance with the incorporation statute, requirement (c) is often omitted. *Paper Products Co. v. Doggrell*, (Tenn. 1953) 261 S.W. (2d) 127; *Pearson Drainage District v. Erhardt*, (Mo. App. 1947) 201 S.W. (2d) 484; *Municipal Bond & Mortgage Corp. v. Bishop's Harbor Drainage District*, 133 Fla. 430, 182 S. 794 (1938); annotation, "What Constitutes a Corporation De Facto," 118 Am. St. Rep. 253 (1907); BALLANTINE, CORPORATIONS 77 (1946).

⁴The doctrine of corporations by estoppel is beyond the scope of this note. Cases on this subject are collected in BALLANTINE, CORPORATIONS 88-96 (1946).

⁵Inherent in the first consideration is a recognition of the need for business stability in the fields of activity where corporations are widely used. *Industrial Building & Loan Assn. v. Williams*, 131 Okla. 167, 268 P. 228 (1928); *Duggan v. The Colorado Mortgage & Investment Co.*, 11 Colo. 113, 17 P. 105 (1887).

⁶*Bushnell v. Consolidated Ice Machine Co.*, 138 Ill. 67, 27 N.E. 596 (1891); *Colonia Investment Co. v. Cherrydale Cement Block Co.*, 194 Va. 454, 73 S.E. (2d) 419 (1952).

establish *de facto* existence?⁷ Where this question has arisen in the past, a clear majority of the courts have held that *de facto* status cannot be achieved without any attempt to comply with the statute authorizing incorporation.⁸ The attempted incorporation in the present case was completed nineteen years prior to enactment of statutory authority.⁹ Initially, the concept of a "good faith attempt" to incorporate under a non-existent statute is difficult to accept. It is equally difficult to find "colorable compliance" with a non-existent statute. On the other hand, the fact that the incorporators did comply in 1922 with an existing statute (which did not authorize holding corporations) indicates that the Nebraska court has not done away with the requirement of attempted incorporation.¹⁰ The court has rather modified the requirement so as to allow the attempt prior to any statute which actually authorizes incorporation. An appraisal of the case then involves the advisability of such a modification of traditional legal rules. In the light of the two policy considerations underlying the *de facto* doctrine given above, the facts of the principal case indicate that application of that doctrine was proper. The defendant's corporate existence had nothing to do with the merits of the dispute,¹¹ and rights and franchises of the state alone had been usurped. Under such circumstances the Nebraska court was justified in modifying the general requirements to conform to the peculiar facts of the case. As to cases which may arise in the future, since the possible combinations of errors and omissions in the process of incorporation are limitless, it is impossible to predict (except in

⁷ In the principal case the court does state that there has been "colorable compliance" with the statutes since 1941. This, however, refers to business activity carried on since that time rather than to the process of incorporation under the statute.

⁸ Note 3 *supra*. In *Finnegan v. Noerenberg*, 52 Minn. 239, 53 N.W. 1150 (1893), the court said at 243, "To give a body of men assuming to act as a corporation, where there has been no attempt to comply with the provisions of any law authorizing them to become such, the *status* of a *de facto* corporation might open the door to frauds upon the public. It would certainly be impolitic to permit a number of men to have the *status* of a corporation to any extent merely because there is a law under which they might have become incorporated, and they have agreed among themselves to act, and they have acted, as a corporation." See also *In re Johnson-Hart Co.*, (D.C. Minn. 1929) 34 F. (2d) 183.

⁹ Nev. Rev. Stat. (1943) §21-1,141 provides, "Any corporation operating or organized under this act may guarantee, purchase, hold, sell, assign, transfer, mortgage, pledge, or otherwise dispose of, the shares of the capital stock of, or any bonds, securities or evidence of indebtedness created by any other corporation or corporations of this state or any other state, country, nation or government, and while owner of said stock may exercise all the rights, powers, and privileges of ownership including the right to vote thereon."

¹⁰ It is interesting to note that the court in the principal case cites with approval *Parks v. James J. Parks Co.*, 128 Neb. 600, 259 N.W. 509 (1935), where the court states at 603, "It is essential to the existence of a *de facto* corporation that there be (1) the existence of a charter or some law under which a corporation with the powers assumed might lawfully be created; (2) a *bona fide* attempt to organize a corporation under such law; (3) a colorable compliance with the requirements of such law; and (4) an actual user of corporate power." That all four requirements are not "essential" in Nebraska any more is now obvious. See also *Hansen v. Village of Ralston*, 147 Neb. 251, 22 N.W. (2d) 719 (1946).

¹¹ This was primarily due to the fact that the plaintiffs had been "dealing on a corporate basis" with the defendant since 1922. See 84 UNIV. PA. L. REV. 514 (1936).

extreme cases) what facts will preclude de facto corporate status.¹² For this reason the principal case is instructive mainly as an illustration of the flexibility of the de facto corporation concept as it is applied today.

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¹²In Frey, "Legal Analysis and the 'De Facto' Doctrine," 100 *UNIV. PA. L. REV.* 1153 (1952), the author collects and analyzes all the reported American cases in which a "corporate creditor" has sought to obtain a personal judgment against one or more associates because of non-compliance with a general incorporation act. The author omits, however, those decisions which were governed by statutory provisions.