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Elvin R. Latty
University of Missouri

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THE CORPORATE ENTITY AS A SOLVENT OF LEGAL PROBLEMS*

Elvin R. Latty†

IF A LAYMAN were to ask a lawyer what is the reason that a stockholder is ordinarily not liable for his corporation's debts or that a deed to corporate property by the sole stockholder in his own name is not a flawless conveyance, the answer the layman would get would be: a corporation is a wholly different person from its stockholders—it is an entity separate and distinct from them. That answer reveals the traditional approach to scores of problems in corporation law, an approach which, it is submitted, can lead the incautious into considerable trouble.

TRADITIONAL TECHNIQUE

The seat of the trouble has been and is that this approach has concerned itself, and still concerns itself, too blindly with the concept of corporate entity or, what is roughly the same thing, corporate personality. Case after case shows a remarkably uniform technique—a perennial struggle with the question whether the nature of the corporate entity is such that it can or cannot be disregarded. There has even developed a uniform textual structure in which to cast a judicial opinion in this field. After setting forth the facts it is customary immediately to announce either one of two premises: (1) that a corporation is a legal entity separate and distinct from the stockholders, or (2) that, after all, the separate entity of the corporation can be legally disregarded.¹ Such has been the absorption in the struggle over the cor-

* This article is substantially a chapter from a forthcoming book by the writer, with a preface by Professor A. A. Berle, Jr., of Columbia University, copyrighted and to be published by The Foundation Press, Inc., dealing primarily with the rights of creditors of subsidiary and affiliated corporations and touching upon diverse allied problems.

† Professor of Law, University of Missouri. B.S., Bowdoin College; J.D., Michigan.—*Ed.*

¹ Birmingham Realty Co. v. Crossett, 210 Ala. 650, 98 So. 895 (1924), and Majestic Co. v. Orpheum Circuit, (C. C. A. 8th, 1927) 21 F. (2d) 720, are typical,

porate entity issue that a rather important fact has been overlooked, viz., that the issue thus fought out is not a real issue at all but merely a fancied one. The danger lies in taking the entity issue seriously, that is, in failing to recognize that the answer of the lawyer to the layman in the foregoing paragraph really does but one of two things: (a) it serves as a handy, ready-made substitute for hard, analytical thinking in the hands of the time-pressed or the unskilled; (b) it serves as a facile rationalization to the one who, in a given problem, has thoughtfully driven through to a solution upon an analysis and theory which he prefers not to reveal in detail, whether because too complicated or for reasons otherwise embarrassing. Particularly is this true where parent, subsidiary and affiliated corporations are concerned, for here the urge is particularly strong to throw the corporate entity concept to the fore.

The frequent language encountered in the cases which concern themselves with disregarding (piercing, ignoring, looking through, etc.) the corporate entity makes it obvious that "entity" in its technical use requires a word of explanation. Ordinarily and aside from its use in corporation law, "entity" carries with it either the conception of existence, in the abstract, or of the thing which has existence, in the concrete. It indicates either "existence" or "existent being" ("existent thing"). Lawyers, judges and legal writers do not, however, speak of an "existence" theory or an "existent being" theory of corporations, while the expression "entity theory" is familiar.² The explanation is that "entity" has acquired technically, in addition to the meanings in the foregoing examples, the connotation of separateness and distinctiveness from the stockholders; the term has attracted to itself the attributes of the adjectives which normally modify it. Thus, though statements concerning corporate entity are often cast as follows: "a corporation is a separate entity distinct from its stockholders,"³ or "a corporation *has* an entity separate and distinct from its stockholders,"⁴ equally familiar are statements like: "a corporation is an aggregation of individuals, and not a legal entity."⁵ The notion of separateness and distinctiveness

the opinion in the former stressing the disregard and in the latter stressing the separate entity.

² E.g., Canfield, "The Scope and Limits of the Corporate Entity Theory," 17 COL. L. REV. 128 (1917).

³ *The Gloucester*, (D. C. Mass. 1923) 285 F. 579 at 582 (concrete).

⁴ *Majestic Co. v. Orpheum Circuit*, (C. C. A. 8th, 1927) 21 F. (2d) 720 at 724 (abstract).

⁵ *United States v. Milwaukee Refrigerator Transit Co.*, (D. C. Wis. 1905) 142 F. 247 at 254.

of the corporate entity is implicit when the court disregards or pierces the entity.

Dicta like the one last above quoted, that a corporation may be an aggregation of individuals and not an entity, suggest by their antithesis another aspect of entity, viz., unity. They bring out the idea that an aggregation, collection or group of individuals conceivably can be dealt with separately, while an entity presents a united front—is a legal unit.⁶ Moreover, the conception of a corporation as a legal unit makes it easy to understand the reference to a corporation as a “person”; thus we find “person” used interchangeably with “entity” in statements that a corporation is a legal “person” separate and distinct from the stockholders.⁷ It may be noted also that plain “corporation” and even “corporate name” occasionally replaces “entity” in the familiar form of entity-disregard statement.⁸

The objection in resorting to the nature of the corporate entity as the chief instrument in the legal craftsman’s tool chest, with the corresponding technique of observing or disregarding the entity, is not that “entity” should be abandoned in favor of some synonymous term. A verbal substitute stressing the fact that a corporation “is something” or “has existence” separate and distinct from the stockholders would be no more conducive to efficiency of solution or even to lucidity of thought. Entity, as used technically, is probably a convenient way of summing up the distinctive elements of the composite nature of the collectivity on the one hand and its legal unity on the other. One need have no quarrel with use of the term in a proper context, provided that one looks to it advisedly as merely a loose and convenient summary of diverse legal phases and not as the source of the factors of judicial law-making, and provided that in the use of the conception of the corporate entity certain

⁶ This distinction obviously is not apparent where the corporation has but a single stockholder.

⁷ In fact, jurists often call the problem one of corporate “personality.” Machen, “Corporate Personality,” 24 HARV. L. REV. 253, 347 (1911); Dewey, “The Historic Background of Corporate Legal Personality,” 35 YALE L. J. 655 (1926); Laski, “The Personality of Associations,” 29 HARV. L. REV. 404 (1916); Brown, “The Personality of the Corporation and the State,” 21 L. Q. REV. 365 (1905); Radin, “The Endless Problem of Corporate Personality,” 32 COL. L. REV. 643 (1932); HALLIS, CORPORATE PERSONALITY (1930).

⁸ In *Continental Tyre & Rubber Co. v. Daimler Co.*, [1915] 1 K. B. 893 at 906, Lord Reading spoke of looking behind the existence of the entity, while Buckley, C. J., looked behind the “corporation.” In *Bank of the United States v. Deveaux*, 5 Cranch (9 U. S.) 61, 3 L. Ed. 38 (1809), Marshall observed that a court may look through the corporate “name.”

logical pitfalls be avoided. Dissatisfaction with the traditional approach (at least, with its verbal formulation, for one must bear in mind that what courts do and what courts say are two very different things) can in part be traced to the pitfalls in the above proviso.

Analysis reveals at least three objectionable aspects of the entity approach, the second and third of which are probably traceable to the first: (1) the conception of a corporation as separate and distinct from its stockholders tends to acquire an absoluteness which only by strenuous mental effort can be restrained from effacing the stockholders under any and all circumstances; (2) the entity approach, in its generality, does not distinguish between situations essentially different; (3) even when the point of "disregarding" the entity is once reached, this "disregard" may leave one only at the threshold of the solution to the problem under consideration.

The first of the foregoing objections has not prevented courts from making decisions which, moved by other factors, they have desired to reach; courts seldom lose sight of the stockholders in spite of entity concepts. The very fact that they refuse (when they do refuse) to disregard or look behind the entity shows that courts are not unmindful of the existence of the stockholders. The justification for stressing this first objection is that, having formed an extreme concept of the corporate entity, a court will find it more difficult to concern itself with the identity of the stockholders through developing "exceptions" to the rule that a corporation is a separate entity than would be the case were it borne in mind that the separateness of the entity is merely one aspect of the corporation. Though the practical importance of methodological error, as shown more in detail hereafter, is not insuperable, the above-indicated difficulty manifested by certain decisions invites consideration of its source and of the possibility of avoidance.

The fancied necessity of "disregarding" the corporate entity assumes that there is an inconsistency between the existence of the corporation on the one hand and the existence of the stockholders on the other: if we can only deny the one, the other will automatically come into legal view. Likewise, the urge to "look through" or "pierce" the entity leads one to believe that the corporate entity is in the nature of an encasement concealing the substance with which one is concerned and that once this cover is made transparent or broken open one can get at the substance. Expressions like the foregoing indicate that, so long as the corporate entity is regarded, the stockholders by that very fact enjoy a kind of legal oblivion.

FUNCTIONAL ASPECT OF THE CORPORATE
ENTITY CONCEPT

The fault with this "oblivion" theory rests in part upon a rather common philosophical absolutism which cannot fail to be reflected in legal thinking and which has led to a misconception of the statement that a corporation is an entity distinct from its stockholders. This absolutism reveals itself in the notions that a definition fixes with finality the essence of a thing for all purposes, and that a statement is necessarily true or a description adequate irrespective of the purpose for which it is made. The bearing of these notions on the definition of the corporation as an entity separate and distinct from the stockholders is illustrated by numerous writings dealing with corporate entity or personality. Consider for example the statement, in a well-known article by high authority,⁹ that "Any group of men, at any rate any group whose membership is changing, is necessarily an entity separate and distinct from the constituent members," and the illustrative examples of the nature of any composite whole upon which the statement is predicated. One such illustration is that a house is not merely the sum of bricks that compose it, for one may change many of the bricks without changing the identity of the house; another, that one may change the faggots in a bundle without destroying the identity of the bundle; again, that a school or church is not merely a shorthand expression for the members thereof, for every time a new member joins there is not a new school or new church.

Now, it is true that the whole is different from the sum of its parts in the foregoing illustrations, but *only for certain purposes*. For certain purposes the house is the same house though brick by brick each original red brick has been removed and has been replaced by white bricks or by granite blocks; for other purposes it may be considered a different house. The old alumnus who observes that his college fraternity is not the fraternity that it was when he was in college is not necessarily guilty of philosophical error. It is necessary to ask him for what purpose is it different; it is not refutation of his statement to tell him the identity has not changed and to point out the persistence of the same name, same ritual, same house, same mortgage. In other words, for some purposes the attention is directed primarily at the constituent parts of a composite whole, although reference thereto, for convenience, is made through the unit; for other purposes the parts are unimportant and

⁹ Machen, "Corporate Personality," 24 HARV. L. REV. 253 at 259 (1911).

reference is intended to the unit *as such* and not merely as a convenient symbol. To illustrate: if a person is about to buy a frame building for the purpose of tearing it down for lumber, he may be expected to examine the boards, beams and planks; for his purpose those parts are important; to say that for his purpose this building is something entirely separate and distinct from the parts is absurd. His bill of sale, however, will very likely refer to "that certain building" and not to "that certain collection of beams, planks and boards," and most assuredly it will not refer to each individual beam, plank or board. That is, he does not necessarily disregard the "entity" of the building; the building may still serve as a convenient means of reference, though the fact that the boards and beams have a certain organic unity is for his purpose not the primary consideration.

The problem is not essentially different when the "entity" dealt with is a corporation. If *A* has loaned \$1000 to *X* Corporation, which has failed to repay the loan at maturity, and *A* now seeks to recover the amount in question from *X*'s sole stockholders, *Y* and *Z*, the court will deny him recovery and will undoubtedly remind him that a corporation is an entity entirely separate and distinct—that *Y* and *Z* are not visible. All true, if it be granted that *Y* and *Z* acquired limited liability by organizing themselves into a corporation. Assume, however, that in that particular jurisdiction all normal attributes of a corporation were strictly adhered to except that stockholders did not acquire limited liability; it will then become clear that in the first case "separate entity" is merely a way of saying that *A* is not to look to *Y*'s and *Z*'s general assets for reimbursement. Again, assume the participation of that same Corporation *X*, of which *Y* and *Z* are the sole stockholders, in a different transaction: *Y* and *Z*, as partners, are manufacturers who ship their products over the *A* railroad; *X* Corporation agrees with the *A* railroad that it will act as the railroad's agent in getting traffic for the latter for a commission of, say, one-eighth or one-tenth of the freight charges; *X* Corporation then receives these "commissions" on the *Y-Z* shipments. The Interstate Commerce Commission wants to determine whether *Y* and *Z* are getting unlawful rebates, whether there is rate discrimination against other shippers. In this situation the court does not say that a corporation is a separate entity—that the stockholders are shut off from legal view.¹⁰ Whereas in the first case the constituent parts, i.e., the stockholders, were unimportant,

¹⁰ United States v. Milwaukee Refrigerator Transit Co., (D. C. Wis. 1905) 142 F. 247.

in the latter case they assume outstanding importance. For the latter purpose, therefore, the corporation is not a separate entity. In short, the question whether a corporation is an entity separate and distinct from the stockholders cannot be asked, or answered, *in vacuo*.

It is difficult, however, to get away from the idea that a definition is necessarily one that absolutely fixes the substance of the defined concept—a definition in the sense of being “a phrase signifying a thing’s essence.”¹¹ One might be prepared, of course, to admit that a definition may be adequate for one purpose and not for another purpose in an entirely different field of knowledge; that “argument” as defined for purposes of a lawyer may be inadequate for a logician.¹² One might be prepared to concede that not only nominal definitions, which are linguistic or symbolic conveniences substituted for the longer phrase and in which the meaning of the *definiens* is not independent of that of the *definiendum*, but also real definitions, i.e., definitions in the Aristotelian sense of signifying a thing’s essence, must be related to a purpose if they are to be effective. So also of any designation or description:

“My designation of this thing as ‘pen’ reflects my purpose to write; as ‘cylinder’ my desire to explain a problem in geometry or mechanics . . . we cannot describe any particular given *as such*, because in describing it, in whatever fashion, we qualify it by bringing it under some category or other, select from it, emphasize aspects of it, and relate it in particular and avoidable ways.”¹³

But one is still inclined to feel that once the definition, description or designation has been established for some general purpose, say, for jurisprudence, the definition will, by revealing a thing’s nature, provide an ever-ready, simple tool for philosophical handiwork. Now, possibly

¹¹ ARISTOTLE, *TOPICA* 101 b-39 (W. D. Ross trans. 1928).

¹² EATON, *GENERAL LOGIC* 301 (1931): “Any concept equivalent to the one defined could be used as a definition, and the choice would depend on the adequacy of the definition to cover the subject-matter we wish to include in the discussion. The choice, in other words, would be pragmatic. For the purposes of a lawyer it would be sufficient, perhaps, to define an argument as ‘a discussion in which various sides of an issue are put forward;’ but such a definition would never do for a logician.”

See also *id.* at 299: “Having introduced definitions as purely nominal, many writers tend later to treat them as if they were real—as if they conveyed some information about the concept defined, and so, analyzed this concept. Ethical philosophers who nominally define ‘the good’ as ‘any object of desire’ often end by arguing that this is the only meaning ‘good’ can have, since everything that is good is an object of desire, and there is no object of desire that is not good. Tacitly they assign an independent meaning to the term ‘good’; and their erstwhile nominal definition becomes an important truth in their minds.”

¹³ LEWIS, *MIND AND THE WORLD ORDER* 52 (1929).

there are many absolute definitions just like that, applicable with mechanical ease. At least, let the possibility be admitted, although there are not lacking those who doubt it:

“Nor is it [essence] ever the whole of the thing; it is whatever aspect of it is most important for the purpose in hand. . . . The essence being in actual fact a selected *part*, it is obvious that for different purposes different selections will be suitable: ‘the’ essence will always be the essence-for-a-purpose, whether the purpose is stated or only implied, and the definition will vary similarly. It, too, will have to be selected for a purpose, and for its prospective usefulness. . . .

“If the ‘essence’ is thus variable, it follows that no absolute or final definition can be made. Nor, if it could be made, would it be of use. A good definition is always *ad hoc*, for a purpose and a use. But being thus relative to its use, it stands to reason that it cannot be absolute. Nor can it be final, if its subject is still alive and growing. Every development of our knowledge must *in fact* affect the definition of the object we know. . . .”¹⁴

Lest this quotation disturb one too much, let one not agree with it as a general proposition. Rather, as has already been indicated, let one admit the possibility, even in a legal system, of absolute, conclusion-impelling definitions and let one concede the truth of the foregoing quotation only as applied to imperfect definitions, in a primitive stage of knowledge. Nevertheless, it is strikingly apparent to those whose daily work deals with legal definitions and concepts that the great majority of those definitions, designations, descriptions and concepts fall within the statements in the foregoing quotation. Be this ascribed to the failure to develop a body of harmonious principles into a logically consistent, rational science, or to what one will, the fact remains that the workability of most fixed, legal concepts in one situation will not insure their workability, or their judicial acceptance, in another situation.

Even this is possibly disturbing. One likes to think that the nature

¹⁴ SCHILLER, *LOGIC FOR USE* 21-22 (1930). See also his definition of logic, *op. cit.*, 19:

“Definition Relative to Purpose. It is only when we have determined the use of Logic that we can define it—that is, *select* a definition suitable for our purpose, *i.e.*, for the use we intend to make of it. In itself, however, this remark tells us little about the actual definition we need: it is merely a way of denying two obsolete but lingering ideas, *viz.*, (1) that definition has the function of stating the ‘essence’ of a subject, and (2) that there can be an absolute and final definition, either of Logic or of anything else. A little reflection will show that neither of these beliefs is tenable.”

of an object is fixed, that statements concerning its nature, if once correct, are impregnable to accidents of time and function. For example, after it has been frequently repeated that the partner's interest in the partnership property is personalty, one feels a sense of security in thinking of it as such for all purposes; one believes it gives a certainty which would be lacking if the property were personalty for some purposes and not for others. So, where by one statute a partner's interest in the partnership is designated "personal property" and by another statute of the same jurisdiction *lis pendens* could be filed only in actions to recover a judgment affecting "real property," it was held (or at least said) that *lis pendens* was therefore unauthorized in an action for a partnership accounting, though the assets of the partnership consisted almost entirely of real estate and the defendant partner was about to put a parcel thereof beyond the other partner's reach.¹⁵ It would have been entirely possible, of course, to say that a partner's interest is not personal property for the purposes of the *lis pendens* statute.

A frank recognition of the functional and tentative aspect of most of our legal concepts is therefore helpful. Unfortunately, this recognition is gained only at the cost of marring the beautiful symmetry of one's conceptualism by forced concessions to the pragmatic consideration that the concept is rather useless unless it works. And for lawyers it has to work not in a Utopian but in the present legal world, with its imperfections in every field of law and with overburdened concepts—overburdened because they are forced to do far too much work and perform far too many functions. Consider for a moment the concept "personalty" which has already been mentioned. Familiar indeed to the lawyer is the use of that concept and of its co-concept "realty" in the solution of legal problems. A piece of machinery, a crop of growing corn, rolling stock—is it personalty or is it realty? The technique is familiar. Not always, however, is it realized that the very same piece of property may be at one and the same moment both personalty and realty. This depends entirely on what one wants to do with it, its pragmatic function. The point here made is admirably illustrated by a group of four cases from a single jurisdiction, Kansas. Each case involved the same class of property—a growing, unmaturing, agricultural crop of the kind produced annually by cultivation.

In *McClain v. Miller*¹⁶ it was held, under a Statute of Frauds which

¹⁵ *Rosen v. Rosen*, 126 Misc. 37, 212 N. Y. S. 405 (Sup. Ct. 1925). It is not hereby suggested that the actual decision was incorrect.

¹⁶ 95 Kan. 794, 149 P. 399 (1915).

required a written memorandum in sales of land but not in sales of personalty, that an oral sale of growing corn is valid and not within the statute. So, a growing crop of corn is personalty. In *Isely Lumber Co. v. Kitch*,¹⁷ the same court held a crop of growing wheat not subject to levy on execution as personalty. So then, a crop of growing wheat is realty. *Soeken v. Hartwig*¹⁸ decided that, upon a sale and conveyance of the land on which a wheat crop was growing, an oral reservation was sufficient, notwithstanding both the parol evidence rule and the Statute of Frauds above mentioned, to reserve the crop to the grantor. Personalty? *Garanflo v. Cooley*¹⁹ had already decided that upon a sale and conveyance of land where no reservation, oral or written, is made, the grantee is entitled to the crop growing thereon. Realty? Is it not perfectly clear that the bare concepts "personalty" and "realty" are woefully inadequate to solve the problems of the above four cases? Surely something deeper is at work in each of them; the cases are not at all in conflict. The Kansas court is to be congratulated for not having adhered to an eternally immutable and non-functional definition of a class of property.

If, then, for some purposes a growing crop of wheat is personalty and for others realty, which is it for the purpose of the moment and how to tell? There lies the difficulty and its solution is to be found in innumerable factors, some of which are never fully expressed. The answer may turn on a consideration of the intention of the parties, a desire to enforce oral bargains where the danger of perjury is slight, a feeling that it is a hardship socially unwarranted to have a growing crop sacrificed at a forced execution sale. In the difficulty of locating the real factors that determine a judgment lies the explanation for the persistence of the concepts personalty and realty as wishful solvents. They give a promise, alluring but false, of easy, quick, certain and painless solution. One is loath to turn from this promise of simplicity²⁰ to the difficulty of discovering the real elements in that compound which

¹⁷ 123 Kan. 441, 256 P. 133 (1927), overruling *Polley v. Johnson*, 52 Kan. 478, 35 P. 8 (1893).

¹⁸ 124 Kan. 618, 261 P. 590 (1927).

¹⁹ 33 Kan. 137, 5 P. 766 (1885).

²⁰ "Another suggestion for general method lies in the *threat from apparent simplicity*. The urge to find things simple, to establish their simplicity, has panic power. The assumption that things must be simple seems well-nigh compulsive. Whence that persistent posing of false issues against which we are never warned enough: 'Is it this or is it that?' Whereas in sober study it will some day prove to be neither, or both, or both plus several others." Llewellyn, "Legal Tradition and Social Science Method," in *ESSAYS ON RESEARCH IN THE SOCIAL SCIENCES* 89 at 97 (1931).

we know as a judicial decision. Once these elements are found, "personalty" and "realty" can almost be dropped from the legal calculation which is being made. That is to say, when one gets to the point that for the purpose of levy on execution a growing crop is not to be considered personalty because of the hardship factor, then the important thing is that, because of the hardship, levy cannot be made on certain property in a certain manner. The importance of "personalty" drops out.

Possibly it is cause for lament that an easy, all-embracing concept like "personalty" or "realty" cannot solve legal problems.²¹ Law would be much easier to apply and more certain, however sadly deficient in justice, if one had but to fix for all time and every purpose the nature of a growing crop as either personalty or realty. As it is, the farmer who now asks a Kansas lawyer whether his growing corn is realty or personalty must probably think to himself as the lawyer strives by his questions to draw out all the facts:

"Why can't this fellow answer a simple question without asking me a thousand others? I want none of these fancy theories. I ask a simple question and I want a simple answer: is my growing corn realty or personalty?"

Of course, no one believes for a moment that there exists a lawyer of any experience who has a realty-or-personalty fixation in situations like these in the foregoing Kansas cases. At any rate, no legal commentator has written hundreds of learned pages to prove that a growing potato is perforce realty and cannot, without violating fundamental principles of the nature of things, ever be considered personalty. As much cannot be said with respect to the nature of a corporation as an entity separate and distinct from its stockholders.

What has been said in the foregoing pages is equally applicable to corporations and to the numerous aspects which a corporation presents, now for one problem, now for another. Some of the major aspects are those of property, management and stockholders. Any or all of these or other aspects, or any combination thereof, may be involved when we speak of General Motors Corporation. If the purpose of a legal action is to fix liability upon stockholders for a loan by a third party to the

²¹ This is not to say that all concepts must be abandoned in a legal science. Obviously, thought and communication are impossible except through concepts. DEWEY, *HOW WE THINK*, c. 10 (1933). All that is meant is that even when the concept is otherwise adequate (and its adequacy is often illusory), its tentative and functional aspect narrows its effective application in use.

corporation, the stockholder aspect fades into the invisible background; the creditor is remitted to that pool of assets which, for the purpose at hand, is the corporation. A suit to recover corporate property converted by a third person must be brought in the corporate name and not in the name of stockholders, otherwise endless confusion of property held in corporate and individual capacity would ensue. For the purpose at hand it is important to restore the property to that separate estate from which it was taken; it is easy to say, therefore, that the property belongs to a separate entity. The principle of limited liability and the peculiarity of corporate rights to property make the stockholder aspect unimportant for many purposes (including the illustrations just given) and present the corporation in an aspect in which it is said to be separate and distinct from the stockholders. Similarly, when the business community speaks of the "General Motors crowd" it is not necessarily referring to the thousands of stockholders but perhaps rather to the management (or "control"), which not only may be a group separate and distinct from the stockholders but may be in practice (though legal theory has not yet caught up) elected by itself and not by the stockholders.²² Where, on the other hand, the stockholders themselves are the management, as in many family corporations, one viewing the corporation from its management aspect would be less likely to think of the corporation's separate entity. In the *Ohio Standard Oil Trust* case, the management aspect might have given occasion for a different view of the corporation if the management of the corporation had refused to carry out the agreement, executed as it was by the stockholders personally and not in the corporate name. In such an event circumstances may be imagined where the court would say that the contract of the stockholders was not that of the corporation and that a corporation is a separate entity and not a "collection of individuals."²³

A corporation then, like any composite whole, may present different aspects for different purposes. For some purposes the attention is directed to the entity as an organized collectivity and, while the identity of the individual stockholders is not denied, it is really immaterial to

²² BERLE and MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 84-89 (1932).

²³ *State v. Standard Oil Co.*, 49 Ohio St. 137, 30 N. E. 279 (1892). Stockholders owning all the stock of Standard Oil Company, an Ohio corporation, together with stockholders and members of other corporations and firms in the same business, entered into certain agreements creating a trust and resulting in an unlawful monopoly. The State of Ohio brought quo warranto against the corporation and obtained a judgment ousting the defendant from right to make, and power to perform, the agreements.

the purposes in hand. There is no fatal objection to framing this thought somewhat differently, by familiarly saying that the entity is separate and distinct; but there is the danger that in a later situation too much significance be credited to the statement in that form. For other purposes the identity of the individual stockholders becomes important, just as do for some purposes the component parts of a house or a ship, and then one does not say that the corporation is an entity separate and distinct from its stockholders; one does not dispense with the entity but still retains it as a convenient symbol of reference to these individuals. This is simply saying that one may treat the entity as if it were something apart from the stockholders for some purposes but not for others and that one is never forced to disregard the entity. Something of this notion is possibly suggested by Professor Radin when he says that the corporate entity is but a name by which a complex can be dealt with in discourse, a simple device for securing limited liability and facilitating reference to a complicated group of relations, a shorthand symbol for "A. B. C. . . . N., Stockholders, acting through R. S. T., their duly authorized agents," and that there is no necessity of disregarding such an entity.²⁴

ILLUSORY CONFLICT OF CORPORATE THEORIES

No concept of corporate entity, however, will be of itself sufficient to solve an actual problem. If it is herein occasionally urged that there is no need to consider the corporation as something entirely separate and apart from the stockholders, it is merely because a contrary concept may lead to complete oblivion of the stockholders and to the reasoning to be found in some of the decisions—such decisions, for example, as indicate that a domestic corporation cannot possibly come under the Trading With The Enemy Act though its stockholders are all alien enemies,²⁵ or that a restrictive covenant that title to certain land should never vest in colored persons is not violated by a conveyance to a corporation constituted entirely of negroes.²⁶ The point here made is not that these cases were wrongly decided, for there may have been valid reasons for the decisions, but that if such were the case the decisions should have been based on those reasons. The court should not have

²⁴ Radin, "The Endless Problem of Corporate Personality," 32 COL. L. REV. 643 at 652, 666-7 (1932).

²⁵ Continental Tyre & Rubber Co. v. Daimler Co., [1915] 1 K. B. 893, reversed on another ground (principally at least) in Daimler Co. v. Continental Tyre & Rubber Co., [1916] 2 A. C. 307.

²⁶ People's Pleasure Park Co. v. Rohleder, 109 Va. 439, 61 S. E. 794 (1908).

felt itself under the fancied compulsion of the entity concept which in the alien enemy case (in the lower court) made it not "permissible to look behind the existence of the entity and to regard the character of the individual shareholders"²⁷ and which in the restrictive covenant case made the corporation "a stranger to its own members."²⁸ The way to handle the alien enemy case would have been to determine whether there could possibly be any harm in allowing the alien-owned corporation to recover for merchandise sold, inasmuch as the proceeds apparently were to remain within the country and a Board of Trade inspector had charge of the corporation's receipts and disbursements; or at least to determine whether that course would have been too cumbersome or inconvenient in administration. Similarly, the result in a case like the restrictive covenant case should turn on whether the color-line type of covenant is valid or invalid, or whether the district surrounding the land in question has become so occupied by the persons against whom the restriction was aimed that the restriction should be lifted.²⁹ In such factors ordinarily lies the "law of the case," despite what the court says. The entity which troubled the courts in the above cases was of the sort which the lawyers for the defendant corporation in the *Standard Oil Trust* case advocated when they urged: "It is a modern heresy, largely invented during the late crusade against the principle of association in business, that a corporation is not a 'legal entity' but simply an association of stockholders endowed with certain legal faculties."³⁰

The statement is frequently made that the basic theory of corpora-

²⁷ *Continental Tyre & Rubber Co. v. Daimler Co.*, [1915] 1 K. B. 893 at 906. In the final tribunal Lord Parker observed that what was involved in the decision of the Court of Appeal was the notion that: "An impassable line is drawn between the one person (the corporation) and the others (the stockholders). When the law is concerned with the artificial person, it is to know nothing of the natural persons who constitute and control it." *Daimler Co. v. Continental Tyre & Rubber Co.*, [1916] 2 A. C. 307 at 340. The majority view in the House of Lords was that the character of the stockholders was material to determine alien control and that this materiality will vary according to the number of shares held by alien enemies. See Hogg, "The Personal Character of a Corporation," 33 L. Q. REV. 76 (1917).

²⁸ *People's Pleasure Park Co. v. Rohleder*, 109 Va. 439 at 446, 61 S. E. 794 (1908).

²⁹ If, on the other hand, in spite of the court's approbation of color-line covenants and its desire to enforce the covenant, the court thought itself inevitably impelled to its decision by what it considered to be the only possible conception of the corporate entity, then the case is wrong and belongs, fortunately, to a minority group. See WORMSER, *DISREGARD OF THE CORPORATE FICTION AND ALLIED CORPORATION PROBLEMS* 24-33 (1927). Then, too, the decision may have been motivated by the desire to keep the color-line question in this case out of the federal courts.

³⁰ *State v. Standard Oil Co.*, 49 Ohio St. 137 at 167, 30 N. E. 279 (1892).

tion law is that a corporation exists as an entity entirely separate and apart from its stockholders. It is difficult to see wherein that theory is the basic one rather than the heresy, above cited, of an association of individuals endowed with certain legal faculties.³¹ In any event, the important thing is to determine those legal faculties. The position herein taken is that one is not put, simply and without further considerations, to a choice between the alleged basic theory and the alleged heresy. Even though a court insists that corporation *A* is a completely different entity from *X* and *Y*, its sole stockholders, the court can generally reach a desired result on the "usual principles of liability for the acts of other persons or for collusion with them."³² A court can admit that the corporation is entirely a separate "person" but take the position that the stockholders are using this "person" as their "agent" to defraud creditors, evade an obligation, circumvent a statute, cover up fraud or gain an inequitable advantage—in short to attain an end to which the law objects. But this is a clumsy circumambulation. The desired results could probably be thus obtained provided the court does not get lost in technical rules of agency, undisclosed principal, sealed instruments, etc., and does not encounter too great obstacles in rules designed to adjust conflicts in very different circumstances. But it is hardly worth while torturing "agency" to save "entity." As has been pointed out in a penetrating article,³³ in several important classes of cases where it has apparently been assumed that justice could not be done without repudiating the doctrine of absolute separate entity, such absolute repudiation was not in fact necessary. The same article then goes on, after noting a number of cases which illustrate the broad scope of the entity theory, to maintain that the separate entity theory is the correct theory and that decisions which are inconsistent with the entity theory, i.e., which cannot be explained on some principle analogous to agency, fraudulent conveyance, etc., are not sound. Such a view is too prone to classify as unsound decisions which do not square with a corporate concept; and even when the view approves a decision as sound, this does not exclude the possibility that correct results might also have been obtained by some other, even though apparently opposite, theory.³⁴ The cases in

³¹ HOHFELD, *FUNDAMENTAL LEGAL CONCEPTIONS* 197-201 (1923).

³² Ballantine, "Separate Entity of Parent and Subsidiary Corporations," 14 CAL. L. REV. 12 at 20 (1925). See also Radin, "The Endless Problem of Corporate Personality," 32 COL. L. REV. 643 at 657 (1932).

³³ Canfield, "The Scope and Limits of the Entity Theory," 17 COL. L. REV. 128 (1917).

³⁴ For example, an examination of the cases relied upon by Canfield, "The Scope

the above-mentioned article which are drawn upon to establish the separate entity theory are equally consistent with an opposite theory; and the fault does not lie in the selection of cases. The same results can

and Limits of the Entity Theory," 17 COL. L. REV. 128 at 130-131 (1917), will reveal that there was in every instance abundant reason, other than the technicality of absolute separateness of the entity, to account for the decision.

Thus, *Gallagher v. Germania Brewing Co.*, 53 Minn. 214, 54 N. W. 1115 (1893), held that in a contract action against a corporation, debts due from the plaintiff to the two sole stockholders of the defendant could not be set off. The case is notable because the plaintiff was insolvent. To establish a precedent that such a debt could be set off, however, would lead to endless confusion and complication. In this case, true, there were only two stockholders; suppose, however, there were many stockholders in different proportions, including different classes and holders of stock of each class. We can complicate it further by making the plaintiff himself stockholder in a corporation which is creditor of defendant but debtor of defendant's stockholders. In part, the problem which faced the court was a choice between "justice" in this case and a rule of convenience. Furthermore, to resort for the moment to the methodology of technical dogma employed by the separate corporate entity theorists, the requirement of mutuality of set-off would permit the debtor of a corporation to avail himself of his claims against stockholders as set-offs to the corporation's claim against him, which would make a corporate balance sheet meaningless. *Erickson v. Revere Elevator Co.*, 110 Minn. 443, 126 N. W. 130 (1910), involves the same point as the *Gallagher* case.

An agreement by a corporation not to engage in business is not binding upon the individual stockholders. *Hall's Safe Co. v. Herring-Hall-Marvin Safe Co.*, (C. C. A. 6th, 1906) 146 F. 37; *Donnell v. Herring-Hall-Marvin Safe Co.*, 208 U. S. 267, 28 S. Ct. 288 (1908). Again, the typical corporate pattern presents numerous stockholders, some with minute stockholdings who do not even know of the corporation's contracts. It might be a considerable hardship to bind the stockholders personally to restrictions assumed by the corporation in its contracts. Even as to managing stockholders, *quere*. Ordinarily, where parties contract with a corporation, only the corporate property answers in damages for failure to perform. Such contract dealings are on the basis that no liability attaches to the stockholders, not because of separate entity necessarily but because of limited liability. In a deal of the sort here involved, it is reasonable and customary to contract with the stockholders themselves if the parties really intend a variation from the usual contract situation.

A bridge company was held entitled to recover tolls for the use of a bridge by a street railway company, pursuant to a contract between them, notwithstanding that a municipality had acquired all the stock of the bridge company and that the railway company was a taxpayer. *Monongahela Bridge Co. v. Pittsburg & B. Traction Co.*, 196 Pa. St. 25, 46 A. 99 (1900). Though a portion of the tax burden to finance the acquisition of the stock of the bridge company would fall on the traction company as a taxpayer, the burden would not justify permitting the traction company to escape payment of the toll; a toll was justifiable because of the special privileges to the traction company under the contract and because otherwise the entire tax-paying public would be forced to relinquish a right for which they paid (in the purchase price of the stock) to the very party who owed the corresponding duty.

A loan to Corporation *A* which owns all the stock of Corporation *B* is not a loan to *B*. *Exchange Bank of Macon v. Macon Construction Co.*, 97 Ga. 1, 25 S. E. 326 (1895). To have permitted the plaintiff to recover from the subsidiary, however, would have placed the plaintiff on an equal footing with the creditors of the subsidiary which was insolvent. This is reason enough irrespective of whether the

be reached if the position is taken that a corporation is but an aggregation of individuals who, by complying with statutory formalities, have acquired limited liability and a privilege of transferring their partici-

stockholder "is one person created by the Almighty, and the corporation is another person created by the law." (97 Ga. at 6.)

The sole stockholder of an insolvent corporation may be a secured creditor with priority over unsecured creditors. *Salomon v. Salomon & Co.*, [1897] A. C. 22. To hold otherwise would possibly run contrary to the theory that, within bounds not satisfactorily defined, the liability of stockholders is limited to their capital contribution.

Defendant leased property to a South Dakota corporation; the stockholders, under a Maine charter, organized the plaintiff corporation, by the same name, which took over the assets and assumed the liabilities of the South Dakota corporation; the lease was assigned to the Maine corporation, which entered into a modification of lease agreement with defendant who was unaware of the corporate change and thought he was dealing with the South Dakota corporation; the plaintiff was held not entitled to specific performance on the part of the defendant of a duty assumed in the modification agreement. *Brighton Packing Co. v. Butchers' Assn.*, 211 Mass. 398, 97 N. E. 780 (1912). It is important that separate pools of assets, with their corresponding liabilities, set up by the same stockholders as business units, should not be confused. It does not appear whether the same assets under the name of the Maine corporation (though the court spoke of "fraudulent concealment") would be subject to rights of a different set of creditors; anyhow, that danger to a creditor should be avoided. Furthermore, the corporation laws of one state may afford more protection than those of another, or one corporate charter more protection than another.

Representations made by the president of Corporation *A*, as to the rights of Corporation *B*, in reliance upon which a person purchases from Corporation *A* all the stock of Corporation *B*, do not create an estoppel in favor of Corporation *B* itself so as to entitle it to an injunction to restrain Corporation *A* from acting contrary to such representations. *Coal Belt Electric Ry. v. Peabody Coal Co.*, 230 Ill. 164, 82 N. E. 627 (1907). The estoppel was invoked to assert a property right in Corporation *B*. Failure to distinguish between property rights in the corporate name and those in the individual name would open the door to endless confusion. There is thus good reason for a decision, say, like *Button v. Hoffman*, 61 Wis. 20, 20 N. W. 667 (1884), that the sole stockholder cannot personally maintain replevin for the corporate property. The formality of use of the corporate name is no hardship, once the requirement of separation of corporate property is laid down.

For torts committed by persons acting for a corporation, the corporation alone is liable and not its stockholders. *Werner v. Hearst*, 177 N. Y. 63, 69 N. E. 221 (1903); *Stone v. Cleveland, C., C. & St. L. Ry.*, 202 N. Y. 352, 95 N. E. 816 (1911). This may go no deeper than a bare recognition of limited liability under circumstances that do not call for restriction of that principle.

A ship owned by a British corporation is entitled to registry though some of the stockholders are foreigners and a statute forbids registration of ships owned by foreigners "in whole or in part, directly or indirectly." *Queen v. Arnaud*, 9 Q. B. 806, 115 Eng. Rep. 1485 (1846). It is to be noted that: (1) the statute evinced no extreme policy of exclusion of foreigners, for ships could be registered if a foreign owner was agent for or partner in any house or co-partnership carrying on trade in Great Britain; (2) the court did not want to decide against registry else the "indirect" ownership clause would have provided a way out; (3) the statute itself evidently foresaw the potential difficulties where the ownership is in a body corporate and the possible hardship to British stockholders from being subject to loss of registry because a

pations in the enterprise without disrupting the bond of union; that certain legal measures have been devised to give effect to the rights of the associates, to protect outsiders and to deal conveniently with large

foreigner purchased shares of stock. Hence, the statute required a form of declaration for registry which provided, in case of individual ownership, for a statement that no foreigner had any part interest in the ship, but in case of ownership by any corporation in the United Kingdom the required statement was merely that the ship "doth wholly and truly belong" to the corporation. 8-9 Vict., c. 89, § 13 (1845). A statute can, of course, for the purposes thereof be drafted on the theory that the corporation is to be regarded as something absolutely apart from its stockholders.

A transfer by a firm of all its property to a corporation composed entirely of the firm partners is subject to tax under a statute imposing a tax on "conveyance or transfer on sale of any property." *John Foster & Sons v. Commissioners*, [1894] 1 Q. B. 516. But it is not at all unusual to find a transfer tax imposed on transfers from a person or persons in one capacity to himself or themselves in another capacity. Thus, under the United States Revenue Act imposing a tax on all "sales" of corporate stock, the Treasury Department interprets this to require a tax even on a transfer of stock to or by a trustee (e.g., by or to himself in his individual capacity) and on a transfer from a firm to the individual members thereof upon dissolution of the business. See Revenue Act of 1932, § 723; *Treas. Reg. 71, Art. 34 (1932)*.

In *Buffalo Loan, etc. Co. v. Medina Gas, etc. Co.*, 162 N. Y. 67, 56 N. E. 505 (1900), a corporation created bonds for certain corporate purposes, as the trustee under the bond issue well knew. The bonds were immediately pledged by the secretary and sole stockholder (all but two shares), for his personal indebtedness, with the trustee. A creditor of said officer bona fide paid the personal indebtedness and received the bonds as collateral. The only thing the court decided was that the bonds were valid in the hands of the creditor; it said the diversion by the stockholder was unauthorized. The dictum that the diversion of the bonds by the officer was unlawful is an obvious platitude; otherwise corporate creditors would have slim protection.

An insurance policy, which contained a provision that the policy would be void if the insured was not the "sole and unconditional" owner of the property, was issued to the sole stockholders as *owners* of the corporate property. Held, the stockholders could not recover on the policy. *Syndicate Ins. Co. v. Bohn*, (C. C. A. 8th, 1894) 65 F. 165. The policy was issued by the insurance company under the belief that the insured owned the property in the individual, not corporate, capacity. As the court pointed out, the risk was greater were the stockholders individually to be beneficiaries in the event of loss of the corporate property. The purpose of the provision was to obtain a full disclosure of the nature of the interest of the insured.

A Pennsylvania statute provided that no foreign corporation should "acquire and hold any real estate within this commonwealth, directly in its corporate name, or by or through any trustee, or other device whatsoever," and that lands so held were subject to escheat. A New York railroad corporation acquired a Pennsylvania subsidiary for the purpose of holding coal mining lands. Held, the lands did not escheat. *Commonwealth v. New York, etc. R. R.*, 132 Pa. St. 591 at 609, 19 A. 291 (1890). The court was loath to decide that the New York corporation was holding "through a device" because of the uncertainty in titles to a large amount of property and found comfort in (1) a section of the statute which declared that shares in mining companies were personal property and did not create a title in the stockholder to such real estate, (2) a subsequent statute making it lawful for railroad companies to purchase stock of coal mining corporations, (3) a still later statute removing the penalty of escheat in

numbers of individuals; that the associates have a peculiar type of property right which is neither a tenancy in common nor a joint tenancy but *sui generis* (cf. "tenancy in partnership" in the Uniform Partnership Act), one that can only be called "corporate," unless "collective-representative"³⁵ be of any help; and that exactly what ends achieved by incorporation will be legally sanctioned is determined by the same principles which determine legal rules in general—that determine, for instance, in the field of negligence whether there is or is not a legal duty to do or refrain from doing a certain act.³⁶

Enough has been said to suggest that precedent does not force one to conceive of the corporation as an entity universally and unqualifiedly separate and distinct from the stockholders regardless of purpose or problem. Equally consistent with legal precedents is the position that the entity is both separate and distinct from the stockholders and yet equal to the aggregation thereof and that for many (in fact, most) purposes no inquiry into the nature and identity of those constituent parts is essential, for their rights and duties can be determined collectively. It is convenient at times not to think in terms of individual stockholders; one can better say: let the term "X" equal the stockholders. At times (especially under certain statutes, although the technique is equally possible elsewhere) a court may conveniently refuse to break down "X," because this method affords a facile rationalization. The danger lies in thinking "X" *cannot* be broken down. As Professor Radin points out:

"There is always a danger of indirection and confusion when, for any purpose and even for a moment, lawyers or publicists lose

certain cases and, (4) an ingenious argument that since the parent corporation did not have title, "how can it hold title by a 'device'?" The foregoing reasons (more properly, excuses for getting around what the court thought to be an embarrassing statute), except the last one, afforded a basis for decision regardless of corporate theory. As to the last reason, if, in the eyes of the court, the policy of the statute were one of absolute exclusion of foreign corporate rights in the field covered by the statute, an entity would hardly stand in the way. Furthermore, lest one be inclined still to make this case prove some entity theory, one will note that, if one looks solely to the entity issue, *Stockton v. Central R. R.*, 50 N. J. Eq. 52, 24 A. 964 (1892), is flatly *contra* (a corporation unauthorized to lease its properties to a foreign corporation held unauthorized to lease it to a domestic subsidiary of a foreign parent).

Continental Tyre & Rubber Co. v. Daimler Co. has already been mentioned, *supra*, at notes 25 and 27. Five out of eight in the House of Lords did not seem to think of the British company as absolutely distinct from the German stockholders: one likened it to a partnership and four said its character depended upon its control and that they would look to the stockholders to determine who controlled.

³⁵ FREUND, *THE LEGAL NATURE OF CORPORATIONS* 22-23 (1897).

³⁶ GREEN, *JUDGE AND JURY*, c. 3, esp. pp. 74-77 (1930).

sight of the fact that their fundamental units are human beings, nearly all human beings, but nothing but human beings. These are persons in the proper sense of the term. Law exists for them to express their relations and subserve their needs. One of these needs is to speak of collectivities as though they too were persons. But an equal need is not to forget that they are not."³⁷

The opinion is reported to be entertained by some authorities in the field of corporation law (though no such published statement of theirs has been found by the writer) that no case has ever been rightly decided which is necessarily inconsistent with the separate-entity theory. Subject to the possibility of disagreement as to whether or not a case has been correctly decided, one need not quarrel with the statement. On the other hand, one could with equal accuracy maintain that no case has ever been rightly decided to which the entity theory, as commonly conceived, is indispensable. The analysis of the cases heretofore made,³⁸

³⁷ Radin, "The Endless Problem of Corporate Personality," 32 COL. L. REV. 643 at 665 (1932). See also, 36 YALE L. J. 254 (1926), with its suggestion of the "non-sanctity" of the entity notion and of the use of "entity" merely as a designation of the result reached; and with this compare 10 MINN. L. REV. 598 (1926), viewing with alarm recent "triflings" with the corporate entity.

³⁸ *Supra*, note 34. See also, *infra*, note 41. Nor do other classes of cases frequently commented upon in texts and periodicals compel a different conclusion. Thus, a corporation whose stock is entirely owned by the sovereign may not be immune to suits. But this does not mean that the reason is to be sought in the separate entity theory. If no reason other than that can be given to support a decision so holding, one may doubt its soundness. The entity argument, however, may be justified as an excuse to get away from the criticized rule that the sovereign cannot be sued; opportunity should be taken to cut it down. On the other hand, if it is felt that there is a strong public policy behind such a rule and that it should be extended to governmental acts as far as possible, the entity will not stand in the way. Again, if there is a good reason why there should be immunity from suit in one situation and not in another, the reasons explain the decision and not some concept of entity. See 21 COL. L. REV. 485 (1921); 35 HARV. L. REV. 335 (1922); 36 HARV. L. REV. 218, 737 (1922-3); 8 MINN. L. REV. 427 (1924); 32 YALE L. J. 283 (1923).

Both to furnish corporate creditors the protection which is essential to them as the result of their being limited to corporate assets for payment and to avoid the utter impracticability and multiplicity of suits by stockholders in their own right, whether against outsiders or against the management, suits to redress or prevent injuries to the stockholders collectively must generally be brought in the corporate name; to say that this is because the injury is not to the stockholder but to an entirely separate entity is not the explanation. Of course, where there are only a few stockholders, or *a fortiori* only one, the multiplicity argument is inapplicable. Nevertheless, there still remains the uncertainty of the protection of creditors' rights and the difficulty of computing damages. And even if there are no creditors, and but few stockholders, there is something to be said for the certainty of an established rule of procedure which does not force one who is about to bring a suit to wonder whether there are too many stockholders in his case. Even at that, a representative suit may be unnecessary where the

if not too far off the mark, should at least raise doubts even in the mind of the extreme right-wing fundamentalist.

Presumably, if one inclines to the opinion that no correctly decided case is inconsistent with the concept of the corporation as an absolutely separate entity, or if one, though willing to "disregard" the corporate entity, believes that decisions hinge on the entity issue, one will question the correctness of cases like *Swift v. Smith*³⁹ and *First National Bank of Gadsden v. Winchester*.⁴⁰ Yet the results reached in those cases are far from shocking, even though one need not approve of everything that the courts said in course of the opinions. In the former case, the sole stockholder of the corporation made a mortgage on the property of the corporation to secure a personal obligation of himself, though a part of the consideration was a release of a debt owed by the corporation to the mortgagee; the mortgage was executed by the stockholder personally as well as by himself as president of the corporation; for various reasons it was urged that the execution by the corporation was void. The court held that even if this were so the mortgage was still good as against a trustee for the benefit of creditors who gave credit after the execution of the mortgage and, most likely, without reliance on its defects. No creditors existing at the time of execution of the mortgage were prejudiced thereby; accordingly the court significantly stated that a man can do what he pleases with *his own property* if he does not thereby prejudice creditors. In the latter of the two cases the situation was similar: the sole stockholders executed a mortgage on corporate property to secure their personal debt; both the stockholders and the corporation joined in the execution but the execution by the corporation was said to be *ultra vires*; thereafter the corporation executed a mortgage on the same property to the plaintiff. As against this subsequent incumbrancer with notice the first mortgagee had priority, there being no creditors or other parties in interest to be affected at the

plaintiff stockholder is the only person interested in enforcing the corporate cause of action against the wrongdoers; the basis of the rule requiring a single action in the corporate right is then satisfied. For allowance of suit by stockholder individually in such circumstances, see *Ward v. Graham-Jones Motor Co.*, 74 Colo. 145, 219 P. 776 (1923); 8 MINN. L. REV. 348-349 (1924); 38 YALE L. J. 965-971 (1929).

Taxation cases are *sui generis* to an even greater degree than other types of cases arising under a statute. A tax statute is necessarily to a certain extent arbitrary; it often has irreconcilable provisions in the light of unforeseen situations; the distinction between form and substance is a recurrent issue; the decision is sometimes explainable by the desire to avoid multiple taxation or to patch up a loophole.

³⁹ 65 Md. 428, 5 A. 534 (1886).

⁴⁰ 119 Ala. 168, 24 So. 351 (1898).

time. Cases like these have been criticized for losing sight of the fact that a corporation is an absolutely different person from the stockholders. Nevertheless, they are neither in conflict with cases sometimes cited against them⁴¹ nor are they black marks upon our legal history; in each instance one finds it hard to feel that injustice was done in the allocation of the losses in question. The alleged conflict exists only if the attempt is made to file the cases into a legal pigeon-hole labelled "the corporation is an entity absolutely separate and distinct from the stockholders" or into one labelled "the corporation is the same as the stockholders." If legal oblivion of the stockholder does not rest upon an empirical base, i.e., induction from decided cases, does it nevertheless rest upon a rational base and follow deductively from an axiomatic

⁴¹ The two cases commented upon in the text are, for instance, not necessarily inconsistent with the following cases often cited to show that they prove something or other about the corporate entity: *Parker v. Bethel Hotel Co.*, 96 Tenn. 252, 34 S. W. 209 (1896) (a deed of corporate property by the sale stockholders individually was held void where the stockholders, after pledging to certain creditors most of the corporation's stock, conveyed to certain other favored creditors the corporate property); *Wheelock v. Moulton*, 15 Vt. 519 (1843) (held, no mortgage created upon the corporate property by an instrument which described the mortgaged property as "a certain piece of land—viz . . . two hundred shares" of stock. As the court said: "How anyone, from the deed alone, should suspect the intention of conveying the land and buildings of the corporation, and not its shares, is beyond my comprehension . . ."); *Humphreys v. McKissock*, 140 U. S. 304, 11 S. Ct. 779 (1891) (stock owned by a railroad corporation in an elevator corporation held not covered by a mortgage executed by the railroad corporation on the *railroad* and "appurtenances thereto belonging"); *Smith v. Hurd*, 12 Metc. (53 Mass.) 371, 46 Am. Dec. 690 (1847) (a stockholder, as an individual, held not entitled to maintain an action against directors for negligent conduct of corporate affairs making his stock worthless); *Sellers v. Greer*, 172 Ill. 549, 50 N. E. 246 (1898) (contract of one stockholder to transfer to the only other stockholder a part of the corporate property held not enforceable where from anything appearing to the contrary in the opinion, there might well have been corporate creditors who might have been prejudiced thereby); *Palmer v. Ring*, 113 App. Div. 643, 99 N. Y. S. 290 (1906) (defendant, who had loaned money to the corporation and to the president personally and who had received property of the corporation therefor pursuant to a bill of sale executed by the president and sole stockholder, was held to be liable in conversion to the receiver of the corporation); *Baldwin v. Canfield*, 26 Minn. 43, 1 N. W. 261 (1879). In the last case a deed to corporate property by a sole stockholder in his own name was held not to constitute a cloud upon title. At the time of the execution of the deed, the stock of said stockholder had been pledged to secure certain creditors; under these circumstances, even assuming that in the absence of corporate creditors the court would normally not insist on all the corporate formalities upon transfer of the property of the corporation, the stockholder is not free to deal as he pleases with the corporate property. From this disability to such complete inefficacy of the transfer as not even to amount to a cloud on title is, admittedly, a considerable step; but, after all, a step which merely indicates that, except in unusual circumstances, the corporate property must be at all times formally labelled and distinguished from individual property. At that, the decision is questionable.

principle? Does it follow because a corporation is a fiction—an intangible, invisible, immortal something? ⁴² We find courts constantly asserting that they are disregarding the corporate “fiction.” Whether or not the corporation is a fiction and, if not, what is the nature of the reality of a corporation have been sources of endless dispute even where the common law prevails, although compared to the vast writing of the civilians on the subject our own considerable literature is almost negligible. Besides the philosophical complications of the collective concept, the whole and the part, realism and nominalism, vitalism and mechanism, etc., the question is tinged with political aspects of sovereignty and the nature of the state. The “invisible, intangible, immortal” designation is properly applicable to a ghost or, as has been pointed out, to the fictitious John Doe in ejection. ⁴³ It has an air of mysticism, something in the nature of a theological plurality-in-unity.

But we are also told that the corporation admits of a real personality or at least of something so like personality that we may call it by that name; ⁴⁴ that it is a real person with body, members and will of its own; ⁴⁵ that it is an artificial person; ⁴⁶ that it is a real person because what is artificial is real; ⁴⁷ that even an individual is after all but an artificial

⁴² Both Coke and Marshall, in the cases famed for the ghost-like corporate theory which they expressed, were dealing with corporations where the beneficial-interest-group may easily be characterized as invisible, intangible, etc. The case of *Sutton's Hospital*, 10 Co. Rep. 1a, 77 Eng. Rep. 937 (1613), involved “a hospital for the relief of the poor, aged, maimed, needy or impotent people”; while *Trustees of Dartmouth College v. Woodward*, 4 Wheat. (17 U. S.) 518, 4 L. Ed. 629 (1819), involved a corporation “for the education and instruction of youth of the Indian tribes.” It may be relevant to point out that one is accustomed for many purposes to identify the “corporation” with the members for whose benefit the corporation was formed and the rights of the corporation with the interest of those members. Where the parties in interest constitute an indefinite number and an unascertainable portion of humanity, including generations yet unborn, the corporate concept may well be different from that where *A* and *B* file a certificate of incorporation to do business with certain advantages which they would not otherwise have. The difference is likely to be overlooked if both types are lumped under the name “corporation” and if remarks which fit possibly the one are without challenge applied to the other.

⁴³ Machen, “Corporate Personality,” 24 HARV. L. REV. 253 at 267 (1911).

⁴⁴ Geldart, “Legal Personality,” 27 L. Q. REV. 90 at 102 (1911).

⁴⁵ GIERKE, *POLITICAL THEORIES OF THE MIDDLE AGE*, introduction xxv-xxvi (Maitland's translation, 1913).

⁴⁶ 1 BLACKSTONE, *COMMENTARIES* *467 (1765); *Trustees of Dartmouth College v. Woodward*, 4 Wheat. (17 U. S.) 518, 4 L. Ed. 629 (1819).

⁴⁷ Machen, “Corporate Personality,” 24 HARV. L. REV. 253 at 257 (1911); Pollock, “Has the Common Law Received the Fiction Theory of Corporations?” 27 L. Q. REV. 219 at 220 (1911).

legal person, a subject of rights and duties;⁴⁸ that a corporation is not a thing, it is a method;⁴⁹ that the entity is a fiction but a rational fiction, not an arbitrary or artificial fiction;⁵⁰ that the "person" is a fiction but the entity or "thing" is real.⁵¹ Amid all these assertions we may at least have misgivings as to what kind of a fiction theory, if any, our law has purported to accept. For most purposes, aside possibly from political implications, one need not be particularly concerned with either the *pros* or *cons* of a fiction theory; one need not worry whether or not "the chief difficulty which the Fiction Theory presents is its first and obvious implication, that the corporate person is something apart from the members of the corporate body, since it is a fiction while they are realities."⁵² Of course, if one took literally the fiction theory implied in the dicta of Coke and Marshall, this would lead to concepts of absolute separability and tend to efface the identity of the stockholders for all purposes; but the theory of a corporation as a fiction of the Coke-Marshall type exists only in picturesque dicta. Our law has not taken the view that the corporation is but an ethereal whiff; at least it is admitted all around that there are some things about a corporation that are not pure fiction. (We do not mean to suggest that our law has or has not accepted the concession or restrictive theory of corporations, which is often thought to be a corollary of the fiction theory but which has nothing in common with that theory.⁵³) A fiction theory in the sense that we speak of collectivities as though they too were persons, while we well know that they are not,⁵⁴ carries no inevitable implication of absolute separation. Fur-

⁴⁸ 3 MAITLAND, COLLECTED PAPERS 306-308 (1911); Dewey, "The Historic Background of Corporate Legal Personality," 35 YALE L. J. 655 (1926).

⁴⁹ Farmers' Loan & Trust Co. v. Pierson, 130 Misc. 110 at 119, 222 N. Y. S. 532 (Sup. Ct. 1927); Douglas and Shanks, "Insulation from Liability Through Subsidiary Corporations," 39 YALE L. J. 193 at 194 (1929).

⁵⁰ Canfield, "The Scope and Limits of the Corporate Entity Theory," 17 COL. L. REV. 128 (1917); Canfield, "Corporate Responsibility for Crime," 14 COL. L. REV. 469 (1914).

⁵¹ SALMOND, JURISPRUDENCE, 8th ed., § 114 (1930); GRAY, THE NATURE AND SOURCES OF THE LAW 49-55 (1909).

⁵² HALLIS, CORPORATE PERSONALITY xlii (1930).

⁵³ Dewey, "The Historic Background of Corporate Legal Personality," 35 YALE L. J. 655 at 666-667 (1926). See generally HENDERSON, THE POSITION OF FOREIGN CORPORATIONS IN AMERICAN CONSTITUTIONAL LAW (1918), for scope and consequences of the concession of restrictive theory.

⁵⁴ Radin, "The Endless Problem of Corporate Personality," 32 COL. L. REV. 643 (1932). Apparently this was not the type of fiction that Pollock had in mind when he answered in the negative the question forming the title of his article, "Has the Common Law Received the Fiction Theory of Corporations?" 27 L. Q. REV. 219 (1911).

thermore, even a theory that a corporation is a real person might conceivably lead to a concept of absolute separation of a corporation and its stockholders if pushed to the extreme limit of logic. It is imaginable that the argument might be advanced that if *X* and *Y* organize themselves into a corporation called *Z*, the law now has three real persons capable of jural relations and since one person cannot be both himself and another (or others), *Z* is entirely distinct from *X* and *Y*. This obviously sounds as suspicious as the extreme fiction argument. It is possible, by noteworthy dialectical feats, to formulate either a fiction or reality theory that effaces the stockholder; on the other hand, neither a fiction nor reality theory need do so. One may advantageously bear in mind that real personality has been now asserted, now denied, as Professor Dewey points out, to serve the same ends and to serve opposing ends.⁵⁵

ERRONEOUS CLASSIFICATION IN TERMS OF CORPORATE ENTITY

The defects of the intransigent conceptualism which apparently accompanies the entity technique are of themselves a source of danger in legal thinking. A second and more serious objection (which follows from the first) that the approach which concerns itself with regarding or disregarding the entity conceals the real issues and paves the way for a mechanical jurisprudence. This approach falls into the habit of believing that the doctrine of corporate entity is the answer to all questions. Entity-disregard rules are applied to the solution of various problems which have little in common except that they involve cor-

⁵⁵ Dewey, "The Historic Background of Corporate Legal Personality," 35 *YALE L. J.* 655 at 669 (1926): "The fact of the case is that there is no clear-cut line, logical or practical, through the different theories which have been advanced and which are still advanced in behalf of the 'real' personality of either 'natural' or associated persons. Each theory has been used to serve the same ends, and each has been used to serve opposing ends. The doctrine of the personality of the state has been advanced to place the state above legal responsibility on the ground that such a person has no superior person—save God—to whom to answer; and in behalf of a doctrine of the responsibility of the state and its officers to law, since to be a person is to have legal powers and duties. The personality of the state has been opposed to both the personality of 'natural' singular persons and to the personality of groups. In the latter connection it has been employed both to make the state the supreme and culminating personality in a hierarchy, to make it but *primus inter paros*, and to reduce it to merely one among many, sometimes more important than others and sometimes less so. These are political rather than legal considerations, but they have affected law. In legal doctrines proper, both theories have been upheld for the same purpose, and each for opposed ends."

porations and lend themselves to a common entity terminology. A few cases will illustrate this point. In *Joseph R. Foard Co. v. State of Maryland*⁵⁶ suit was brought against the parent corporation to recover damages caused by the negligence of an employee of a subsidiary corporation. The court held the parent corporation liable, saying that "the two corporations must be regarded, as to the outside public, identical"⁵⁷ because the subsidiary was so "organized and controlled and its affairs so conducted as to make it a mere instrumentality."⁵⁸ From these dicta, the court apparently felt that the issue was whether the corporate entity was to be disregarded in cases of such organization and control. The case was decided in part on the authority of *Interstate Telegraph Co. v. Baltimore & Ohio Telegraph Co.*,⁵⁹ in which the parent corporation, which had sold all the assets of the subsidiary and kept the proceeds, was held liable to a creditor of the subsidiary. The court in the *Foard* case apparently felt, heeding some incidental remarks in the opinion in the *Interstate Telegraph* case, that this decision involved disregarding the entity. Obviously the solution to these two cases depends upon entirely different considerations. Where the parent corporation strips the subsidiary of all assets, it has removed a pool of assets originally set up to answer to the claims of possible creditors; to hold it liable to the extent of the assets thus removed is merely forcing it to make those assets available to those creditors. At least this is so where, as here, apparently the proceeds of the property exceeded the debts of the subsidiary to the plaintiff. Even in the absence of traditional fraudulent conveyance law, the same result could be reached without worrying over corporate entity. To hold the parent liable for the tort of a subsidiary, however, is to deny an outstanding incident of incorporation. If one uses entity language, a superficial analogy appears: in both cases the separate entity of two legal beings is disregarded and they are treated as one. This does not mean to say that the decision in the *Foard* case was incorrect; it may be a sound decision and extremely important in its significance. To say in the *Foard* case that the two corporations involved are identical is an easy way out but is no solution of the problem.

*Dillard & Coffin Co. v. Richmond Cotton Oil Co.*⁶⁰ held a parent corporation liable for overdrafts drawn by the subsidiary upon the plaintiff and paid by the latter, the drafts exceeding the value of the mer-

⁵⁶ (C. C. A. 4th, 1914) 219 F. 827.

⁵⁷ *Id.* at 829.

⁵⁸ *Id.*

⁵⁹ (D. C. Md. 1892) 51 F. 49.

⁶⁰ 140 Tenn. 290, 204 S. W. 758 (1918).

chandise sold by the subsidiary to the plaintiff. The problem facing the court here was similar to that in the *Foard* case; that is, whether the stockholders had succeeded in limiting their liability to a specific pool of assets (although this does not mean that both cases should be decided the same way). The court said that the subsidiary was organized by the parent for its own business convenience and that its separate legal identity could be disregarded. In reaching its decision, the *Dillard* case relied heavily upon *McDonald v. Charleston, C. & C. R.*⁶¹ There, a statute gave liens in favor of persons with whom railroad companies contracted for construction work. The statute differentiated for certain purposes between a principal contractor and a subcontractor. The *X* construction company contracted with the *Y* railroad company to construct the road for the latter, payment to be in stock and bonds of the latter; the *X* construction company in turn contracted with the plaintiffs for the construction. Plaintiffs were not paid in full and filed a bill to have a lien declared in their favor on the line of railroad constructed by them. Apparently the plaintiffs had to be considered "principal contractors" under the statute in order to succeed and the court held them to be such contractors, saying that the two companies were really one and the same and that contracts made with the one were in legal effect made with the other. But the issue in the *McDonald* case was whether or not the plaintiff was a "principal contractor," defined in the statute as "one who contracts *directly* with the railroad company." Now, in construing this phrase a number of considerations are involved: the purpose of the statute, the class whom it intends to protect, whether or not these plaintiffs were of the class which need such protection, the fact that "direct" is a word which often opens the door to equitable interpretation, etc. Once these factors have been resolved in favor of the lien claimant, the resort to the "disregard of the corporate entity" is only a smoke screen. To avoid the consequences of a harsh statute or to remedy the gaps in a defective one, courts exercise their ingenuity; one must be prepared to recognize that decisions in such cases often contain remarks which must not be taken too seriously in other situations.

As a further illustration of the difficulties arising from the false appearance of similarity which the entity approach creates, consider a group of California cases which are nearly always cited whenever the alleged issue of separate corporate entity arises. One is *Erkenbrecher v.*

⁶¹ 93 Tenn. 281, 24 S. W. 252 (1893).

Grant,⁶² where the court refused to disregard the corporate entity, the result being to allow the plaintiff to recover contribution from his co-guarantor of certain promissory notes which the plaintiff had paid. These notes had been purchased shortly after their maturity by a corporation wholly owned by the plaintiff, from which corporation the plaintiff had acquired the notes on payment to it of the amount due upon them. The defendant urged that the Statute of Limitations had barred the plaintiff's cause of action for contribution because, argued the defendant, the statute began to run from the moment that the plaintiff's corporation acquired the notes, since such acquisition amounted to ownership by the plaintiff himself and since the reason for the corporation's acquisition of the notes was that the holder was pressing the plaintiff for payment. The defendant showed that the plaintiff was in complete control of the corporation's management and affairs, which he dictated, and was using the corporation "for the purpose of conducting his business for his own personal convenience."⁶³ Therefore the defendant undoubtedly believed that he was in a position to avail himself of the dictum in a prior decision of the same court which had indicated that if the corporation is but the instrumentality through which the stockholder, for convenience, transacts his business, the entity will be disregarded.⁶⁴ But the court in the *Erkenbrecher* case refused to "disregard" the entity. Now obviously the ultimate issue here was whether the action was barred by the Statute of Limitations. How strong is the policy behind the statute? And *what* is that policy? A fixed limitation often seems shockingly arbitrary; a desire on the part of courts to seek any plausible loophole to get around the statute must be considered. Thus, the very same court in *Minifie v. Rowley*⁶⁵ a few months later again avoided the defense of the Statute of Limitations, although this time, if the entity issue is to be believed, *the court did exactly the opposite; it "disregarded" the entity.* This was an action by executors against a co-executor on a promissory note, owned by the deceased, of which the maker was a corporation wholly owned and managed by the defendant co-executor. The defense of the Statute of Limitations was met by the successful contention that the case was to be treated as if the defendant himself were the maker of the note, in which case action on the note, as an obligation from the executor to the deceased, would not

⁶² 187 Cal. 7, 200 P. 641 (1921).

⁶³ 187 Cal. 7 at 9.

⁶⁴ *Llewellyn Iron Works v. Abbott Kinney Co.*, 172 Cal. 210, 155 P. 986 (1916).

⁶⁵ 187 Cal. 481, 202 P. 673 (1921).

be barred by California law. How did the court, attacking the problem (verbally, at least) with the familiar technique—to be or not to be an entity—and faced with the *Erkenbrecher* case, achieve the dialectical feat, notwithstanding such precedent, of allegedly disregarding the corporate entity? If seized upon a chance dictum of its own, in the *Erkenbrecher* case, that if the corporation is merely the *alter ego* of the stockholder then the entity may be disregarded, at least to prevent consummation of a wrong; here (in the *Mimfie* case) the corporation was only an *alter ego*. There was just as much *alter egoism*, whatever be the significance of that epithet, in the one case as in the other. A point to bear in mind is that the net result was to avoid the Statute of Limitations in both cases. Also, in the *Mimfie* case, the rationalization offered a way of compensating the estate for the defendant's neglect of duty in not bringing action on the claim in time. Consider, for instance, a situation presenting exactly the same facts as the *Erkenbrecher* case with these variations: the plaintiff's wholly-owned corporation is the principal debtor on the note, the plaintiff and defendant are joint accommodation makers, the plaintiff has paid the note in full and the plaintiff is now seeking contribution from the defendant. The court might well hesitate to say that the entity is here to be treated just as in the *Erkenbrecher* case.⁶⁶

The other California case usually mentioned with the two foregoing cases is *Wenban Estate v. Hewlett*,⁶⁷ where the plaintiff corporation brought suit to declare null and void the bonds of the plaintiff in the hands of bona fide purchasers on the ground that the bonds were issued without authority or consideration. The act of the sole stockholder in authorizing the delivery of the bonds and stipulating the consideration therefor was held to be the act of the corporation (here labelled the "*alter ego*" of the stockholder), there being no rights of other creditors involved. The consideration received by the stockholder (either directly or by an agent) was treated as if received by the corporation. Since the annulment of the bonds would have resulted solely in benefit to the stockholder in question, the court was justified in finding the necessary authority and consideration to validate the bonds in the hands of the bona fide purchasers. All the above California cases show that the court had admirable aptitude for reaching a sound result. If the language about *alter ego* and disregard of the entity unfortunately conceals the real issue, so much the worse for the language.

⁶⁶ Cf. *Phoenix Safety Inv. Co. v. James*, 28 Ariz. 514, 237 P. 958 (1925).

⁶⁷ 193 Cal. 675, 227 P. 723 (1924).

Thus, the approach from the point of view of regarding or disregarding the corporate entity tends to cause different situations to be treated in the same manner. Instances could be multiplied. Almost any case involving the intercorporate vicarious liability problem, i.e., the right of creditors of one corporation to proceed against a related corporation, will reveal the same tendency. The dangers of an epithetical jurisprudence which make dissimilar things look similar by giving them the same name need little comment.⁶⁸ Of course, the vice is not limited to lawyers and judges. They probably suffer from it less than laymen. The urge to label a thing and consider the job thereupon finished is a universally prevalent ailment. Dean Pound brought this fact to the attention of lawyers by, *inter alia*, familiarizing them with the observation of William James:

“So the universe has always appeared to the natural mind as a kind of enigma, of which the key must be sought in the shape of some illuminating or power-bringing word or name. That word names the universe’s *principle*, and to possess it is after a fashion to possess the universe itself. ‘God,’ ‘Matter,’ ‘Reason,’ ‘the Absolute,’ ‘Energy,’ are so many solving names. You can rest when you have them. You are at the end of your metaphysical quest.”⁶⁹

The force of the above observation appears in the mechanical manner in which the fancied entity issue often is verbally determined. If in case *A* the “entity is disregarded” because the stockholder owns all the stock, actively manages the business, tells the directors what to do and uses the corporation “for his convenience,” then the urge is strong to

⁶⁸ Thus, *Tyson & Bro. etc. v. Banton*, 273 U. S. 418, 47 S. Ct. 426 (1927), held unconstitutional an act which sought to fix prices at which theater tickets should be sold by ticket brokers. Then later, in *Ribnick v. McBride*, 277 U. S. 350, 48 S. Ct. 545 (1928), an act to regulate prices charged by employment agencies was held unconstitutional, the majority opinion remarking that the business was “that of a broker” and that it had been settled in the *Tyson* case that a “broker’s” price cannot be regulated.

Again, in *Brass v. North Dakota ex rel. Stoesser*, 153 U. S. 391 at 403, 14 S. Ct. 857 (1894), involving the constitutionality of a North Dakota statute similar to statutes of New York and Illinois, previously held constitutional, regulating grain elevators, the Court said: “When it is once admitted, as it is admitted here, that it is competent for the legislative power to control the *business of elevating and storing grain*, whether carried on by individuals or associations, in cities of one size and in some circumstances, it follows that such power may be legally exerted over the *same business when carried on in smaller cities and in other circumstances.*” (Writer’s italics.)

⁶⁹ Pound, “Mechanical Jurisprudence,” 8 COL. L. REV. 605 at 621 (1908), quoting JAMES, PRAGMATISM 52-53 (1914).

disregard the entity in case *B* where these same earmarks exist, notwithstanding that in case *A* the result is to prevent the stockholder from getting discriminating freight rates while in case *B* the result may be to make him respond with all his assets for a liability which by incorporation is normally limited to a particular segregated part of his assets. For an example of this one may revert to the *Dillard case*.⁷⁰ In the *McDonald case*,⁷¹ which preceded it, the court recited that *X* corporation planned, originated and organized *Y* corporation, controlled its stockholders, dictated to its board of directors, took its stock and bonds and floated them, expended its revenues; that the same president dictated, dominated and controlled the affairs and operations of both companies; that the general manager, treasurer, auditor, and every other officer was the same in each company. This, allegedly, made *Y* corporation a "dummy." In the *Dillard case* substantially similar elements existed: after the organization of *Y* corporation its stock and stock-books were delivered to *X* corporation, *X* dictated *Y*'s board of directors and its policies, it had the latter adopt a by-law enabling *X* to discharge the board, the officers of *Y* made daily reports to *X*, the manager of *X* testified that the business of *Y* was the business of *X* (the business of the corporation is always in a sense that of the sole stockholder), *X* paid obligations of *Y* on more than one occasion, *X* "financed the operations" of *Y*. Therefore this *Y* was also a "dummy." All of which completely overlooks the essential differences which have already been pointed out⁷² between the two situations and permits a false concept to cloud the issue. Perhaps the fascination of the nature of the corporate entity as the key to problem solution lies in the belief that it is something very technical, inexplicable to the lay mind—a sort of glorified Rule in Shelley's Case, as one writer has suggested.⁷³

The failure to keep the question of corporate entity out of legal reasoning is not confined to the courts. Legal writers ascribe to the entity an importance far beyond the merits of that elusive concept. On the assumption that corporate entity is the key to the solution, cases have been said to be inconsistent with each other when in fact they are not, and vice versa. On that same assumption, a recent book has unjustifiably accused the New York courts of worshipping the "fetish of a

* ⁷⁰ *Dillard & Coffin Co. v. Richmond Cotton Oil Co.*, 140 Tenn. 290, 204 S. W. 758 (1918), *supra* at note 60.

⁷¹ *McDonald v. Charleston, C. & C. R. R.*, 93 Tenn. 281, 24 S. W. 252 (1893), *supra* at note 61.

⁷² *Supra*, pp. 622-623.

⁷³ Machen, "Corporate Personality," 24 HARV. L. REV. 253 at 358 (1911).

corporate entity.”⁷⁴ This statement was based on three New York cases which held that the sole stockholder was not liable for injuries to the plaintiff caused by negligence attributable to the corporation.⁷⁵ Together with these cases, a Maryland case⁷⁶ of similar holding was disapproved with the comment: “It is not easy to harmonize this holding of the Maryland court when it is remembered how it has taken the lead in discarding the corporate fiction in the interest of justice.”⁷⁷ The allusion to such leadership was to *Swift v. Smith*.⁷⁸ Regardless of what one may think of the correctness of the decision of the *Swift* case or of the disapproved Maryland and New York cases, it is obvious that the questions which they present are essentially different: in the one group of cases the dispute is between a stockholder who claims limited liability and a creditor of the corporation; in the *Swift* case it is between a mortgagee of corporate property and subsequent corporate creditors with notice who seek to set aside the mortgage and who have not been injured by the corporate act which they seek to invalidate. To say it is a matter of corporate entity does not explain the real factors operating in those cases to produce the decision.

Again, the same writer, under the heading: “*Where an Individual Manages Property Through Corporate Agency, Entity Disregarded,*” states:

“Where an individual manages his property through and by means of a corporate agency, under such circumstances, the court will refuse to recognize the fiction of a separate corporate existence and will treat the act of the owner as the act of the corporation and will treat the act of the corporation as the act of its owner. There is essentially no difference in such cases when the sole stockholder is a corporation.”⁷⁹

Between a case like *Milbrath v. State*,⁸⁰ one of the cases cited in support of the foregoing statement, and *Bosanich v. Chicago N. S. & M. R. R.*,⁸¹ (referred to as “indeed difficult to harmonize with neoteric adjudica-

⁷⁴ ANDERSON, LIMITATIONS OF THE CORPORATE ENTITY 247-248 (1931).

⁷⁵ *Werner v. Hearst*, 177 N. Y. 63, 69 N. E. 221 (1903); *Elenkrieg v. Siebrecht*, 238 N. Y. 254, 144 N. E. 519 (1924); *Berkey v. Third Avenue Ry.*, 244 N. Y. 84, 155 N. E. 58 (1926).

⁷⁶ *Bethlehem Steel Co. v. Raymond Concrete Pile Co.*, 141 Md. 67, 118 A. 279 (1922).

⁷⁷ ANDERSON, LIMITATIONS OF THE CORPORATE ENTITY 247, note 10 (1931).

⁷⁸ 65 Md. 428, 5 A. 534 (1886), discussed supra at note 39.

⁷⁹ ANDERSON, LIMITATIONS OF THE CORPORATE ENTITY 250 (1931).

⁸⁰ 138 Wis. 354, 120 N. W. 252 (1909).

⁸¹ 173 Wis. 280, 181 N. W. 297 (1921).

tions" and apparently considered as in conflict with the *Milbrath* case) there is a factual difference which needs no harmonization. The former held, in a criminal action for converting money of another to the use of the defendant, where the money was mingled with the funds of a corporation with the consent and by the act of the defendant, that it was not error to admit evidence that the defendant was an officer and one of the two stockholders of the corporation and in control and management thereof; such facts tending to show conversion to defendant's use. The latter held that an employee of corporation *A* could not recover from corporation *B* (the stock of both of which was owned by the same parties) for injuries sustained by the plaintiff through the negligence of employees of corporation *A*. Only by calling the decision in the *Bosanich* case a "holding that these corporate entities were not one and the same"⁸² can one possibly be led into thus misinterpreting the significance of the two cases.

Another author⁸³ states that it is impossible to reconcile the decision of the House of Lords in *Daimler Co. v. Continental Tyre & Rubber Co.*⁸⁴ (the alien enemy case heretofore discussed) and the grounds on which it was given with the judgment in *Salomon v. Salomon & Co.*⁸⁵ In the *Salomon* case the Chancery Division had ordered that the liquidation of the corporation, of which Salomon was substantially the sole stockholder, recover from Salomon a sum of money sufficient to pay the corporation creditors; this order was reversed in the House of Lords. The effect of the decision was that Salomon personally did not have to pay the corporation creditors.⁸⁶ Even assuming that the decision of the House of Lords in the *Daimler* case was a square reversal of the decision in the court below,⁸⁷ nevertheless it is submitted that a court can with perfect consistency hold (a) that trading with a local corporation, all of whose stockholders are alien enemies, is trading with the enemy (though in each case the nature and effect of the trading is to be taken into consideration) and (b) that a stockholder is answerable to corporate creditors only out of the corporate property. Undoubtedly there

⁸² ANDERSON, LIMITATIONS OF THE CORPORATE ENTITY 252 (1931). For further illustrations of situations sought to be explained by precedents which purport to observe or disregard the entity in entirely different circumstances, see Anderson, op. cit. §§ 22, 24, 95.

⁸³ HALLIS, CORPORATE PERSONALITY, li (1930).

⁸⁴ [1916] 2 A. C. 307, discussed supra at notes 25 and 27.

⁸⁵ [1897] A. C. 22.

⁸⁶ Another aspect of the decision is that the secured debentures held by Salomon were a valid charge on the corporate assets ahead of unsecured creditors.

⁸⁷ See discussion supra in notes 25 and 27.

are dicta in the *Daimler* and *Salomon* cases which are difficult to reconcile. One of the interesting aspects of the decisions that struggle with the issues of the corporate entity is that in spite of conflicting and misleading dicta the judicial hunch usually carries through to a correct decision. If the bases of the judicial hunch were not left inarticulate, questions of corporate entity and personality would relinquish the space they occupy in the decisions. It would be extraordinary, however, if all courts were entirely insensitive to the influence of previous dicta and if questionable decisions were not to be found; the strange fact is that their proportion is not greater.

ENTITY DISREGARD NOT DETERMINATIVE OF LIABILITY

Suppose, however, that the concession be made, for the purposes of argument, that the sole issue in a concrete situation is whether to disregard or not to disregard the corporate entity and that, after applying the rules (if they be ascertained) for disregarding the entity to the situation, the decision is reached that the entity should be disregarded. Does that automatically permit or deny relief to the one or the other litigant in a controversy concerning intercorporate liability? When the entity is disregarded, the stockholders, no longer concealed by the protective covering which incorporation bestows upon them, presumably stand before the penetrating eye of the law as an unincorporated association. That is, if orthodox legal literature is correct, one of the essential differences between a corporation and an unincorporated association is that the former is an entity while the latter is but an aggregation of individuals, although there are not lacking those who criticize and cast doubts upon this difference between incorporated and unincorporated groups.⁸⁸

⁸⁸ Laski, "The Personality of Associations," 29 HARV. L. REV. 404 (1916); Burdick, "Some Judicial Myths," 22 HARV. L. REV. 393 at 394-396 (1909); Machen, "Corporate Personality," 24 HARV. L. REV. 253 at 260 (1911), stating: "Therefore, what needs explanation in the common law is not the doctrine that a corporation is an entity, but the doctrine that a partnership or other voluntary association is *not* an entity."

In *United Mine Workers v. Coronado Coal Co.*, 259 U. S. 344 at 385, 42 S. Ct. 570 (1922), a suit against a number of defendants of which one was an unincorporated trade union, Chief Justice Taft said of that body of 450,000 members: "an extensive financial business is carried on, money is borrowed, notes are given to banks, and in every way the union acts as a business entity, distinct from its members."

In *Eisner v. Macomber*, 252 U. S. 189 at 231, 40 S. Ct. 189 (1920), Brandeis, J., stated: "There is much authority for the proposition that, under our law, a

The mere fact, however, that the group is an aggregation of members does not necessarily lead to the imposition of full liability upon the members of the association. At least, as against those creditors who dealt with the group on the understanding that the group was incorporated, it may very well turn out that the liability of the members of the unincorporated group is no greater than that of members of a corporation. The *de facto* corporation may not, perhaps, afford the best illustration of the limited liability of stockholders who do not constitute an entity in the eye of the law, for such a *de facto* organization is close enough to a corporation to be treated by the courts as a corporation.⁸⁹ Still, even those writers who are careful to refer to a group which has not been constituted into a *de jure* corporation as "associates" are willing to allow those associations limited liability as against a creditor who dealt with them as though they constituted a corporation:

"Nevertheless, he has consented to enter into a contract with the associates on a corporate basis. The associates expected to be shielded, by their possession of the corporate privilege, against unlimited liability for a breach of the contract, and A may fairly be charged with knowledge of this. In consenting to contract with them as a corporation, he has, by necessary inference, consented to avail himself on a breach of the contract of only such remedies as could be used if the associates possessed the corporate privilege. 'Upon broad grounds of right, justice and equity,' A ought not, with his eyes open, to enter into a contract which assumes the existence of a corporation, and then ask for remedies which involve a denial of such existence."⁹⁰

A group which has not attained the status of even a *de facto* corporation affords a better illustration because here are individuals who have not, in orthodox theory, merged into a legal entity. Yet it is by no means the unanimous opinion that a creditor who has dealt with them on a corporate basis can hold them to unqualified liability.⁹¹ Many

partnership or joint stock company is just as distinct and palpable an entity . . . as is a corporation."

⁸⁹ Magruder, "A Note on Partnership Liability of Stockholders in Defective Corporations," 40 HARV. L. REV. 733 at 742, note 29 (1927).

⁹⁰ Warren, "Collateral Attack on Incorporation," 20 HARV. L. REV. 456 at 475-476 (1907).

⁹¹ BALLANTINE, PRIVATE CORPORATIONS, §§ 27, 28 (1927). Compare the divergent views expressed by: Warren, "Collateral Attack on Incorporation," 20 HARV. L. REV. 456 (1907) and 21 HARV. L. REV. 305 (1908); WARREN, CORPORATE ADVANTAGES WITHOUT INCORPORATION 814-830 (1929); Lewinsohn, "Liability to Third Persons of Associates in Defectively Incorporated Associations," 13 MICH. L. REV. 271

courts speak of the persons so contracting with an unincorporated group as being "estopped" to deny the existence of a separate entity, and the group is referred to as a "corporation by estoppel." If the objection be raised that there is no technical estoppel here because the persons seeking to avail themselves of it have not been misled by the other party, the decisions may yet rest on an implied contractual limitation of liability. The argument is that the creditor who dealt with the associates on the understanding that they constituted a corporation must also have understood, as a necessary corollary, that he looked only to the assets held by the group in their associated capacity; that the associates, by holding themselves out as a corporation, had a similar understanding; that to allow the creditor now to enforce full liability against the members is violating one of the terms of the contract. In *Planters' & Miners' Bank v. Padgett*⁹² there was complete failure to incorporate because the alleged incorporation was effected by a court judgment which was void. A creditor who had dealt with the group on the understanding that it constituted a corporation sought to hold the members responsible. The court denied relief on the argument that:

"Having contracted with the company as a corporation, through its officer or agent, both parties believing the corporation to exist *de jure* as well as *de facto*, and with no intention at the time of giving credit to or binding the members individually or as partners, an action cannot be maintained against them as partners on that contract. It would be to make a new contract for the parties, never contemplated when the real contract which they made themselves was executed. The members never agreed to enter into the contract, either severally or jointly, and it is difficult to see how they can be bound by it. . . ."⁹³

The writer does not contend that the above quotation represents the law everywhere as to the liability of members of an unincorporated association where there have been dealings on a corporate basis; perhaps it does not even represent the majority view. Nor is the contention here made that the stockholders in an entity which has been disregarded are in exactly the same situation as the members of *de facto* or less-than-

(1915); Carpenter, "De Facto Corporations," 25 HARV. L. REV. 623 (1912); Carpenter, "Are the Members of a Defectively Organized Corporation Liable as Partners?" 8 MINN. L. REV. 409 (1924); Magruder, "A Note on Partnership Liability of Stockholders in Defective Corporations," 40 HARV. L. REV. 733 (1927).

⁹² 69 Ga. 159 (1882).

⁹³ 69 Ga. 159 at 164 (1882).

de facto corporations. Indeed, some of the reasons which are given for refusing to limit the liability of members in an unincorporated association to the assets of the association are not present where the entity-disregard is thought to be in issue in a case involving the liability, say, of a parent corporation for debts of its de jure subsidiary. For example, the argument that in the case of an unincorporated association the creditors are not in a position to enjoy the safeguards which the corporation laws provide for the protection of corporate creditors is not applicable where a de jure corporation has been formed. The only point here made is that the mere determination that the entity is to be disregarded does not necessarily settle the case. If the finality of the disposition of the case is made to depend on the issue of entity-disregard rather than on the basis of the facts of the particular transaction which gave rise to the alleged claim against the stockholders, the decision is likely to be questionable. In the *Dillard* case⁹⁴ the course of the business transactions, in consequence of which the cotton was shipped to the plaintiff and the shipper's draft was paid by the plaintiff, is not shown in the opinion. Had the plaintiff dealt with the subsidiary on the basis that he looked to it or to others for performances? Nor is the draft itself described. A few years prior to the *Dillard* case the same court had held that the name "Ingle System Company" on a promissory note put a person who dealt with the "company" on notice that he was dealing with a corporation and that, therefore, he was estopped to deny that it was a corporation.⁹⁵ The signature of the drawer in the *Dillard* case is not set forth but if it were the usual type of corporate signature, i.e., "X Company by Y, president," this would point in the direction of notice to the plaintiff of the corporate character of the drawer. Facts of this kind, not brought out in the opinion of the court (and possibly a wide variety of other relevant facts that may have been present) should be known before one can express an opinion as to the correctness of the decision.

The judicial urge to disregard the corporate entity is traceable to a belief that the existence of the corporation shuts the stockholders from legal view. To deal effectively with a situation where this legal blindness would be embarrassing, the court will therefore attempt to find

⁹⁴ *Dillard & Coffin Co. v. Richmond Cotton Oil Co.*, 140 Tenn. 290, 204 S. W. 758 (1918), discussed supra at notes 60 and 70.

⁹⁵ *Ingle System Co. v. Norris & Hall*, 132 Tenn. 472 at 476, 178 S. W. 1113 (1915): "The name 'Ingle System Company' does not indicate that it is a firm of individuals. While it is not a conclusive fact, yet it may be fairly assumed as a presumption from the name of the company that it is a corporation, especially at this time, when corporations form so large a part of the concerns engaged in business. . . ."

some defect in the organization of the corporation—some defect in the protective covering in the nature of a hole through which the stockholders are visible. But it should be borne in mind that the defect, once discovered, does not abolish all the legal consequences of the existence of a corporation. One must not suppose, for example, that because the court in *Chicago, M. & St. P. Ry. v. Minneapolis Civic and Commerce Association*⁹⁶ (perhaps the most frequently cited case for the proposition that the corporate entity will be disregarded when it is a “mere instrumentality”) disregarded the corporate entity of a subsidiary organized so as to discriminate between shippers over the roads of the parent corporations, the court would have held the parent corporations liable for the obligations of the subsidiary or would have refused to let the parent corporations share as creditors in the insolvent estate of the subsidiary. The corporation is still a separate entity (if one persists in talking of entity), but one of the normal attributes of this separation is denied to it *for the purposes of the case before the court*. This is not to suggest that a court would necessarily be misled by a prior adjudication that the entity of the very corporation involved in the present controversy has been disregarded; nevertheless, the danger is there, a danger against which the court would have to be on its guard.

There may be sound reasons (some of which the writer hopes to suggest elsewhere⁹⁷) why courts in some situations restrict and in others expand the rights of creditors of corporations. This expansion includes, in certain circumstances, the liability, let us say, of a parent corporation for the obligations of its subsidiary. When this expansion is permitted, the stockholder is denied the stockholder's normal privilege to limit his liability to the property which he puts into a given corporate fund. Why the stockholder is denied this privilege in the particular case under consideration is the question which the court must face. In answering this question, interests have to be balanced and issues determined; but the regard or disregard of the corporate entity is not one of those issues. Similarly, there may be reasons why courts deny the stockholder the right to share as a creditor in the insolvent estate of the corporation, a right which all other bona fide creditors have. Here again the question presents difficult issues, of which the corporate entity is not one. Not that it is impossible for a court to reach a correct decision, state the result in orthodox entity language and yet reveal the real reasons for holding

⁹⁶ 247 U. S. 490, 38 S. Ct. 553 (1918).

⁹⁷ In the forthcoming work referred to at the beginning of this article.

one way or the other; but, with so convenient a verbal formula as the separate-and-distinct-entity concept and its antidote, entity-disregard, judicial opinions are not likely to reveal the real reasons for the decision. Again, such formulæ make correct results more difficult to attain.

The notion that the key to the solution of the problem lies in sheer analysis of the essential, eternal, plurality-in-unity nature of corporate personality must be abandoned. Much of the controversial literature on corporate personality is of such quasi-theological flavor that it is of very little use to the lawyer who is faced with a practical problem. Unfortunately, the very mystery associated with conceptions of corporate entity or personality is, no doubt, one reason for the strained and abundant efforts to solve legal problems by explaining the nature of that entity or personality. This attitude is quite comprehensible, given the traditional approach. Perhaps one reason that legal literature does not likewise abound in theses that growing wheat is inherently realty (or personalty) and cannot in the very nature of things be otherwise is that visible, tangible wheat lacks the mystic quality of the corporation; it can, therefore, be dealt with much more realistically.

Professor Warren has pointed out, correctly, that most business men, while they have no difficulty in thinking of partners as merged into a composite unit, also have no difficulty in thinking of partners as not so merged, and that they in fact sometimes think of them in the one mode and sometimes in the other.⁹⁸ Both modes of thought are familiar not only to business men but to persons in general who have occasion to think of a partnership. The same is true as to corporations, although it may become increasingly difficult to think of the individual members of a corporation as their numbers increase. But apparently what is possible and common for business men and other rational beings is impossible, or at least extremely difficult, for those learned in the law; the laws tells us (at least, according to the orthodox doctrinarians) that we must think of members of a corporation as merged in a composite unit and that we *must not* think of partners as so merged. It is not to be wondered at, therefore, that heretics should spring up in rebellion; that we find within the same law school the instructor who teaches the course on corporations advocating the view that corporate rights and obligations are really the rights and obligations of the stockholders and the instructor who teaches the course on partnerships urging that the partnership is an entity.⁹⁹ The source of the conflict lies at least partly in the attempt

⁹⁸ WARREN, CORPORATE ADVANTAGES WITHOUT INCORPORATION 2 (1929).

⁹⁹ WARREN, *op. cit.*, 6.

to deny the unity of parts which are organized into a composite whole and which operate and are to be treated as a whole for certain purposes and in overlooking the fact that a composite whole is made up of (and when convenient may be broken down into) its constituent parts. Legal science does not force us to determine either that we must always look to the identity of the members in a partnership or that we must never look to the identity of the members of a corporation.