

does not seem to be of great aid. Though in view of these cases it perhaps might be said that Missouri seems to be in accord with the majority view and will thus hold to be immaterial, in cases involving drivers' licenses, the fact that the driver had no license, unless a casual connection with the accident can be shown.

It does seem, however, that if the purpose of such ordinances is to be fully carried out the father should be held liable if he knowingly permits a member of his family to use his car when they do not have a driver's license. The purpose seems to be to deny the use of the streets to negligent and incompetent drivers, and such can only properly be carried out by strict enforcement of the rules. Wilfully and knowingly becoming a party to the violation of such a statute might well constitute such negligence as is by the direct sequence of events the proximate cause of any damage that may be sustained by another, when the other elements of actionable negligence are established.

PHILIP A. MAXEINER, '36.

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## LIABILITY OF A PARENT CORPORATION FOR THE DEBTS OF ITS SUBSIDIARY

### I.

"A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created. Among the most important are immortality, and, if the expression may be allowed, individuality; properties by which a perpetual succession of individuals are considered the same, and may *act as a single individual* . . . . By these means, a perpetual succession of individuals are capable of acting for the promotion of the particular object, *like one immortal being*." This is the now classic definition of a corporation by John Marshall in the Dartmouth College Case.<sup>1</sup> To those who do not have a fairly good idea of the nature of a corporation before they read it, this so-called definition is probably unintelligible. But to those lawyers and students of law who have become accustomed to the legal fictions in which the reasoning of courts is so often enshrouded, it expresses that very old concept of a corporation as something separate and distinct from the persons composing it, as something with an individuality and personality of its own.

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causal connection with the accident. This case held that the fact that such chauffeur was negligent or incompetent must still be proven by the plaintiff.

<sup>1</sup> 4 Wheat. 518, 4 L. Ed. 629.

The exact nature of this personality has been a very fertile field of controversy among the legal philosophers. Mr. Machen in his article, "Corporate Personality," 24 Har. L. R. 253, sets forth the various theories and then demonstrates why he believes them to be inaccurate and confusing. In attempting to clarify the situation Mr. Machen explains what he believes is the sound theory, to the following effect. In the first place, a corporation is not some immortal, spiritual being conjured up by legal magic but is simply an association of real persons for the carrying on of some enterprise. It is in that respect similar to the church, the labor union, the social club, the partnership and joint stock company, and the state. In the second place, the so-called corporate entity is simply an instance of that natural and inevitable concept of the human mind which treats a group as something distinct from the sum of its members, or a whole as different from the sum of its parts. All groups of persons, such as those already mentioned, are considered as unities, and each is given a name to distinguish it from its members.

The corporate entity being merely a thought concept and as such no different from other group entities, how is it distinguishable? What constitutes the individuality and personality of a corporation? According to Mr. Machen and most of the writers on the subject the peculiar characteristic of the corporate entity is that the law recognizes it and attaches legal rights and duties to it, as though it were a real person, whereas the law does not so recognize other group entities. It is true that courts speak of the corporate entity in language similar to that of John Marshall, and in that respect do give legal recognition to a concept existing in the minds of the people. But it seems clear that the legal corporate entity is just as fictional as the lay corporate entity. How can the law confer rights and impose duties upon "an artificial being, invisible, intangible, and existing only in contemplation of law"? Surely it is obvious that the law can act effectively only on real persons. Therefore it seems to the writer that corporations must be distinguished from other group entities by the difference in the legal rights and liabilities attaching to the members of the group. Among the most important are (1) the capacity of the group to act as a unit and under a common name for the purpose of holding and transferring title to property, making contracts, suing and being sued, and other incidents of the enterprise; (2) the ability of the members to withdraw from the group and of new members to enter it without disturbing the continuity of the enterprise; (3) the personal immunity of the members from the liabilities of the association except to the extent of their capital contribution thereto; (4) the necessity of conducting the enterprise through a prescribed form of organization and procedure, i. e. the members of the group

in meeting assembled elect the directors of the enterprise, who as a board formulate the policy and appoint officers to carry it out, etc. When the courts speak of corporate entity, they mean the sum total of the legal incidents of conducting an enterprise in corporate form.

## II.

A doctrine has been developing that in exceptional circumstances the courts will "disregard the corporate entity." From the above discussion it will be inferred that by "disregarding the corporate entity" the courts mean they will not give effect to one or more of the normal legal incidents of an incorporated association. In the usual case of disregarding the corporate entity the stockholders are held personally responsible for the obligations of the corporation, whereas normally they are immune from such obligations. Professor Wormser in his article, "Piercing the Veil of Corporate Entity," 12 Cal. L. R. 496, classifies the exceptional circumstances in which courts have been prone to apply the doctrine. (1) One of the situations is where debtors form a corporation and transfer to it all their assets, thereby attempting to defraud their creditors. The courts however allow the creditor to pursue the assets as the property of the debtor, even though the title has passed to the corporation.<sup>2</sup> *Kellogg v. Douglas County Bank*, 58 Kan. 43. (2) A second situation is where persons under existing contract obligations form a corporation and cause it to do that which they were bound not to do. Such persons will be held liable for the breach of their contract even though the acts were those of the corporation.<sup>3</sup> *Beal v. Chase*, 31 Mich. 490. (3) Another situation is where the corporation is used to accomplish a fraud or other tort.<sup>4</sup> The persons so using the corporation will be held responsible for the wrong. *Clark v. Millsap*, 197 Calif. 765. (4) A similar situation is where persons use a corporation to accomplish what would amount to a crime or evasion of a statute if done by

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<sup>2</sup> *Booth v. Bunce* (1865) 33 N. Y. 139. In *Re Rieger, Kapner, & Altmark* (1907) 157 Fed. 609; *Hibernia Ins. Co. v. St. Louis & N. O. Transp. Co.* (1882) 13 Fed. 516; *Montgomery Webb & Co. v. Dienelt* (1890) 133 Pa. St. 585; *Ist Nat. Bank of Chicago v. Trebein* (1898) 59 Oh. St. 316; *Donovan v. Purtell* (1929) 216 Ill. 629; *Bremen Savings Bank v. Branch* (1891) 104 Mo. 425; *Lush v. Riggs* (1902) 65 Neb. 258; *Terhune v. Hackensack Savings Bank* (1889) 45 N. J. Eq. 344; *Andres v. Morgan* (1900) 62 Oh. St. 236; *Bennett v. Minott* (1896) 28 Ore. 339; *Vance v. McNabb Coal Co.* (1892) 92 Tenn. 47.

<sup>3</sup> *Beal v. Chase* (1875) 31 Mich. 490; *Booth & Co. v. Seibold* (1902) 37 Misc. 101; *Kramer v. Old* (1896) 119 N. C. 1; *Higgins v. Calif. Petroleum & Asphalt Co.* (1898) 122 Cal. 373; Cf. *People's Pleasure Park Co. v. Rohleder* (1909) 109 Va. 439.

<sup>4</sup> *Meily v. London & Lancashire Fire Ins. Co.* (1906) 148 Fed. 683; *Kirkpatrick v. Allemania Fire Ins. Co.* (1905) 92 N. Y. S. 466; *Felsenthal Co. v. Northern Assur. Co.* (1918) 284 Ill. 343.

them personally, including the formation of illegal monopolies.<sup>5</sup> Here again the courts do not tolerate the defense that the corporation and not its members committed the wrong.<sup>6</sup> *U. S. v. Milwaukee Refrigerator Transit Co.* 142 Fed. 247. (5) Finally there is the situation where a corporation is said to be the mere *instrumentality* of a single stockholder, whether person<sup>7</sup> or another corporation. In such cases the courts hold the controlling person or corporation responsible for the obligations of the controlled corporation. *The William Van Driel, Sr.*, 252 Fed. 35.

When the state has conferred on stockholders immunity from the liabilities of the corporation, what explanation do the courts offer for ignoring such immunity in these exceptional circumstances? The prevalent theory seems to be that the privilege of doing business in a corporate capacity, with its accompanying advantages, is conferred only to enable persons to carry on a legitimate enterprise in a legitimate way. So if a corporation is used to carry on an unlawful enterprise, or to carry on a lawful enterprise in an unlawful way, then the persons so using it cannot claim the accompanying advantages.<sup>8</sup> Professor Wormser says that the corporate entity is a legal fiction and "all fictions of law are introduced for the purpose of convenience and to subserve the ends of justice. When they are urged to an intent and purpose not within the reason and policy of the fiction, they must be disregarded by the courts."

One of the largest groups of cases in which courts speak of "disregarding the corporate entity" is the fifth group mentioned above, that is, when one corporation is said to be the "mere instrumentality" of another corporation. The courts do not always use the word "instrumentality," but often use some equivalent such as "agency," "adjunct," "dummy," "puppet," etc. The general rule applied in this group of cases is well stated by the court in the case of *Radio Craft Co. v. Westinghouse Electric and Manufacturing Co.*, 7 Fed. (2) 432: "Where stock control has been resorted to not for the purpose of participating in the affairs of the corporation in the normal and usual manner, but for the purpose of controlling the company so that it may be used as a mere agency or instrumentality of the owning company,

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<sup>5</sup> *People v. North River Sugar Refining Co.* (1890) 121 N. Y. 582; *State v. Standard Oil Co.* (1892) 49 Oh. St. 137; *Ford v. Chicago Milk Shipper's Union* (1895) 155 Ill. 166; *Distilling & Cattle Feeding Co. v. People* (1895) 156 Ill. 448.

<sup>6</sup> *Metropolitan Holding Co. v. Snyder* (1935) 79 Fed. (2) 263; *U. S. v. Lehigh Valley Ry.* (1911) 31 S. Ct. 387; *U. S. v. United Shoe Machinery Co.* (1916) 234 Fed. 127.

<sup>7</sup> *Wenben Estate v. Hewlett* (1924) 193 Cal. 675; *Wood Estate v. Chanslor* (1930) 286 Pac. 1001; *Phoenix Safety Inv. Co. v. James* (1925) 28 Ariz. 514.

<sup>8</sup> See *Canfield, Scope & Limits of Corp. Entity Theory*, 17 Col. L. Rev. 128; *Powell, Parent & Subsidiary Corps.*, secs. 1 & 2.

courts will look through the screen of separate corporate control and place the responsibility where it actually belongs," in the owning company.<sup>9</sup> This is the rule with which this article is mainly concerned.

The mere statement that one corporation might be responsible for the obligations of another controlled by it sufficiently stresses the importance of the subject to one who is familiar with the fact that today the large majority of corporations are either controlled or controlling corporations. As an illustration of this fact Berle and Means, in their recent book, "Modern Corporations and Private Property," state on page 205 that out of the 573 corporations listed in the N. Y. Stock Exchange 92 were pure holding companies, 395 were both holding and operating companies, and only 86 were operating companies. A holding or parent company is "any company which is in a position to control or materially to influence the management of one or more other companies, by virtue, in part at least, of its ownership of securities in the other company or companies."<sup>10</sup> A "pure" holding company is one whose only purpose is to control the policies of the companies whose stock it holds, and whose income is derived from their operations. The large number of holding companies, however, are operating companies also, and their control of other companies is incidental to their main purpose. The companies which are owned and controlled by the holding companies are called subsidiaries.<sup>11</sup>

Before entering into a discussion of the so-called instrumentality rule, it is well to define the exact scope of the discussion. First, it must be noted that the authorities on the subject have placed the "instrumentality situation" in a class by itself, thereby indicating their opinion that it is different from the other four situations where corporate entity is disregarded. In the other situations the corporate entity is apparently being used by its stockholders as a shield to protect themselves from the legal consequences of their own wrongful conduct. It makes no difference in such cases whether the stockholders are persons or other corporations. Therefore a parent corporation might be held liable when it uses its subsidiary in such ways, i. e., to defraud creditor, to evade an existing contract obligation, or to commit a tort or crime. Such instances of liability are not within the scope of this article. Second, the instrumentality rule might be applied both in criminal and civil cases;<sup>12</sup> It might also be

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<sup>9</sup> See also, *Ross v. Penn. Ry.* (1930) 106 N. J. Law 536.

<sup>10</sup> Bonbright & Means, *The Holding Co.*, p. 10.

<sup>11</sup> Bonbright & Means, *The Holding Co.*, p. 10, etc.; Burchett, *Corporation Finance*, Chap. 17.

<sup>12</sup> See Cases under note 6. *Bishop v. U. S.* (1926) 16 Fed. (2) 410.

used to solve procedural as well as substantive law problems.<sup>13</sup> This article is limited to a discussion of the cases involving the substantive law liability of a parent corporation for the *civil* obligations of its subsidiary. Third, there are a large number of cases involving parent and subsidiary corporations in which the courts by way of dicta speak of disregarding the corporate entity, but the actual basis of the decisions against the parent corporation is that the liability was incurred directly by the parent, either because of estoppel or because the parent acted through its own agents, rather than through the subsidiary.<sup>14</sup> Sometimes it is very difficult to decide whether a particular decision was based on estoppel or on the instrumentality rule, and because of such difficulty, a few cases which perhaps could have been decided on the theory of estoppel have been included in the following discussion of the instrumentality rule.<sup>15</sup> Except for these, all cases in which the liability of the parent was directly incurred are beyond the scope of this article. Finally, the primary purpose of this article is to ascertain, if possible, the meaning of the word "instrumentality" as it is used in the instrumentality rule. The question is then, when is a subsidiary corporation a "mere instrumentality" of the parent corporation so as to make the parent vicariously responsible for the civil obligations of the subsidiary?

### III.

To find an answer to the question the writer has surveyed the cases in the United States wherein the rule was applied, and also those wherein the court refused to apply it. This survey led first of all to the conclusion that the courts have not yet defined in so many words just what they mean by "instrumentality." Therefore the only way to discover what they mean is to study the factual set-up and the decision of each case. This method is far from satisfactory because many of the cases did not set forth the facts in sufficient detail to be of any help,<sup>16</sup> and

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<sup>13</sup> *Goodwin v. N. Y. Ry.* (1903) 124 Fed. 358; *Industrial Research v. General Motors* (1928) 29 Fed. (2) 623; *Miller & Lux v. East Side Canal* (1908) 211 U. S. 293.

<sup>14</sup> *Abney v. Belmont Country Club Properties* (1929) 279 Pac. 829. In *Re Culhane's Estate* (1934) 256 N. W. 807; *Gulf Coast & S. F. Ry. v. Cities Service Co.* (1922) 231 Fed. 214.

<sup>15</sup> *Stark Electric Ry. Co. v. McGinty Cont. Co.* (1917) 238 Fed. 657; *Ross v. Penn. Ry.* (1930) 148 At. 741.

<sup>16</sup> *Canton Co. of Baltimore v. Brown* (1924) 299 Fed. 147; *Davis v. Alexander* (1925) 46 S. Ct. 34; *Ehlers v. Bankers Fire Ins. Co.* (1922) 189 N. W. 159; *Finnish Temperance Society v. Publishing Co.* (1921) 130 N. E. 845; *Gay v. Hudson River Elec. Power Co.* (1911) 187 Fed. 12; *Kelley v. Ning Yung Benevolent Ass'n.* (1905) 84 Pac. 321; *O'Brien v. Champlain Const. Co.* (1901) 107 Fed. 338; *Old Ben Coal Co. v. Universal Coal Co.* (1929) 227 N. W. 794; *Mobile & Ohio Ry. v. Barnhill* (1892) 19 S. W. 21; *Radio Craft Co. v. Westinghouse Electric* (1925) 7 Fed. (2) 432.

because even in cases which do state the facts the courts may have been influenced in part by other facts not stated. However, there are at least thirty-eight cases of liability and twenty-two cases of non-liability which may furnish an answer to the question.

There are a large number of factors which the courts take into consideration in determining whether one corporation is the mere instrument of another.<sup>17</sup> These might be conveniently grouped as follows:

1. Stockholders:
  - a. Are the stockholders of the two corporations identical?
  - b. Does the parent corporation own a controlling portion of the stock of the subsidiary or is such stock in the hands of dummies subject to parent's control?
  - c. Are the stockholders of the subsidiary inactive?
2. Directors:
  - a. Are the directors of the two corporations identical?
  - b. Are the directors of the subsidiary mere dummies subject to parent's control?
  - c. Are the directors of the subsidiary inactive?
3. Officers:
  - a. Are the officers of the two corporations identical?
  - b. Are the officers of the subsidiary mere dummies subject to the parent's control?
  - c. Are the officers of the subsidiary inactive?
4. Employees:
  - a. Are the employees of the two corporations identical?
  - b. Are the employees of the subsidiary hired, fired, paid or otherwise subject to control of parent?
  - c. Are the employees of the subsidiary inactive?
5. Property and Financing:
  - a. Was the subsidiary financed by the parent or by stockholders of parent? Or does the parent supply the funds needed by the subsidiary for current expenses?
  - b. Is the property of the subsidiary subject to use by parent at will? Or do the earnings of the subsidiary go into the treasury of the parent?
  - c. Is the subsidiary inadequately financed, or is it without any separate property or bank account?
6. Books:
  - a. Are the books of the corporation kept by the same person?
  - b. Does the parent corporation keep the accounts of the subsidiary?

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<sup>17</sup> Fletcher's Encyclopaedia of Corps., No. 43; Douglas & Shanks, Insulation from Liability through Subsidiary Corporations, 39 Yale L. R. 193; Powell, Parent & Subsidiary Corps., No. 5.

- c. Are the affairs of the subsidiary so mingled with those of the parent on the books as not to be distinguishable?
7. Business Purpose:
- a. Is the business of the two corporations identical?
  - b. Is the subsidiary treated as a mere branch or department of the parent's business and does it deal almost exclusively with the parent?
  - c. Is the subsidiary inactive?
8. Incorporators:
- a. Were the two companies incorporated by the same persons?
  - b. Did the parent corporation cause the incorporation of the subsidiary?
9. Name:
- a. Do the two corporations have substantially the same name?
  - b. Does the subsidiary act and advertise in the name of the parent?
  - c. Was the subsidiary entirely unknown to the plaintiff?
10. Offices:
- a. Do the corporations use the same offices?
  - b. Are the offices of the subsidiary connected with those of the parent and used by parent at will?
  - c. Does the subsidiary have no offices?

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55	1 b	2 a	3 a		5 a c	6 b	7 b			
56	1 b	2 b	3 b		5 a	6 b	7 b			
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58. *Wichita Falls & N. W. Ry. v. Puchett* (Okla. 1915) 53 Okla. 463.
59. *Am. Nat. Bk. v. Nat. Wall Paper Co.* (U. S. C. C. A. 1896) 77 Fed. 85.
60. *Bishop v. U. S.* (U. S. C. C. A. 1926) 16 Fed. (2nd) 410.

In the chart, page 242, the factors involved in each of the sixty cases have been tabulated. A "factor" is an affirmative answer to any one of the questions listed on page 240, and is evidence that the subsidiary is a mere instrumentality of the parent corporation. The number of the factor in the chart corresponds to the number of the question. The number of the case in the chart corresponds to the index number found in the list of cases on pages 241-3. The first twenty-two cases, found above the black line, are cases in which the parent corporation was held not liable for the debts of the subsidiary. The last thirty-eight cases are cases in which the parent was held liable. The cases above and below the line are grouped according to the number of factors involved, ranging from one to five in those above the line, and from two to six in those below it.

It will be seen from the chart that the first factor appears in every case involving parent and subsidiary corporations, for without it the parent-subsidiary relationship would not exist. In most of the cases the parent itself owned stock of the subsidiary. In a few the same persons owned the stock of both corporations, which are not, strictly speaking, parent and subsidiary, but they are often considered as such by the courts. In either situation it is clear that a corporation cannot be deemed the mere instrumentality of its stockholders merely because of stock ownership. First of all, the management of a corporation lies almost wholly in the hands of the directors and their agents, the officers. The stockholders are mere investors, and they take no part in the management other than to elect the directors periodically and approve extraordinary proposals of the directors as to fundamental changes in the financial structure or business purpose of the corporation. Furthermore, the primary purpose of corporate organizations is to allow limited investment with corresponding limited liability. For these reasons it is well settled throughout the country that one corporation will not be liable for the debts of another merely because it owns a controlling portion of the stock therein, or because the same persons own a controlling portion in both. The first two cases in the chart are examples of a large number of cases so holding.<sup>18</sup>

If stock ownership of itself does not result in liability, it would seem to follow that the exercise of the rights incidental to stock ownership will not lead to that result. Stockholders have the absolute right to vote in the election of directors, passage of

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<sup>18</sup> Elenkrieg v. Siebrecht (1924) 238 N. Y. 254; Broderip v. Salomon L. R. (1895) 2 Ch. 323; Minifie v. Rowley (1921) 187 Cal. 481; Continental Securities v. Rawson (1929) 280 Pac. 954; Mid West Aid Filters Co. v. Finn (1927) 201 Cal. 587; Richmond & I. Const. Co. v. Richmond Ry (1895) 68 Fed. 105; Ballantine on Corporations, No. 6; Cook on Corporations, No. 6.

by-laws and other matter requiring stockholders' action in any way they see fit, and the exercise of this right will not subject the parent corporation to liability.

There is no other one factor which appears in all of the cases. Looking at the chart it may be seen that factor number 3, the situation of the officers of the subsidiary, appeared in more cases than any other factor. Of the others it is apparent that factors number 2, the situation of the directors, number 5, the financial relation of the companies, and number 7, the business relation of the companies, also are involved in most of the cases. But it is equally apparent that these four factors occur in the cases of non-liability as well as in the cases of liability. Furthermore, factors number 8, the incorporation of the subsidiary, number 9, the name, and number 10, the offices used by the subsidiary, seem to appear in cases both above and below the line. The only factors appearing in the cases of liability and not appearing in cases of non-liability are number 4, the situation of the employees of the subsidiary, and number 6, the books of the subsidiary. But these two factors appear in such a small number of cases that they cannot be said to be the distinguishing factors of the liability cases. It can also be seen from the chart that the number of factors involved has little or nothing to do with liability, for there are cases with five factors holding the parent not liable, and on the other hand, cases with only from two to four factors holding the parent liable. There seems to be no way of distinguishing the cases of liability from the cases of non-liability, at least on the basis of the factorial set-up. For nearly every one of the cases above the line, there may be found one below the line involving exactly the same factors and the same number of factors.

Now looking only at the cases below the black line, in which the subsidiary was said to be the "mere instrumentality" of the parent corporation, we find that factors number 3, 5 and 7 appear almost constantly. Thus we can say that where (1) the officers of the subsidiary are the same persons as the officers of the parent or are controlled by the officers of the parent, and (2) there is some close financial connection between the two corporations, and (3) the subsidiary operates merely a branch or division of the parent's business, there is very strong evidence that the subsidiary is a mere instrumentality, and many courts have held that a combination of these three factors or any two of them, plus stock ownership, is sufficient to establish the liability of the parent. If another factor is necessary, it is usually either (1) the fact that the directors of the subsidiary are the same persons as those of the parent, or are controlled by the parent, or (2) the fact that the subsidiary was incorporated by the parent. And if additional factors are needed to

hold the subsidiary an instrumentality, any one or more of the following may be used: (1) the fact that the two companies use the same set of books, (2) that they use the same offices, or (3) that the employees of the subsidiary are the same as those of the parent or are hired, fired, paid or otherwise subject to the control of the parent.

It seems, however, that the only conclusion one can draw from a study of *all* the cases is that there is no rule or principle used by the courts to determine whether the subsidiary is such an instrumentality as to make the parent liable for its debts. It seems that each case was decided almost without regard to the other cases, and that each court had only its own vague "hunches" to reply upon. And yet the general instrumentality rule itself is recognized by all the authorities.

#### IV.

The method of the present writer has been to analyze the facts and decisions of the pertinent cases in an attempt to discover some definite and consistent principles with which the problem of determining when a subsidiary is an instrumentality can be solved. Some writers on this subject used this method. Other writers start out with a theory of their own and then attempt to fit the cases into it, and distinguish and criticize those which will not fit. With the cases so conflicting and vague one would expect to find a variety of theories offered by the writers.

Mr. Ballantine, in his book on Corporations, p. 33, and his article in 60 Am. L. R. 17 came to the same conclusion as the present writer, i. e., that the cases are conflicting and lay down no rule or principle to determine when the subsidiary is an instrumentality. However, he contends that there must be not only the complete control by the parent over the affairs of the subsidiary, but also fraudulent purpose in order to hold the parent liable. By "fraudulent purpose" he means that the parent must use the subsidiary to accomplish some wrong, intending to escape the legal consequences by using the corporate entity of the subsidiary as a shield. If Ballantine is correct, then the liability of the parent company may be put in one of the other four classes of cases mentioned by Mr. Wormser, *supra* p. 236, and the "instrumentality situation" does not belong in a class by itself.

Among the writers following the *a priori* method are Mr. Douglas and Shanks. Their article is entitled "Insulation from Liability Through Subsidiary Corporations," 39 Yale L. R. 193. Instead of trying to discover when the parent will be liable, they approach the problem from the other angle, when will the parent not be liable. First of all, they conclude that the combination of the factors of stock ownership, directors and officers

will not make the parent liable. Then they say that in order for the parent to avoid liability four things are necessary: (1) The subsidiary must be adequately financed. (2) The everyday business of the two companies must be kept separate and distinct so that every transaction and part of a transaction can be identified with the one or the other. (3) The formal barriers between the two companies must be maintained. The stockholders and directors must meet separately for each company. The officers must in every transaction purport to act for one or the other. (4) The two companies must not represent themselves as being part of the same company and must not allow the public to be misled as to their independence. Douglas and Shanks fit a number of cases into their theory and then attempt to distinguish just as many. They finally conclude rather weakly that the courts themselves seem to have no theory and phrase their opinions in metaphors and vague terms such as "instrumentality" and "inequitable results." In that respect their conclusion is in accord with that of Mr. Ballantine and this writer. However, they disagree with Mr. Ballantine and agree with Mr. Wormser as to whether the instrumentality situation belongs in a class by itself. They do not believe that a "fraudulent purpose" is necessary to hold the parent liable.

Another writer adopting the *a priori* method is Mr. Powell, in his recent book, "Parent and Subsidiary Corporations" (1931). He starts with the general principle that the capacity to do business in corporate form with its accompanying advantages is a special privilege conferred by the state, and if the privilege is abused, the advantages will be denied. The privilege may be abused in one or both of two ways: (1) the management of the subsidiary corporation may conduct its business in the interest of the parent corporation alone rather than in the interest of all the stockholders of the subsidiary; (2) the subsidiary may disregard the formal procedure required of all corporations, as the holding of stockholders' and directors' meetings, keeping its own books and accounts, and acting in its own name as an independent concern. In discussing the various factors which evidence such abuse Mr. Powell agrees with Douglas and Shanks that mere identity of stockholders, directors and officers is not enough. And in addition, the fact that the subsidiary was originally financed by the parent is not enough because stockholders or bondholders of a corporation are not liable for its debts. But the appearance of any one or more of the following facts may cause the court to decide that the subsidiary is an instrumentality of the parent: (1) the fact that the subsidiary has not an adequate amount of capital, (2) that the parent uses property of the subsidiary as its own, (3) that the parent pays salaries and other expenses of the subsidiary, (4) that the parent caused the

incorporation of the subsidiary, (5) that the subsidiary has no business except with the parent and is treated as a department or branch of the parent.

Mr. Powell believes, along with Mr. Ballantine, that the mere fact that the subsidiary is an instrumentality does not make the parent liable for its debts. In addition the parent must have made use of the subsidiary to accomplish some wrong similar to those in the first four situations mentioned by Mr. Wormser. So Mr. Powell apparently would not put the instrumentality rule in a class by itself, as does Mr. Wormser.

Finally, Mr. Powell states that not only must the subsidiary be an instrumentality and used to accomplish a wrong, but also the wrong must result in unjust loss or injury to the plaintiff, according to equitable principles. For example: (1) If the plaintiff in dealing with the subsidiary knew of all the circumstances constituting the parent's relation with the subsidiary, he cannot recover from the parent. (2) The parent must have been in control of the subsidiary at the time the obligation arose; otherwise the parent could not have caused it. (3) The remedy against the subsidiary must be inadequate, as where it is insolvent or has removed itself from the jurisdiction or dissolved.

A fourth writer on the subject who was able to come to some conclusion other than that reached by the present writer is Mr. Elson in 15 St. L. L. R. 333. He agrees with the last two that mere identity of stockholders, directors and officers of the two corporations will not make the parent liable. In order to hold the parent liable three things are necessary: (1) the real parties in interest, that is, the stockholders, must be identical; (2) the parent company must exercise control over the management of the subsidiary and (3) the control must be exercised for the benefit of the parent company and its stockholders rather than for the benefit of the stockholders of the subsidiary, as such. Mr. Elson apparently did not deem that the "fraudulent purpose" or "unjust loss" was necessary, and in that respect he sides with Mr. Wormser and Douglas and Shanks.

Another aspect of the subject on which the authorities disagree is whether or not the doctrine of disregarding the entity of the subsidiary and holding the parent liable is purely equitable. Fletcher's Encyclopedia states that it is.<sup>19</sup> Mr. Powell, in believing that unjust loss or injury, or a so-called inequitable result, is necessary, apparently agrees with Fletcher. Mr. Wormser on the other hand, states that though the doctrine may be more willingly and frequently applied in equity, it is a legal doctrine as well.<sup>20</sup> It seems to the present writer that

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<sup>19</sup> Fletcher, sec. 41.

<sup>20</sup> 12 Columbia Law Review 496.

Mr. Wormser is clearly correct; for out of the thirty-eight cases listed in the chart, in which the parent was held liable, not over five were equitable actions, and all the rest were simple actions for damages.

## V.

Altogether there are six possible bases for holding the parent company liable for any violation of duty:<sup>21</sup> (1) The parent has incurred the liability directly; (2) the two companies are identical in fact; (3) the parent has used the subsidiary to accomplish some wrong; (4) the subsidiary is actually the agent of the parent according to the established principles of agency; (5) the subsidiary is the instrumentality of the parent; (6) the subsidiary may be in fact non-existent except as a sham.

1. A corporation can incur liability directly only when its managers, agents or servants have acted for it within the scope of their authority or in the course of their employment. Liability based on such ground has nothing to do with the doctrine of disregarding the corporate entity or the instrumentality rule. But there are many cases where the manager, agents, or servants of the parent and subsidiary corporations are identical. If the business of the companies is distinct, there is no difficulty in such cases in deciding whether in the particular transaction they were acting for the parent or the subsidiary. But if the business of the companies is all part of one enterprise and cannot be distinguished, upon which company must liability fall? Douglas and Shanks stress the importance of transacting the business of the two corporations separately, and are of the opinion that if this is not done either corporation may be held liable. That is probably the only solution to the problem.

2. It is going only one step further to hold the parent liable on the theory that the two companies are identical in fact. All of the factors lettered "a" in the chart are evidence of identity, rather than control. If the stockholders, management, employees, capital, business purpose, etc., of the two companies are substantially the same in fact, there is no good reason why the companies themselves should not be treated as identical in law. Of course, this theory would require the holding that the subsidiary would be liable for the debts of the parent as well as the other way around, but there is no objection to that, and it has been so held.<sup>22</sup>

3. It was noted earlier in this article that Mr. Wormser discusses five distinct situations where the corporate entity may be disregarded. In the first four, apparently, the members of

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<sup>21</sup> Ballantine on Corps., p. 33. Fletcher, *Encyclopaedia of Corps.*, No. 43. *N. Y. Trust Co. v. Carpenter* (1918) 250 Fed. 668.

<sup>22</sup> *In re Muncie Pulp Co.* (1905) 139 Fed. 546.



the corporation cause it to commit some wrong for their benefit and when sued they would put up the defense that it was the corporation's wrong, not theirs. It is clear that a parent corporation will be liable where it uses its subsidiary for such purposes.

Of course a corporation will itself be liable for its own wrongs. And ordinarily the stockholders will not be liable for its wrongs even though it is nearly always attempting to act for their benefit when it commits the wrong. On what basis then can the stockholders be held personally liable unless the corporation was acting under their direction and control rather than independently of them as it is supposed to do? So in the first four situations the corporation must have been a mere instrumentality as well as in the fifth. If so, then what distinguishes the fifth situation, "the instrumentality situation," from the first four? The only distinction seems to be the lack of fraudulent purpose or wrongdoing. The subsidiary in the normal conduct of its business incurs an ordinary contract or tort liability and the parent is held liable for it not because it directed or caused the commission of the wrong but merely because the subsidiary was its instrumentality. As stated above, Mr. Powell and Mr. Ballantine do not consider this a valid distinction. They think that in order to hold the parent liable it must have used its control over the subsidiary to cause it to commit a wrong with intention of shielding itself behind the separate entity of the subsidiary. Mr. Wormser, Mr. Douglas and Shanks, and Mr. Elson, on the other hand, think otherwise. After studying the cases the present writer is inclined to agree with the latter, for in only three cases out of the thirty-eight cases of liability listed in the chart was the element of fraudulent purpose involved.<sup>23</sup>

4. It is well settled that unless prohibited by its charter or by statute there is nothing to prevent one corporation from acting as the agent of another.<sup>24</sup> *Liebhardt v. Wilson*, 38 Colo. 1. Agency is a relation in which one party has conferred on the other the power to affect the legal rights and duties of the former. The relation is ordinarily created by contract; in any event it is always consensual. But it may be implied from circumstances as well as expressed in so many words. Therefore a parent corporation may be liable for obligations incurred by the subsidiary where the subsidiary was acting as its agent, express or implied, and within the scope of its authority.

Many of the courts place their decision against the corporation on this ground,<sup>25</sup> but usually they do not treat the situation as

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<sup>23</sup> Cases sec. 51, 50, 46.

<sup>24</sup> 6 *Fletcher*, Chap. 27.

<sup>25</sup> *Lehigh Valley Ry. v. Dupont* (1904) 128 Fed. 840; *Specht v. Mo. Pac. Ry.* (1923) 191 N. W. 905; *Spokane Merchants Ass'n. v. Clere Clothing Co.* (1915) 84 Wash. 616.

one of agency. They use the words "agency" and "instrumentality" interchangeably and indiscriminately. However, Cardozo in the well known case of *Berkey v. Third Ave. Ry.*<sup>26</sup> says: "Dominion may be so complete, interference so obtrusive, that by the general rules of agency the parent will be a principal and the subsidiary an agent. Where control is less than this, we are remitted to the tests of honesty and justice. The logical consistency of a judicial conception will indeed be sacrificed at times, when the sacrifice is essential to the end that some accepted public policy may be defended or upheld. This is so, for illustration, though agency in any proper sense be lacking, where the attempted separation between parent and subsidiary will work a fraud upon the law. At such times unity is ascribed to parts which at least for many purposes retain an independent life, for the reason that only thus can be overcome a perversion of the privilege to do business in corporate form. We find in the case at hand neither agency on the one hand, nor on the other, abuse to be corrected by implication of a merger." Cardozo therefore distinguishes agency from the situations where the subsidiary is a mere instrumentality to "work a fraud upon the law." Apparently he agrees with Powell that unless actual agency is present the parent will not be liable unless there is a fraudulent purpose.

Included in the cases based on the agency theory are those cases wherein the doctrine of agency by estoppel was invoked to hold the parent liable.

5. The theory with which this article has been most concerned is the instrumentality theory. In other words, the parent may be held liable for the debts of the subsidiary because the parent has complete control over the subsidiary and of course exercises it for its own benefit. All of the factors in the chart which are lettered "b" are evidence of such control.

The instrumentality theory might be distinguished from the agency theory on the ground that the relation does not arise out of a consensual agreement. Thus says Mechem in his book on *Agency*, p. 30: "Authority or power in one person to bind another as his agent may be conferred without any contract between the principal and the agent, and even in some cases without any actual or effective consent upon the part of the agent. In many of these cases the alleged agent would be more properly deemed an instrument or agency than a true agent. The command or direction of the principal to one who is subject to his command will if acted upon suffice to bind him." However, in spite of this minor distinction it is evident that the policy behind the instrumentality theory is the same as that which caused

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<sup>26</sup> (1926) 244 N. Y. 84.

the development of the doctrine of agency, i. e., that one should be liable for the acts of another subject to his control and for his benefit.

The instrumentality theory has already been distinguished from what might be called the "fraudulent purpose" theory.

6. A final possibility for holding the parent liable exists when the subsidiary is inactive, a mere sham, existing in name only. It seems clear that if the parent acts in the name of the subsidiary in such situations to avoid liability, it will be held liable for any obligations incurred. All of the factors lettered "c" in the chart are evidence of this situation. The outstanding example of a case of this sort is number 53, Auglaize Box Board Co. v. Hinton.

#### VI.

The above theories have been suggested by the writers on the subject rather than by the courts. Sometimes the courts mention in their opinions one or another of the various theories, but for the most part they do not attempt to analyze their cases and base their decisions on any one logical theory. Their opinions are thus as vague and conflicting as their actual decisions. At the present time, therefore, we can only say with Justice Cardozo that "the whole problem of parent and subsidiary corporations is still enveloped in the mists of metaphor."<sup>27</sup>

ROBERT W. YOST '36.

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### SUPPLEMENTARY NOTE—WHEN IS A FOREIGN CAUSE OF ACTION BARRED BY LIMITATIONS IN MISSOURI?\*

In the December, 1935, number of the St. Louis Law Review, there appeared a note by John H. Haley of the Class of 1936 on the subject "*When is a Foreign Cause of Action Barred by Limitations in Missouri?*" In that note Mr. Haley had occasion to criticize adversely the decision of Judge Reeves of the United States District Court for the Western District of Missouri in the case of *Wright v. New York Underwriters Insurance Company*.<sup>1</sup> In the *Wright* case it was held by the court that when an original action was commenced in Missouri on a foreign cause of action, within the time allowed therefor by the law of the state in which it originated, then the requirements of R. S. Mo.

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<sup>27</sup> (1926) 244 N. Y. l. c. 94.

\* Compare the views expressed in this supplementary note, with those stated in Note, 21 St. Louis Law Rev. 43.

<sup>1</sup> (1933) 1 Fed. Supp. 663.