Disregarding the Entity of Private Corporations [Part 2]

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The Nature of the Duty Enforced

It is illuminating to observe the rather broad field in which courts have held the doctrine of disregarding the corporate entity applicable in an apparent attempt to enforce the duty owing.65

Duties imposed by common law or equity are frequently enforced by piercing the corporate entity. Thus cases in which a corporation seeks to resist liability for the negligence of its subsidiary or predecessor by asserting the independent character of the latter are frequent.66 Cases of this character are to be distinguished from negligence cases decided on the theory of joint tortfeasor, or even express authority to commit the tort in question. Such grounds make unnecessary the resort to the doctrine of disregarding the entity, the assigned grounds being enough.67 Other cases of tort involving the disregard of the entity are cases of libel,68 false representation,69 fraud,70 patent in-
fringement,\(^1\) conveyance in fraud of creditors,\(^2\) purchase by a fiduciary of trust property through a corporate "instrumentality,"\(^3\) and misappropriation of assets.\(^4\) These illustrations are obviously not exhaustive.\(^5\)

Rights and duties created by contract have been frequently enforced, the courts purporting to apply the doctrine of disregard.\(^6\) Thus, where a person under a contractual duty not to compete attempts to do so by organizing and manipulating a corporation for that purpose on the plea that the corporation and not himself is competing, both he and the corporation will be restrained from doing so, the separate entity of the corporation being disregarded.\(^7\) Again, an agreement to

\(^{1}\) sap, 197 Cal. 765, 242 Pac. 918 (1926); Isaacson v. Union Trust Co. of San Diego, 273 Pac. 119 (1928), 275 Pac. 529 (1929), 286 Pac. 1017 (1930), 210 Cal. 473, 292 Pac. 448 (1930); Ehlers v. Bankers Fire Ins. Co., 108 Neb. 756, 189 N. W. 159 (1923); see Dootov v. Purtell, 216 Ill. 629, 75 N. E. 334 (1905). The use of an instrumentality corporation to obtain property free of equities on plea of bona fide purchaser was frustrated. Simmons Creek Coal Co. v. Doran, 142 U. S. 417 (1892); Wilson Coal Co. v. United States, 188 Fed. 545 (C. C. A. 9th, 1911); Noble v. Joseph Burnett Co., 208 Mass. 75, 94 N. E. 289 (1911). Such cases charge the corporation with notice of the equities.


\(^{3}\) "In re Bullwinkle, 111 Fed. 364 (S. D. N. Y., 1901); Blanc v. Paymaster Mining Co., 95 Cal. 524, 50 Pac. 765 (1892); Kellogg v. Douglas County Bank, 58 Kan. 49, 46 Pac. 587 (1897); Matchen v. Phoenix Land Inv. Co., 159 Minn. 132, 198 N. W. 417 (1924); Terhune v. Skinner, 45 N. J. Eq. 344, 19 Atl. 377 (1889); Bennett v. Minott, 28 Ore. 339, 39 Pac. 997, 44 Pac. 288 (1895); Montgomery Web Co. v. Diehlert, 133 Pa. 585, 19 Atl. 428 (1890); Roberts v. Hughes Co., 86 Vt. 76, 83 Atl. 807 (1912). In cases of conveyances in fraud of creditors, the stock or property of the subsidiary corporation may be administered by the trustee in bankruptcy or receiver of the assets of the parent. In re Muncie Pulp Co., 139 Fed. 546 (C. C. A. 2d, 1905) (stock-bankrupt's receiver); Kimberley Coal Co. v. Douglas, 45 F. (2d) 25 (C. C. A. 6th, 1930) (equity receiver); Isaacson v. Union Trust Co. of San Diego, 210 Cal. 473, 292 Pac. 448 (1930) (trustee); Day v. Postal Tel. Co., 66 Md. 354, 7 Atl. 608 (1887) (equity receiver). Parent corporation cannot obtain payment of a claim in bankruptcy against its subsidiary. Finch Co. v. Robie, 12 F. (2d) 360 (C. C. A. 8th, 1926); Clere Clothing Co. v. Union Trust & Sav. Bank, 224 Fed. 363 (C. C. A. 9th, 1915); see Rembar, Claims Against Affiliated Companies in Reorganization (1939) 39 Col. L. Rev. 907; Comment (1937) 36 Mich. L. Rev. 88.


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A business cannot be evaded through the device of obtaining such business through a corporate subsidiary and then refusing to make the transfer. Likewise, the transfer of a lease to a corporate instrumentality for the purpose of evading the obligation to pay royalties, or for the purpose of evading other terms of a lease, will be frustrated through application of the doctrine. Nor will a court permit one to escape the necessity of observing a contract providing plaintiffs with an exclusive selling agency as long as defendants should manufacture lumber, defendants later manufacturing lumber through a corporate instrumentality and claiming to be no longer engaged in the business; or, being unable to sue, organize a corporate instrumentality for the purpose of being enabled to do so in its name. Nor will a corporation be permitted to recover on a fire insurance policy issued to it where the incendiarism was occasioned by the act of the sole creditor and beneficial owner in control of the corporation to whom the proceeds of the policy would go. The separate personality of the corporation will be disregarded. Similarly, a defense good against all the stockholders has been held good against the corporation, and vice versa, as, for example, the defense of res judicata or estoppel. Closely related to questions of evasion are cases involving obstruction to the proper enforcement of duties contractual in character. The entity will be disregarded to resist such obstruction.
Duties or debts created by contract include the duty to pay. The desirability of enforcing payment of debts incurred does not necessarily mean that the doctrine of disregarding the corporate entity of the immediate debtor may be invoked in order to render liable a solvent defendant. Nevertheless, the nonpayment of debts frequently gives rise to an attempt to utilize the doctrine. The evasion phase of this matter frequently relates not so much to the attempt of a parent corporation to escape liability as it does to escaping financial responsibility for an admitted liability of the immediate debtor. Thus, attempts of individuals or firms to organize a corporation for the purpose of placing and dealing with their property in its name so as to place that property beyond the reach of their creditors are frequently frustrated, courts treating the corporate property as that of the firm or individual. Likewise, an attempt to prefer a creditor by having him become a stockholder and creditor in a corporation to which the insolvent debtor conveyed his property will be held ineffective for such purpose.

Closely related to the subject of contractual duty is the duty usually contractual in character successfully asserted against a corporation by reason solely of the acts of its only stockholder. The corporation being treated as his mere instrumentality, its separate personality is disregarded and it is held liable for his acts.

The attempted obstruction or evasion of statutory duties by use of the concept of corporate entity furnishes many cases on the subject. Thus, an individual cannot use the mails to defraud by organizing a

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Pittsburgh Reflector Co. v. Dwyer & Rhodes Co., 173 Wash. 552, 23 P. (2d) 1114 (1933).


Polsom v. Detrick Co., 85 Md. 52, 36 Atl. 446 (1897).


This phase is generalized in Barbour v. Thomas, 7 F. Supp. 271, 277 (E. D. Mich., 1933) as follows: "... the corporate concept cannot be employed to evade a statute or defeat its intent."
corporation controlled by him and carrying on his fraudulent scheme in its name. The crime is his, not merely the corporation's.\textsuperscript{94} Nor may railway carriers in violation of the Commodities Clause of the Hepburn Act organize a corporate instrumentality for the purpose of engaging in the business of manufacturing, mining, producing or owning commodities.\textsuperscript{95} Likewise, a corporation may not be used to enable its stockholders to violate the Federal Anti-Trust Law,\textsuperscript{96} or the Clayton Act;\textsuperscript{97} or to shield stockholders from the payment of stock assessments by claiming that the corporation rather than they themselves owe them;\textsuperscript{98} or to evade or obstruct liability for taxes;\textsuperscript{99} or to collect taxes not otherwise assessable;\textsuperscript{100} or to enable the creation of monopoly;\textsuperscript{101} or to permit the violation of rate statutes;\textsuperscript{102} or to enable the granting of rebates in violation of the Elkins Act.\textsuperscript{103} Nor may a corporate instrumentality be used for the purpose of exercising the right of eminent domain, which right would not otherwise exist;\textsuperscript{104} nor may corporate personality be used to collusively confer jurisdiction on the federal courts;\textsuperscript{105} nor to prevent such jurisdiction from attaching;\textsuperscript{106} nor may a foreign corporation prohibited from doing business in a state organize another corporation for that purpose;\textsuperscript{107} nor may individuals through the device of a corporation obtain coal lands in excess of the statutory maximum.\textsuperscript{108} Other illustrations involving the enforcement of statutory duty by application of the doctrine of disregard will be found in the footnotes.\textsuperscript{109}

\textsuperscript{94}Redmond v. United States, 8 F. (2d) 24 (C. C. A. 1st, 1925).
\textsuperscript{95}United States v. Delaware L. & W. R. R. Co., 238 U. S. 516 (1915);
\textsuperscript{96}Northern Securities Co. v. U. S., 193 U. S. 197 (1904).
\textsuperscript{100}Miller v. Milwaukee, 272 U. S. 715 (1927).
\textsuperscript{103}United States v. Milwaukee Refrigerator Transit Co., 142 Fed. 247 (E. D. Wis., 1905).
\textsuperscript{104}Parkside Cemetery Ass'n v. Cleveland, B. & G. Lake T. Co., 93 Ohio St. 161, 112 N. E. 596 (1915).
\textsuperscript{107}State v. Safford, 117 Ohio 576, 159 N. E. 829 (1927).
\textsuperscript{109}Linn & Lane Timber Co. v. United States, 236 U. S. 574 (1915).
What has been noted concerning the evasion of statutory duties suggests the query: Will the entity be disregarded for the purpose of positively enforcing the duty, rather than merely resisting an attempted evasion? Like the frustration of attempted evasion, the court seeks to make the statutory duty effective. The answer to the query proposed would seem to be in the affirmative, and the cases so hold.\(^\text{110}\)

The Supreme Court of the United States has stated the rule as to duty (or its correlative right) as follows:

"As a general rule a corporation and the stockholders are deemed separate entities **. Of course, the rule is subject to the qualification that the separate entities may be disregarded in exceptional situations where it otherwise would present an obstacle to the due protection or enforcement of public or private rights.\(^\text{111}\)"

The foregoing illustrations of duty, common law, contractual and statutory, assume that unjustified loss would occur to the recipient of the duty owed if the entity were not disregarded.\(^\text{112}\) But a person may, even under such circumstances, place himself in such a position that he may not invoke the doctrine. The loss is not "unjustified". Thus if one knowingly agrees to accept the sole liability of a subsidiary corporation or individual, its entity cannot be disregarded for the purpose of visiting liability upon the parent individual or corporation. The theory of election,\(^\text{113}\) or possibly that of estoppel,\(^\text{114}\) is applicable.

Again, if at the time the subsidiary incurred the obligation it was independent, later, however, becoming a mere instrumentality, the


\(^{111}\) New Colonial Ice Co. v. Helvering, 292 U. S. 435 (1934); cf. note 93, supra.

\(^{112}\) On the other hand, to avoid violation of duty and consequent loss, the corporate entity may be regarded. Continental Securities Inv. Co. v. Rawson, 208 Cal. 228, 280 Pac. 954 (1929); Voll v. Zelch, 198 Iowa 133, 172 N. E. 521 (1930) (usury); Tucker v. Binenstock, 310 Pa. 254, 165 Atl. 247 (1933) (prohibition laws).

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creditor cannot hold the new parent corporation liable for the old obligation unless it has, for example, deprived the subsidiary of assets which should otherwise have been available to satisfy the creditor's claim.

It has been suggested that cases of evasion of duties do not necessarily require a court to disregard the corporate entity. It is argued that they merely require the scope of the duty owed to be enlarged so as to become enforceable against the obligor and his controlled corporation regarded as an entity. Thus, in case of a contract not to compete, the contract must be construed to apply to the obligor's instrumentality corporation forbidding competition by it as well. Again, in case of a conveyance of property in fraud of creditors to an instrumentality corporation, the law prohibiting such conveyance must be held to have been violated by the grantor through such corporation regarded as an entity. This view of the matter is in many cases logically possible and deserves more consideration than it has received. However, the suggested mode of stating the matter is not generally relied on; most cases of duty evasion expressly proceed on the footing that the corporate entity is disregarded.

V.
ENFORCEMENT OF DUTY OWED WHEN THE RIGHTS OF THIRD PARTIES ARE NOT PREJUDICED

Occasionally the doctrine of disregard can be invoked to enforce a duty owing by the parties involved as a matter of convenience, no rights of third persons being involved or prejudiced. In such cases the


principles heretofore discussed\textsuperscript{118} may also (but not necessarily) justify application of the doctrine of disregard. Cases cited in support of illustrations given in this section should therefore be considered in the light of both possible explanations, either or both of which may apply. Thus, two owners of a corporation have been treated as partners by disregarding the corporate entity.\textsuperscript{119} In a suit to quiet title, the court has disregarded the entity of a family corporation, no corporate creditors’ rights being prejudiced.\textsuperscript{119} A corporation has become liable on the contract of its sole stockholder.\textsuperscript{120} In a suit on a note by a corporation, the defendant is permitted to set off a debt owed to him by the corporation’s sole stockholder.\textsuperscript{121} A sole stockholder has been personally held liable for breach of a corporate contract.\textsuperscript{122} A sole stockholder has been permitted or compelled to pay,\textsuperscript{123} or secure his personal debts with corporate property,\textsuperscript{124} subject to the rights of existing creditors. Likewise he has been forced to pay corporate debts with his private property.\textsuperscript{125} Sole stockholders have been permitted to assert corporate rights.\textsuperscript{126} In cases of this character the entity is properly disregarded because the rights of the parties involved may be finally determined without regard to the corporate entity and without prejudice to the rights of third persons. Indeed, this principle seems to be implicit in the number of decisions involving one-man corporations, the reason for disregarding the entity of which seems difficult to otherwise justify.\textsuperscript{127}

\textsuperscript{118}See notes 144 to 147, infra.
\textsuperscript{120}Sheffield Co. v. Hoe & Co., 173 Wash. 489, 23 P. (2d) 876 (1933).
\textsuperscript{122}Knight v. Burns, 22 Ohio App. 482, 154 N. E. 345 (1926); Western Securities Co. v. Spiro, 62 Utah 623, 221 Pac. 856 (1923); cf. State v. Weston Bank, 125 Neb. 612, 231 N. W. 164 (1933), and Gallagher v. Germania Brewing Co., 53 Minn. 214, 54 N. W. 1115 (1893) (refusing setoff).
\textsuperscript{126}See notes 91 and 120, supra.
\textsuperscript{127}See Panich v. Curtis, Owen, Fuller Corporation, 124 S. W. (2d) 619 (Mo., 1939); Waring v. WDAS Broadcasting Station, 327 Pa. 433, 194 Atl. 631 (1937).
VI.
SUGGESTED TESTS FOR DISREGARDING CORPORATE ENTITY

A consideration of the elements relied on by the courts in piercing the corporate entity gives rise to the query as to whether there are not some common and specific principles running through the various cases that may be profitably utilized.

It will be remembered that the formation, control and manipulation of separate entities is intentional in character. The word "intentional" is not used to mean secret, uncommunicated intent but rather intent as manifested by outward act or conduct—overt intent. Thus, the intention to obliterate corporate personality may be shown in various ways. Intimacy is, of course, evidence of such intention. More specifically, however, attention may be directed to manipulation, confusion of assets, payment of a subsidiary or other corporation's expenses, use of the subsidiary's property in the interest of the parent, failure to observe formal legal requirements and the use of the corporation to transact its owner's business. On the other hand, proof may fall short of establishing such intention. Thus understood it becomes at once apparent, at least in most cases, why stock ownership, common officers, loans, common names, organization by the parent corporation and similar facts do not necessarily establish intention to disregard the corporate entity. Mere intimacy is not necessarily inconsistent with intention to regard rather than to disregard the corporate entity.

Recognition that the facts above stated are but evidence of intent is reminiscent of the earlier history of partnership law. The early law seized upon various indicia of partnership, such as sharing of profits and losses, existence of ownership and control or community of interest. Later these came to be recognized as mere evidence of intention to be partners, and the test of partnership established that it was the intention of the parties that determined whether partnership existed. This

(1938) 51 HARv. L. Rev. 1373, 1389.
See notes 35 to 43, supra.


intention was not a secret intention but rather an intention as manifested by outward act or conduct—overt intention.\textsuperscript{120}

However, merely because overt intent to disregard exists does not mean that such intent will be enforced by the courts if to do so would be to permit the achievement of purposes condemned by law. Thus, if overt intent to regard the corporate entity or to disregard the corporate entity is used for the purpose of violating a duty owed, such intent should no more be enforced than would a contract, partnership or agency for an illegal purpose.\textsuperscript{131}

However, the use of the concepts of overt intent and purpose will not altogether explain a group of cases heretofore discussed\textsuperscript{132} in which overt intent to disregard does not necessarily appear. In this class of cases overt intention is not decisive. The corporate entity may be disregarded even though there be an overt intention to regard the entity for a proper purpose. To explain this class of cases by resort to overt intention is to resort to intention fictional in character. The analogy of contract and quasi-contract helps make this clear. Whereas contracts are enforced when the object is lawful because of the factual intention or agreement of the parties, quasi-contracts are imposed by law irrespective of the intention of the parties. Such obligations are not contract obligations at all but are clothed with the semblance of contract for the purpose of utilizing a contractual remedy. Here, too, the reason assigned is that of doing justice.\textsuperscript{133} Similarly, in the case of trust and constructive trust, the latter is not a trust in fact based on intention but rather one imposed by law irrespective of intention for the purpose of utilizing a trust remedy “to do justice”.\textsuperscript{134} The principle implicit in decisions such as these is apparent in various branches of the law and accounts for doctrines such as constructive delivery, constructive eviction, constructive knowledge, constructive notice, constructive possession, constructive service and similar constructive juridical facts constructed by law for the purpose of “doing justice”. So, in the class of cases of disregarding the corporate entity now considered, the entity is disregarded irrespective of overt intent in order to enforce a duty owing, particularly when some collateral advantage accrues thereby, or, as the courts often say, in order “to do justice”. Unlike the case of constructive trust or contract, the court does not treat the situation as if there were in fact a trust or a contract but rather negatively, as if there were no corporate entity. The principle, however, is the same. Actual intent is not involved.

Bearing in mind the foregoing considerations, it is believed that the

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\item[\textsuperscript{120}]\textsuperscript{20 R. C. L. 818, 823-33.}
\item[\textsuperscript{121}]\textsuperscript{RESTATEMENT, AGENCY (1933) \$ 19; see also note 130, \textit{supra}.}
\item[\textsuperscript{122}]\textsuperscript{See Section V, \textit{supra}.}
\item[\textsuperscript{123}]\textsuperscript{Miller v. Schloss, 218 N. Y. 400, 407, 113 N. E. 337 (1916).}
\item[\textsuperscript{124}]\textsuperscript{RESTATEMENT, \textit{RESTITUTION} (1936) \$ 160.}
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following principles may be profitably used in solving problems involving the disregard of the corporate entity, and to furnish reasonable limits within which the doctrine may be invoked:

1. (a) If there is an overt intention to regard or disregard the corporate entity, effect will be given thereto unless so to do will violate a duty owing.

(b) The overt intention is that of the corporation whose entity is sought to be disregarded or of the person or persons owning its stock and sought to be visited with the consequence of regard or disregard of the corporate entity.

(c) The duty owing must be owing to the person seeking to invoke the doctrine, and such duty may arise from common law and equity, contract or statute.

The foregoing principles can be easily illustrated even though the reasons assigned in the decisions (although consistent with those suggested in this paper) are not necessarily the same as those here urged.

The case of *Sommer v. Yakima Motor Coach*\(^{125}\) illustrates a case of an overt intention to regard the corporate entity for a proper purpose, i. e., a purpose involving the violation of no duty. In that case the plaintiff brought an action to recover damages for the negligence of a stage driver. He sought to recover judgment against two stage companies on the theory that they were in substance one and the same company. The court held that the fact that the two stage companies had identical trustees and officers and were closely allied in their business relationships and that the one was financially irresponsible and kept alive by the other by loans to it and by purchases of its stock, each, however, conducting its business separately but under a close working arrangement, did not establish a single identity in law. The court held that the evidence did not show that there was such a commingling of affairs as to render it apparent that the corporations were intended to function as one or that they were intended to work a fraud on others.

The case of *Grotheer v. Rosenberg*\(^{126}\) illustrates a case of overt intention to regard the corporate entity for an improper purpose, i. e., for the purpose of violating a duty owed. In that case an individual, in anticipation of a judgment being rendered against him, transferred his property to a corporation organized by him in exchange for its shares of stock, for the purpose of conducting his business as a separate entity. The court held that the corporation was liable to pay the judgment obtained against the individual. The intention to regard the corporation as a separate entity was frustrated because not to do so would have been to violate the duty owed to the individual's creditor to pay the judgment.

\(^{125}\) 174 Wash. 638, 26 P. (2d) 92 (1933).

The case of *Deeds v. Gilmer*\(^{137}\) illustrates a case of overt intention to disregard a corporate entity for a proper purpose, *i. e.*, no duty being violated. In that case two equal owners of the stock of a corporation disregarded the corporate entity and conducted the business as a partnership composed of themselves. In a suit as between themselves and as between one of them and the creditors of the other, it was held that the corporate entity would be disregarded. In such a case it is apparent that since no duty is violated there, is no reason for not enforcing the intention of the parties in disregarding the entity of the corporation.\(^{137}\)

Should there be a case involving an overt intention to disregard the corporate entity for the purpose of violating a duty owing, the courts will have ample precedent, by analogy at least, to refuse to disregard the corporate entity under such circumstances.\(^{138}\)

The case of *In re Armbruster Store Co.*\(^{139}\) illustrates the principle that it is the overt intention of the corporation whose entity is sought to be disregarded that may be the controlling intention that determines whether the corporate entity should be regarded or disregarded. In that case a new corporation was created under a reorganization plan and was held not liable for the debts of the old corporation, the court expressly refusing to invoke the doctrine of disregard because creditors were estopped by their conduct from invoking the doctrine. The intention of the reorganized corporation to regard its corporate entity is given effect, no duty to creditors being violated thereby. If, however, a duty owed to creditors is violated, then as in the case of *Sheild v. Smith*\(^{140}\) overt intention of the successor corporation should not be given effect. In that case the corporation succeeded to the business of a partnership, taking over its assets and issuing its stock in payment therefor. It was held liable on a debt incurred by the partnership prior to the transfer of assets. Obviously, if the successor corporation intends to regard its corporate entity, the intention is to regard its entity for the purpose of violating a duty owed to the creditor of the partnership, for that creditor has a right to be paid with the assets of the partnership, possession of which has been taken by the corporation.

However, as distinguished from cases involving successor, merged or consolidated corporations, the more common overt intention that is held controlling is that of the stockholder of the corporation, par-

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\(^{137}\)162 Va. 157, 174 S. E. 37 (1934).
\(^{139}\)The doctrine of disregard may often be justifiably applied on the basis *either* that an overt intent to disregard exists *or* that the overt intent to regard involves the violation of a duty owed.
\(^{140}\)See notes 130 and 131, supra.
\(^{153}\)53 S. D. 477, 221 N. W. 87 (1928).
ticularly in parent and subsidiary corporation cases. Thus, in *Kentucky Electric Power Co. v. Norton Coal Mining Co.* a parent corporation conducted its business separately from that of its subsidiary. Its intention was to regard the separate entity of the subsidiary corporation. Accordingly, in that case, the court refused to give a subsidiary corporation an equitable lien on the parent corporation's realty on account of expenditures mistakenly made on the realty of the parent corporation, applying the general rule applicable to separate and distinct entities. In *Williams v. Freeport Sulphur Co.* the court held that a citation to a foreign parent corporation could be served on a domestic subsidiary corporation for the reason (in effect) that the corporation's intention was that the subsidiary corporation should be its agent.

The doctrine of disregard is applied to enforce the duty owing to the person for whose benefit the doctrine is invoked. The overt intention discussed above should not, however, be confused with the contention made by a complaining party. Thus, in *In re John Koke Co.* a lender, knowing that money was borrowed for the benefit of a corporation, elected to take the promissory note of the individual who owned eighty of its eighty-two shares of stock, the note being secured by collateral. The court held that the lender was bound by his election and that a claim against the corporation, which had become bankrupt, could not be allowed. In that case the lender's contention was that the entity should be disregarded, but the overt intention of the individual stockholder was to regard the corporate entity. Accordingly, that intention was enforced because no duty was violated thereby.

Attention is called to the fact that in applying the principles of regarding or disregarding the corporate entity, it is assumed that the rights of third persons not before the court must not be prejudiced. The court will not in applying the doctrine do so if third persons who are not before the court, such as creditors or stockholders, are injured. After all, it is only the right and convenience of the parties before the court that is being served. The enforcement of the duty owing, involving the doctrine of disregarding the corporate entity as a matter of convenience, should not justify the enforcement of that duty at the expense of third persons. Consequently, there is a class of decisions that may be explained by the following principle:

2. Where the rights of a third party are not prejudiced, a corporate entity may be disregarded in determining the rights of the immediate

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19"33 F. (2d) 923 (C. C. A. 6th, 1938). However, ownership of every share of stock by the person sought to be held liable is unnecessary. See Sunset Farms v. Superior Court, 9 Cal. App. (2d) 389, 50 P. (2d) 106 (1935).


19"38 F. (2d) 232 (C. C. A. 9th, 1930).
parties interested as a matter of convenience to them (e. g., obviating further litigation) in order to enforce a duty owing. The question of overt intention is not here necessarily involved.

For example, in *Oscarson v. Norton* a deed from all stockholders of the property of a corporation was held effective to convey title (the duty owing being thereby enforced), the stockholders being the persons beneficially interested and there being no creditors or other third persons who would be prejudiced by such conveyance. Similarly in *Western Securities Co. v. Spiro*, a corporation seeking to recover an indebtedness was held subject to a counterclaim or set-off in favor of the defendant (who was owed the duty) and against the individual who organized the corporation for the transaction of his personal business and of the transactions involved and who was beneficial owner of all of its shares of stock. The court treated the individual as the real party in interest, i. e., the person beneficially interested. In *Knight v. Burns* where a set-off under similar circumstances was permitted, the court followed the reasoning of an earlier New York case, calling attention to the fact that "no superior equities of third persons will be affected by such adjustment", and that circuity of action would be avoided—an obvious advantage gained by disregarding the corporate entity.

The existing theories of abuse of corporate privilege, agency, identity, and of the substance and justice rules, are, it is believed, rather general ways of stating the specific principles above mentioned. Agency is a relationship arising through mutual intention, actual or apparent. Identity is the theory most often relied on in cases of confusion of assets or cases involving merged, consolidated or successor corporations in which the assets of the predecessor have been transferred to the new corporation resulting in a practical physical identity. What the parties have done manifests an intention to disregard the corporate personality for proper purposes, such as the payment of the predecessor's debts. Cases involving abuse of corporate privilege are cases in which the intention to keep corporate entities separate is for the purpose of evading duties created by law or contract; hence they are frustrated. The test of "justice" or "substance", even when combined

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1439 F. (2d) 610 (C. C. A. 9th, 1930).
1442 Utah 623, 221 Pac. 855 (1923).
1442 Ohio App. 482, 154 N. E. 345 (1926).
144See notes 60 and 116, supra.
144Note reasoning in Blumenthal v. Schneider, 186 Wis. 588, 203 N. W. 393 (1925); Walker v. Rome, 6 Ga. App. 69, 64 S. E. 310 (1909); Shadford v. Detroit Ry., 150 Mich. 500, 89 N. W. 980 (1902); see note 15, supra.
144See note 11, supra.
with other tests, are but more vague ways of stating the tests here suggested. Thus, to enforce a duty owing, i.e., to do justice, the entity is disregarded. Again, when under the facts of a given case one corporation is manipulated for another's benefit (i.e., an overt intention to disregard the entity of the manipulated corporation exists), the court states it looks to the substance of the matter and disregards the entity of the corporation in question. Even when overt intention to disregard does not exist, and it is convenient to disregard the entity in order to enforce a duty, the theory that the court looks through the form to the substance in order to do justice is but a more general way of stating the more specific second principle above mentioned.

It must be admitted that so far as express recognition of the tests suggested is concerned, there is little in the decided cases or legal writings on which to rely. The tests suggested are as yet implicit in the decisions rather than explicit. It must also be admitted that if the tests suggested are accepted, a certain number of decisions will be subject to criticism, either for failure to regard the corporate entity, or for failure to disregard the corporate entity. Nevertheless, it is believed that the principles suggested should lead to a proper adjustment of the balance that must be maintained between the legitimate functions of corporation on the one hand, and the abuse of those functions on the other.

VII.

The Washington Law

The Washington cases are on the whole decided along the same lines as are cases of other jurisdictions. Ordinarily the corporate entity will not be disregarded. Washington cases involving the disregard of the corporate entity have assigned the usual reasons for applying the doc-

151See note 15, supra.
152See note 144, supra.
154See notes 171 and 172, infra.
156State ex rel. Tacoma v. Tacoma Ry. & P. Co., 61 Wash. 507, 112 Pac.
trine: requirements of justice;\(^{157}\) prevention of fraud;\(^{156}\) disregard of the corporate entity in practice by the parties;\(^{159}\) as in cases of confusion of assets;\(^{160}\) colorable or sham character of the corporate entity;\(^{161}\) confusion of identities of individual and corporation or corporation and corporation.\(^{162}\) Sometimes the court has assigned no particular reason but has implicitly recognized the rule that the form will be disregarded and the substance considered.\(^{163}\) Finally the agency theory has frequently been invoked.\(^{164}\)

The later cases in Washington have attempted to formulate a rule on the subject, at least insofar as corporate stockholders are concerned. Thus, in *Sommer v. Yakima Motor Coach Co.*\(^{165}\) the court approved the following statement of the rule to be applied:


\(^{159}\) *Spokane Merchants Ass'n v. Clere Clothing Co.*, 84 Wash. 616, 147 Pac. 414 (1915); *Pohlmans Inv. Co. v. Virginia City Co.*, 184 Wash. 273, 51 P. (2d) 363 (1935).


\(^{161}\) *Spokane Merchants Ass'n v. Clere Clothing Co.*, 84 Wash. 616, 147 Pac. 414 (1915); *Clark v. Schwaegler*, 104 Wash. 12, 175 Pac. 300 (1918); The National Bank of Commerce of Seattle v. Dunn, 194 Wash. 472, 78 P. (2d) 535 (1938); *Allman Hubble Tugboat Co. v. Reliance Development Corporation*, 193 Wash. 234, 74 P. (2d) 985 (1938).

\(^{162}\) *Roberts v. Hilton Land Co.*, 45 Wash. 464, 88 Pac. 946 (1907); *Clark v. Schwaegler*, 104 Wash. 12, 175 Pac. 300 (1918); *Sheffield Co. v. Hoe & Co.*, 173 Wash. 489, 23 P. (2d) 876 (1933); *Garvin v. Matthews*, 193 Wash. 152, 74 P. (2d) 990 (1938).

\(^{163}\) See note 161, supra.

\(^{164}\) *Mitchell v. Lea Lumber Co.*, 43 Wash. 195, 86 Pac. 405 (1906); *Spokane Merchants Ass'n v. Clere Clothing Co.*, 84 Wash. 616, 147 Pac. 414 (1915); *DeLano v. Tennent*, 138 Wash. 39, 244 Pac. 273 (1926); *Wilson v. Washington Concrete Pipe Co.*, 178 Wash. 545, 35 P. (2d) 71 (1934); *Celian v. Coast Finance Corp.*, 189 Wash. 676, 66 P. (2d) 365 (1937).

\(^{165}\) 174 Wash. 638, 657, 26 P. (2d) 92, 99 (1933).
it must appear that the one so dominates and controls the others as to make the other a mere tool or instrument of the one so that justice requires the dominant corporation to be held responsible for the results, and further, that there shall be such a commingling of their funds and property interests, and their affairs so intimately related in management that to consider them other than as one would work a fraud upon third persons."

It is interesting to note that while the rule thus stated requires the existence of two elements, an earlier statement of the rule required the existence of one or the other of the elements mentioned. The rule laid down in the Sommer case is unduly restrictive under the decisions both in Washington and elsewhere. It is subject to criticism, not only on account of its somewhat general and indefinite character and its use of terms "tool", "instrument", "justice", "fraud", but also because it fails to provide for the case of corporate entity intended to be disregarded for proper purposes. Furthermore, it fails to take into account cases involving the second principle above discussed not without illustration in Washington. Nevertheless it is one of the few cases suggesting that intention to regard or disregard corporate entity is of juridical importance.

Although the tests for disregarding the corporate entity suggested in this paper have not been in express terms adopted in this state, an examination of Washington cases shows that with rare exception all the cases may be explained by such principles. The Washington cases are classified in the footnotes.

If the principles announced in this paper are correct, the statement

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107Pittsburgh Reflector Co. v. Dwyer & Rhodes Co., 173 Wash. 552, 23 P. (2d) 1114 (1933).
108See note 137, supra.
109See notes 144 to 147, supra, and Sheffield Co. v. Hoe & Co., 173 Wash. 489, 23 P. (2d) 876 (1933); see note 170 (d), infra.
10bIn the following cases the intention to regard the corporate entity for an improper purpose was frustrated. In some of the following cases principle (a) above might alternatively be applicable as explained in note 137a, supra. Platt v. Bradner Co., 131 Wash. 573, 230 Pac. 633 (1924); Associated Oil Co. v. Seiberling Rubber Co., 172 Wash. 204, 19 P. (2d) 940 (1933); State v. Davies, 176 Wash. 100, 28 P. (2d) 322 (1934); Kelley v. Von Herberg, 184 Wash. 165, 50 P. (2d) 23 (1935); Allman Hubble T. Co. v. Reliance Dev. Corp., 193 Wash. 234, 74 P. (2d) 985 (1938).
of the doctrine of disregard in the case of Garvin v. Mathews\textsuperscript{171} and the decision of National Bank of Commerce of Seattle v. Dunn\textsuperscript{172} must be deemed in conflict with them. The Garvin case correctly holds that a corporation cannot sue its stockholder merely because it is his alter ego. No duty owed is violated. The court, however, in stating that the doctrine of disregard can be invoked only "at the behest of third parties" sustaining injury, unduly restricts the application of the doctrine. Thus in a suit between stockholders to determine their rights inter se, or in a suit for divorce involving a family corporation, the doctrine of disregard should be applicable under the second test herefore suggested.\textsuperscript{178}

In the Dunn case the assignee of the lease to stop liability for future rent reassigned it to a corporation organized by him, nearly all of whose stock he owned. The lease contained no covenant to pay rent, nor a prohibition against reassignment. The corporation, though managed by Dunn, was continuously kept separate and apart from his personal affairs and in good faith regarded by him as a separate entity. No duty being violated, the entity under the overt intention test should have been regarded. The court, however, disregarded the entity and held the reassignment ineffective as colorable. Had the holding been predicated on the basis that the corporation was Dunn's agent, rather than a separate entity, the decision would have been consistent with the test suggested, but the decision does not seem to be predicated upon that view.\textsuperscript{174}

\textbf{CONCLUSION}

There is nothing particularly new about the concepts of intention and purpose in our law. Nor is the device of disregarding corporate entity in light of intention, purpose or convenience, without analogy in other branches of the law. It is the suggestion of this paper, however, that the doctrine of disregarding the corporate entity should be utilized in light of these fundamental concepts. If this is done, the whole subject is illuminated by the rich experience of other branches of the law and it becomes an easier task to extend legitimate protection to stockholders and at the same time to prevent unwarranted injury to others.

\textsuperscript{171} See Sections V and VI and note 169, supra.
\textsuperscript{172} See notes 15 and 170 (c), supra.
\textsuperscript{174} See note 170 (c), supra.