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## Contractual Liability of Defectively Organized Corporations

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pany twenty years ago, followed by disintegration into many smaller units, to the control of the industry by several very large companies. Furthermore, while twenty years ago the Standard Company was responsible for approximately 80 per cent of the refined products, today, the separate Standard companies in the aggregate control almost 25 per cent of the crude production and approximately 45 per cent of the output of refined products. About half of the crude is still produced by a very large number of individuals or small companies, but more than two-thirds of the "proven acreage" of oil bearing lands of the country is in the hands of nine Standard Companies and six independent companies.

A consideration of the facts summarized heretofore may be an aid to the formulation of some plan for stabilization. The plans which have been suggested by various authorities are too numerous and involved to be considered here. A brief study of some of these plans, which may be found in recent volumes of the Congressional Record and in other governmental documents, law journals, periodicals and treatises, will disclose that most of the solutions center their attention on the production end of the industry. From the economic standpoint, however, it would seem that possibly more effective control might be exercised through the refiners who are fewer in number. A national plan for cooperation among them would transcend irrelevant state lines. The resulting lack of a market for excess production of crude might well induce a voluntary control in the oil fields, which militia are now being used to enforce sporadically. The necessary revision of the anti-trust laws and the establishment of suitable regulation over a consolidated petroleum industry constitute a major challenge to statesmanship.

H. ROBERT SHAMPAINÉ, '32.

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### CONTRACTUAL LIABILITY OF DEFECTIVELY ORGANIZED CORPORATIONS

The approach to the problem of the judicial treatment of defectively organized corporations is one hedged about by many conflicting ideas and many concurrent considerations of which notice must be taken.<sup>1</sup> First of all it may be said that from the

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<sup>1</sup> The following factors must be considered: the nature of the body which has presumably been brought into existence; for what purpose the question of corporate existence is being urged; the nature of the defect in the corporate structure, and whether or not the particular defects are regarded in that jurisdiction as supermandatory, mandatory or merely directory re-

standpoint of organization, corporations can be divided into two all-inclusive categories, invulnerable corporations,<sup>2</sup> properly, carefully and correctly organized, on the one hand, and defective corporations on the other hand. Of the latter class there are many types varying from de facto corporations to "naked" associations according to the quality of their defectiveness, and it can be said safely that the difference between them is largely a matter of degree.

Where there is defectiveness of incorporation the courts are put to the task of deciding whether or not a de facto corporation has been brought into existence. The definition of a de facto corporation which is now commonly accepted by the text-writers and one followed by the courts in this country involves three requisites: a statute or general law under which such a corporation might exist, a bona fide attempt under that law and a colorable compliance therewith, and finally the exercise of corporate powers or "user" as it is called.<sup>3</sup> It is the second requisite that has become the bone of contention. When is the defect such that there has been a failure to make a colorable compliance with the law? This question has met with a variable response from the courts. It is essentially upon this ground that the nature of the defective corporation is determined.<sup>4</sup> Thus it might be well to advert to a brief survey of the treatment accorded the more prevalent defects in corporate organization.

(a) *The failure to file a certificate of corporate existence*

It has been held that the filing of a certificate is a condition precedent to the existence of a de jure corporation and as to this

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quirements; special statutory provisions covering specific instances, and what is not the least confusing of all, the meaning to be implied from the language of the opinions and the influences upon the court of considerations of public policy.

<sup>2</sup> Invulnerable corporations are intended to designate those corporations which, so far as their original incorporation goes, would be safe from dissolution by the state on direct attack.

<sup>3</sup> There are cases which demand only the existence of a statute, and the user of corporate powers. *Methodist-Episcopal Union Church v. Pickett* (1859) 19 N. Y. 391. But this case has been severely criticised. *Society of Perun v. City of Cleveland* (1885) 43 Ohio St. 481, 33 N. E. 357; *Finnegan v. Noerenberg* (1893) 52 Minn. 239, 53 N. W. 1150; *Von Lezerke v. City of New York* (1912) 150 App. Div. 98, 134 N. Y. S. 832; Ballantine, *MANUAL OF CORPORATION LAW* (1930) 77, n. 19; Warren, *Collateral Attack* (1906) 20 HARV. L. REV. 454.

<sup>4</sup> It is obvious that the user of corporate powers will not be often called into question, because it is the attempt to use corporate powers in the absence of taking proper legal steps to secure such right that brings about litigation. If the state does not sanction the existence of corporations for the

point there is little difficulty.<sup>5</sup> However, where the statute requires filing in more than one place the failure to file in each place does not prevent the formation of a de facto corporation if there has been an attempt to comply as evidenced by filing in one of the places specified.<sup>6</sup> Some cases without determining whether or not there is a de facto corporation say that one is estopped to deny the corporate existence.<sup>7</sup> There is a respectable number of cases expounding the contrary view to the effect that a failure to file defeats corporate existence.<sup>8</sup> Here, too, many of the opinions do not indicate clearly whether or not a de facto corporation is meant. In some states there are statutes which declare that "a corporation shall have no legal existence" or "a corporation shall not transact business" if certificates have not been duly filed. These, likewise, have received various treatment.<sup>9</sup>

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purpose involved, etc., so that no law exists under which the corporation can be formed, it is clear that there can be no corporate existence. Warren, *op. cit.*

<sup>5</sup> *Bank of Midland v. Harris* (1914) 114 Ark. 344, 170 S. W. 67; *Hilton v. Mackey* (1912) 225 Ill. 144, 99 N. E. 470; *Martin v. Deetz* (1894) 102 Cal. 55, 36 Pac. 368.

<sup>6</sup> *Wesco Supply Co. v. Smith* (1918) 134 Ark. 23, 203 S. W. 6; *Bakersfield Town Hall Ass'n v. Chester* (1880) 55 Cal. 98; *Hudson v. Green Hill Seminary Co.* (1885) 113 Ill. 618; *Bushnell v. Consolidated Ice Mach. Co.* (1891) 138 Ill. 67, 27 N. E. 596; *Marshall v. Keatch* (1907) 227 Ill. 35, 81 N. E. 29; *Galvin v. Detroit Steering Wheel Corp.* (1913) 176 Mich. 569, 142 N. W. 742; *Grant Chrome Co. v. Marks* (1919) 92 Ore. 443, 181 Pac. 345. Some cases hold that failure to file with the secretary of state is a matter between the state and the corporation. *United States v. Delatour* (C. C. A. 8, 1921) 275 F. 137; *Mokelumne Canal Min. Co. v. Woodruff* (1859) 14 Cal. 424; *Stone v. Great Western Oil Co.* (1866) 41 Ill. 85; *Doty v. Patterson* (1900) 155 Ind. 60, 56 N. E. 688; *Humphrey v. Mooney* (1880) 5 Colo. 282; *Newcomb-Endicott v. Fee* (1911) 167 Mich. 574, 133 N. W. 540; *In re Cordova Shop* (D. C. W. D. N. Y. 1914) 216 F. 818.

<sup>7</sup> *Baker v. Neff* (1880) 73 Ind. 68; *Broadwell v. Merritt* (1885) 87 Mo. 95, 1 S. W. 855; *Rienhard v. Virginia Lead Mine Co.* (1891) 107 Mo. 616, 18 S. W. 17; *Roll v. St. L. & C. Co.* (1892) 52 Mo. App. 60.

<sup>8</sup> *Elgin Watch Co. v. Loveland* (C. C. N. D. Iowa 1904) 132 F. 41; *Harrill v. Davis* (C. C. A. 8, 1909) 168 F. 187; *Perrine v. Levin* (1910) 68 Misc. 327, 123 N. Y. S. 1007; *McClelland v. Hopkins* (1895) 2 Kan. App. 260, 42 Pac. 1061; *Eisfeld v. Kinworth* (1879) 50 Iowa 389; *Guckert v. Hacke* (1893) 159 Pa. 313, 2 Atl. 249; *Bergeron v. Hobbs* (1897) 96 Wis. 641, 71 N. W. 1056.

<sup>9</sup> *Harrod v. Hamer* (1873) 32 Wis. 162, expresses the view that although the statute provides that the corporation shall not do business until the certificates have been filed, the statute recognizes by its very wording that the corporation does exist prior to this. See *Granby Min. & Smel. Co. v. Richards* (1888) 95 Mo. 106, 8 S. W. 246. For treatment of statutes to this effect see, *Badger Paper Co. v. Rose* (1897) 95 Wis. 145, 70 N. W. 302;

(b) *Failure to subscribe capital stock*

There seems to be a clear weight of authority in favor of the protection of members from individual liability where the capital stock has not been fully subscribed. And correlatively the courts will frequently enforce such liability to the extent of the amount subscribed by the stockholder.<sup>10</sup> Upon principle it seems just to enforce liability to this extent, since, as is said in a recent Tennessee case, "Capital in the form of paid in stock is the substitute for personal liability."<sup>11</sup> There are, however, a number of decisions which reach a partnership result.<sup>12</sup> In several cases it should be noted there are statutes which impose this liability.<sup>13</sup> But some courts have protected members despite statutory provisions that at first blush would seem to impose partnership responsibility.<sup>14</sup> Although many of the decisions do not categorize business organizations involved as *de facto* or otherwise, it is tacitly understood from the imposition of partnership liability that the existence of a corporation *de facto* is being denied. The factual point upon which the cases diverge is the time at which the subscription comes, *i. e.*, whether the subscription is made after the assumption of corporate business or prior to incor-

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approved in *Sentinel Co. v. Meiselbach Co.* (1910) 144 Wis. 224, 128 N. W. 861; *Newel River Draining Ass'n v. Durbin* (1868) 30 Ind. 173.

<sup>10</sup> *Sweeney Brothers v. Talcott* (1892) 85 Iowa 103, 52 N. W. 106; *Thornton v. Baclon* (1892) 85 Iowa 198, 52 N. W. 190; *Moe v. Harris* (1919) 142 Minn. 442, 172 N. W. 494; *Crouch v. Gray* (1926) 154 Tenn. 521, 290 S. W. 391; *Tonge v. Item Pub. Co.* (1914) 244 Pa. 417, 91 Atl. 229; *Gartside Coal Co. v. Maxwell* (C. C. E. D. Mo. 1884) 22 F. 197; *Planters & M. Bank v. Padgett* (1882) 69 Ga. 159; *Jessup v. Carnegie* (1880) 80 N. Y. 441; *Morawetz, CORPORATIONS* (1886) 748.

<sup>11</sup> *Eastern Prod. Corp. v. Tenn. Coal & Iron Co.* (1925) 151 Tenn. 239, 269 S. W. 4. It may be noted here that there was only \$800 paid in toward a capitalization of \$2,000,000.

<sup>12</sup> *Ward-Truitt Co. v. Bryan* (1916) 144 Ga. 769, 87 S. E. 1037; *Schaub v. Coffin* (1904) 135 Mich. 435, 97 N. W. 968; *Swietusch v. Becker* (1913) 153 Wis. 213, 140 N. W. 1056; *Meyer v. Brunson* (1916) 104 S. C. 84, 88 S. E. 359; *Kaiser v. Lawrence Sav. Bank* (1881) 56 Iowa 104, 8 N. W. 772.

<sup>13</sup> *Farmers Co-op. Co. v. Floyd* (1890) 47 Ohio St. 252, 26 N. E. 110; *Wechselberg v. Flour City Nat. Bank* (C. C. A. 7, 1894) 64 F. 90 (statute prohibited doing business). *Loverin v. McLaughlin* (1896) 161 Ill. 417, 44 N. E. 99; *Kent v. Clark* (1899) 181 Ill. 237, 54 N. E. 167; *Chicago Coated Bed Co. v. Bear* (1911) 166 Ill. App. 258; *Heinze v. South Green Bay Sand & Dock Co.* (1901) 109 Wis. 99, 85 N. W. 145 (statute prescribed liability expressly).

<sup>14</sup> *American Radiator Co. v. Kinnear* (1909) 56 Wash. 210, 105 Pac. 630; *McKay v. Garman* (1915) 89 Wash. 23; 153 Pac. 1082; *Nat'l Bank v. Almy* (1875) 117 Mass. 476; *Quinn v. Woods* (1929) 134 Miss. 621, 99 So. 510. In the *Almy* case the statute prescribed that there be no exercise of corporate powers until the capital stock was paid in.

poration.<sup>15</sup> Furthermore the lack of subscribed or paid in capital stock is sometimes looked to in determining the presence of a bona fide attempt to incorporate.<sup>16</sup>

(c) *Expiration of the charter*

It may seem illogical to consider a corporation which has become defective because of the expiration of its charter in the same category with corporations which are defective at their very inception by reason of defects in organization. But since all these defects raise similar problems, it may be well to consider briefly the treatment which the courts have accorded the type of defect arising out of the expiration of the corporate charter.

Some courts, in this situation, treat the corporation as de facto.<sup>17</sup> However other courts reach the contrary result.<sup>18</sup> It is submitted that the former is the more just and desirable result, except in those cases where the statute expressly forbids a longer term of existence.<sup>19</sup>

This brief prefatory review of the authorities indicates that little hope may be held for the crystallization of a general rule as to what constitutes colorable compliance. It follows consequently that there is no universal yard-stick by which corporations may be judged to determine whether or not they are de facto entities. Each set of circumstances presents a specific situation and the problem may be resolved by a reference to the holdings of the particular jurisdiction in which the case arises. If it is entitled to de facto status, the corporation can sue and be sued, no collateral attack will be permitted, and the stockholders will not be liable as partners. But if the organization does not

<sup>15</sup> Ballantine, *op. cit.* 89.

<sup>16</sup> Christian Co. v. Fruitdale Lumber Co. (1898) 121 Ala. 340, 25 Ala. 340, 25 So. 566. Liability is sometimes based on fraud. Detroit Electric Works v. Riverside St. Ry. Co. (Mo. 1895) 29 S. W. 412; Burns v. Beck Hdwe. Co. (1889) 83 Ga. 471, 10 S. E. 121; *cf.* Wakeman v. Daley (1872) 51 N. Y. 27.

<sup>17</sup> Miller v. Newbury Orrel Coal Co. (1888) 31 W. Va. 836, 8 S. E. 600; Citizens Bank v. Jones (1903) 117 Wis. 446, 94 N. W. 329; Campbell v. Perth Amboy Shipbuilding Co. (1905) 70 N. J. Eq. 40, 62 Atl. 319; Merges v. Altenbrand (1912) 45 Mont. 355, 123 Pac. 21; Wilson v. Brown (1919) 107 Misc. 167, 175 N. Y. S. 688.

<sup>18</sup> Screwmans Benev. Ass'n v. Monteleone (La. 1929) 123 So. 116; Knight of Pythias v. Weller (1896) 93 Va. 605, 25 S. E. 891; Bradley v. Reppell (1896) 133 Mo. 545, 32 S. W. 645; Clarke v. American Cannel Coal Co. (1905) 165 Ind. 213, 73 N. E. 1083; Bonfils v. Hayes (1921) 70 Colo. 336, 201 Pac. 677; Meramec Springs Park v. Gibson (1916) 268 Mo. 394, 188 S. W. 178.

<sup>19</sup> Ballantine, *op. cit.* 85.

merit de facto existence what then? As has been indicated, many of the courts refuse to permit a suit in the name of the pseudo-corporation and impose partnership liability; nevertheless many cases achieve a corporate result despite the failure to acquire a de facto standing. This is done by the so-called "application of the doctrine of estoppel."<sup>20</sup>

In applying the estoppel doctrine to cases involving contractual liability, the decisions may be divided into three groups:<sup>21</sup>

- (a) cases in which the purported corporation is seeking to escape liability by denying its corporate existence;
- (b) cases in which persons who have dealt with the corporation as such seek to escape liability to the plaintiff corporation by denying its corporate existence;
- (c) cases in which the party having dealt with the corporation seeks to impose liability upon the stockholders personally by a denial of the corporate existence.

The first class of cases alluded to above presents the only situation in which there is a true estoppel.<sup>22</sup> Here the corporation has been held out to the plaintiff as such. Assuming that he is ignorant of actual facts, he has relied upon this representation and has changed his position whereby he will be damaged if the corporate existence is successfully refuted. The majority of decisions hold to this view.<sup>23</sup>

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<sup>20</sup> As will appear later, there is only one type of case in which the estoppel is a real estoppel *in pais*. Furthermore the language of estoppel has sometimes been used in denying collateral attack against a de facto corporation. See *Bash v. Culver* (1893) 7 Wash. 122, 34 Pac. 462. It may be noted that effect of failure to acquire de facto status upon contractual liability is not consistent with the results in other classes of cases where the liability question is not involved, for instance in matters of title of real estate it is very difficult to raise the question of defectiveness of a corporation which is the vendor in a chain of title. *San Diego Ga. Co. v. Frame* (1902) 137 Cal. 441, 70 Pac. 295; *Ferguson Fruit and Land Co. v. Goodding* (1927) 44 Idaho 76, 258 Pac. 557; *Reynolds v. Grand Lodge* (1930) 171 La. 395, 131 So. 186.

<sup>21</sup> *Ballantine, op. cit.* 91; note (1922) 7 MINN. L. REV. 42; (1926) 14 CAL. L. REV. 486.

<sup>22</sup> *Gardner v. Minneapolis Ry. Co.* (1898) 73 Minn. 517, 76 N. W. 282; *Casey v. Galli* (1876) 94 U. S. 673.

<sup>23</sup> *Georgia Fert. Co. v. Foster* (1929) 40 Ga. App. 436, 149 S. E. 812; *Northwest Auto Co. v. Harmon* (C. C. A. 9, 1918) 250 F. 832; *Dugan v. Int. Ass'n* (1917) 202 Ill. App. 308; *Pilliod v. Angola R. Co. v. Woods* (1919) 104 Kan. 729, 180 Pac. 734; *Beal v. Bass* (1894) 86 Me. 325, 29 Atl. 1088; *Gilligan v. Gilligan Co.* (1913) 94 Neb. 437, 143 N. W. 457; *Joint Stock Co. v. Nat'l City Bank* (1924) 210 App. Div. 665, 206 N. Y. S. 476;

The second class of cases does not involve a true estoppel. If the pseudo-corporation sues upon a contract made with it the defendant should not be able to set up defects in the corporate structure to avoid liability.<sup>24</sup> He has made a contract and has involved himself in a liability which would otherwise attach and to force the suit to be brought jointly by the members would do violence to the spirit of simplified procedure. In the field of contract law the courts find no difficulty in raising implied obligations under quasi-contracts. So there should be little hesitancy to imply a condition in the dealings under these cases to the effect that the obligee shall be considered a corporation for the purposes of the contract.<sup>25</sup> Whether the result is reached on this substantive basis or upon the estoppel basis matters little since it is the ultimate result that must finally indicate the attitude of the court regardless of its language.<sup>26</sup>

The third class of cases presents the greatest difficulty. In the situation where a plaintiff tries to secure personal liability upon

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Burke v. Barnum (1917) 40 R. I. 71, Atl. 1027; Shields v. Clifton Land Ass'n (1894) 94 Tenn. 143, 28 S. W. 668; Martin v. South Salem Land Co. (1897) 94 Va. 28, 26 S. E. 591; McCullough v. Tallageda Ins. Co. (1871) 46 Ala. 376; Scheufler v. Grand Lodge (1891) 45 Minn. 256, 47 N. W. 799; Grand Co. v. Rollins (1889) 13 Colo. 4, 21 Pac. 897; Stewart Paper Mfg. Co. v. Rau (1893) 92 Ga. 511, 17 S. E. 748; Fitzpatrick v. Rutter (1896) 160 Ill. 282, 43 N. E. 392; Grand Lodge v. Cramer (1895) 60 Ill. App. 212; Humphrey v. Mercantile Ass'n (1879) 50 Iowa 607; Dooley v. Cheshire Glass Co. (1860) 81 Mass. 494; Rush v. Halcyon Steamboat Co. (1888) 84 N. Car. 702; Williams v. Stevens Point Lumber Co. (1888) 72 Wis. 487, 40 N. W. 154.

<sup>24</sup> City of Greenville v. Greenville Water Works (1899) 125 Ala. 625, 27 So. 764; Plummer v. Struby Estabrooke Merc. Co. (1896) 23 Colo. 190; Ryan v. Martin (1884) 91 N. Car. 464; Lorillard v. Van Houten (N. J. 1829) 5 Halst. 270; Johnston Harvester Co. v. Clark (1883) 15 N. W. 252, 30 Minn. 308; Chapman v. Colby (1881) 10 N. E. 74; Williamsburg Ins. Co. (1877) 122 Mass. 391; Williams v. Cheney (Mass. 1855) 3 Gray 215; Brown v. Scottish Amer. Mortgage Co. (1884) 110 Ill. 235; Gaines v. Bank of Miss. (1851) 12 Ark. 769; Montgomery R. R. Co. v. Hurst (1846) 9 Ala. 513; Toledo Scale Co. v. Young (1909) 16 Idaho 187, 101 Pac. 257; New Idea Spreader Co. v. Satterfield (1928) 45 Idaho 753, 265 Pac. 664; Smith v. Pittler (1928) 95 Cal. App. 101, 272 Pac. 789; Burrows Shoe Co. v. Brotherton (1930) 106 Cal. App. 162, 288 Pac. 879; Erskine Motor v. Chevrolet Motor (1920) 180 N. Car. 619, 105 S. E. 420. A contrary view is held in Welland Canal Co. v. Hathaway (N. Y. 1832) 8 Wend. 480, which denies the rule in Dutchess Mfg. v. Davis (1817) 14 Johns. (N. Y.) 239, but it seems that the Welland case has in effect been overruled by Comm. Nat'l Bank v. Pfeiffer (1888) 108 N. Y. 242, 15 N. E. 701.

<sup>25</sup> Tulane Imp. Co. v. Chapman & Co. (1911) 129 La. 562, 56 So. 509; Braswell v. Scott Lumber Co. (1911) 128 La. 818, 55 So. 468.

<sup>26</sup> See Ballantine's comment on Snider Sons v. Troy (1890) 91 Ala. 224, 8 So. 658, *op. cit.* 93, n. 62.

a pseudo-corporation's obligation, the courts have varied widely in result. The writers are at odds in deciding on what side of the scale rests the weight of authority.<sup>27</sup> It is difficult to estimate accurately just what is the majority rule because many of the cases present a woeful confusion of ideas and an appallingly loose choice of term. Furthermore there is not always a careful discrimination between the three classes of so-called "corporation by estoppel" cases in the citation of the decisions. However, there are many opinions which impose individual liability.<sup>28</sup> It is probably safe to say that in point of numbers this group predominates. On the other hand there is respectable authority for the contrary proposition.<sup>29</sup> But there is by no means, a uniformity as to the theories upon which the cases in either group proceed. *Harrill v. Davis*<sup>30</sup> flatly decides upon grounds of public policy that mem-

<sup>27</sup> Dodd, *Partnership Liability of Stockholders in Defective Corporations* (1927) 40 HARV. L. REV. 521, claims a weight of authority for the imposition of liability. With him stand Professor Warren, *op. cit.*, Wrightington, UNINCORPORATED ASSOCIATIONS (1923) 26, Professor Burdick, *Are Unincorporated Associations Partnerships?* (1906) 6 COL. L. REV. 1, and Professor Ballantine, *op. cit.* But Professor Lewisohn, Professor Carpenter, Mr. Fletcher, and Mr. Morawetz align themselves on the opposite side, while Professor Magruder, as a conscientious objector, remains noncommittal.

<sup>28</sup> *Harrill v. Davis* (C. C. A. 8, 1909) 168 F. 187; *In re Ballard* (D. C. N. D. Tex. 1922) 279 F. 574; *Tucillo v. Petelle* (1911) 127 N. Y. S. 314; *Jones v. Aspen Hdwe. Co.* (1895) 21 Colo. 263; *Martin v. Fewell* (1883) 79 Mo. 401; *Johnson v. Corser* (1885) 34 Minn. 355, 25 N. W. 799; *Fay v. Noble* (Mass. 1851) 7 Cush. 188; *Bates v. Baker-Street Shirt Co.* (C. C. A. 1, 1925) 6 F. (2d) 854; *Bigelow v. Gregory* (1874) 73 Ill. 197; *Guckert v. Hacke* (1893) 158 Pa. St. 303, 28 Atl. 245; *Kaiser v. Savings Bank* (1881) 56 Iowa 104, 8 N. W. 772; *Diehe v. Taylor* (1896) 37 Fla. 64, 19 So. 172; *Winfield v. Truitt*, 71 Fla. 38, 70 So. 775 (1916); *Hall v. Robertson* (1920) 213 Ill. App. 147; *Jennings v. Dark* (1910) 175 Ind. 332, 92 N. E. 778; *Central Nat'l Sav. Bank v. Sheldon* (1912) 86 Kan. 460, 121 Pac. 340; *McClenan v. Hopkins* (1895) 2 Kan. App. 260, 41 Pac. 1061; *Smith v. Shoodoc Pond Packing Co.* (1912) 109 Me. 555, 84 Atl. 268; *Finnegan v. Noerenberg* (1893) 52 Minn. 239, 53 N. W. 1150; *Abbott v. Omaha S. & R. Co.* (1876) 4 Neb. 416; *Poergeron v. Hobbs* (1897) 96 Wis. 641, 71 N. W. 1056.

<sup>29</sup> *In re Western Bank & T. Co.* (1908) 163 F. 713; *First Nat'l Bank of Ocean City v. Zelle* (N. J. 1930) 150 Atl. 413; *Humphrey v. Mooney* (1880) 5 Colo. 282; *Blanchard v. Kaull* (1872) 44 Cal. 440; *American Rad. Co. v. Kinnear* (1909) 56 Wash. 510, 105 Pac. 630; *Braswell v. Scott Lum. Co.* (1911) 128 La. 818, 55 So. 468; *Tulane Imp. Co. v. Chapman & Co.* (1911) 129 La. 562, 56 So. 509; *Slocum v. Head* (1900) 105 Wis. 439, 81 N. W. 673; *Pittsburg Co. v. Beale* (1902) 204 Pa. 53 Atl. 540; *Lockwood v. Wynkoop* (1914) 178 Mich. 388, 144 N. W. 846 (dictum); *Magnolia Shingle Co. v. Zimmerins Co.* (1912) 3 Ala. App. 578, 58 So. 90; *Stafford Bank v. Palmer* (1880) 47 Conn. 443; *John Bernhardt's Estate* (1924) 156 La. 207, 100 So. 399; *Booth v. Scott* (1918) 276 Mo. 1, 205 S. W. 635.

<sup>30</sup> N. 28 above.

bers of an association less than de facto must be liable as partners. *Fay v. Noble*<sup>31</sup> hedges a bit and imposes personal liability upon the active members but relieves from such liability the inactive members. The court argues that the acts done by the representatives in behalf of the organization are acts of agency, but since the inactive members who do not serve as representatives have not authorized the creation of personal liability for themselves and since the organization, being fatally defective, is not a legal entity, there is no principal and, *quod erat demonstrandum*, the active members must be liable on the doctrine of *Younge v. Toynebee*.<sup>32</sup> This logic is open to the objections that it is not at all foreign to the law of agency to impose liability upon the principal despite the absence of authority and that *Younge v. Toynebee* is not unquestioned law, especially in so far as it enunciates principles of policy. In *Tulane Implement Co. v. S. A. Chapman & Co.*<sup>33</sup> and in *Staver & Abbott Mfg. Co. v. Blake*<sup>34</sup> non-partnership liability is achieved by means of an implied contract. When the defendants contracted with the plaintiff there was an implied condition by reason of their very use of a corporate appearance that only the limited liability of a corporate organization was being subjected to the obligation. The case of *In re Western Bank*<sup>35</sup> emphasizes the capacity in which the group has acted, holding that creditors who have treated with the corporation *as such* cannot hold the members individually even though there is no de facto existence. In several cases the plaintiff brought a prior action against the corporation as an entity and now seeks to collect his judgment (rendered against the corporation) from the members but he has not been permitted to do so.<sup>36</sup> The decision in *Braswell v. Scott Lumber Co.*<sup>37</sup> proceeds from a reluctance to set up a contract of which neither party was cognizant at the time of their dealings. Whereas, in *Snider & Sons v. Troy*,<sup>38</sup> the court seizes upon all the possible theories with equal avidity and relish for each in

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<sup>31</sup> *Ibid.*

<sup>32</sup> (1910) 1 K. B. 215, holds that an agent contracting for a non-existent principal is himself liable although the death of the principal is unknown to him. Also *Collen v. Wright* (1874) 8 El. & Bl. 647.

<sup>33</sup> N. 29 above.

<sup>34</sup> (1896) 111 Mich. 282, 69 N. W. 508; *Snider's Sons v. Troy* (1890) 91 Ala. 224, 8 So. 658; *Blanchard v. Kaull*, n. 29 above; *Planters & Miners Bank v. Padgett* (1882) 69 Ga. 159; *Miller v. Coal Co.* (1888) 31 W. Va. 836, 8 S. E. 600; *Sentell v. J. E. Hewitt et al.* (1898) 50 La. Ann. 3, 22 So. 970; *Wesco Supply Co. v. Smith* (1918) 134 Ark. 23, 203 S. W. 6.

<sup>35</sup> N. 29 above.

<sup>36</sup> *Ibid.*

<sup>37</sup> *Ibid.*

<sup>38</sup> N. 34 above and see n. 26.

turn, and finally concludes that the association involved is a de facto organization after all.

Nor is there any harmony among the text-writers as to the appropriate theoretical basis upon which the cases may be resolved. Professor Warren contends<sup>39</sup> that the associates in a defectively organized corporation which has not measured up to de facto requirements should be held liable as partners. "The contention that out of a consensual transaction no obligation can arise except such as the parties intended to arise is not sound. The law frequently imposes upon the parties to a consensual transaction certain obligations not covered by their actual expressed intent. Thus A, owner of a tract of land, may convey a portion of it to B and A may find that the law imposes an easement for B over the land retained although he had no intent that B should have such an easement. Thus A may sell goods to B and find that the law imposes upon him a warranty of their quality although he had no intent to make such a warranty. Then A may without authority assume as agent of B to contract with C and may find that the law imposes upon him personally a liability under the contract." He further suggests that collateral attack be liberally permitted. But it may be suggested in answer to such arguments that ways of necessity and warranties are implied out of the *presumed* intent of the parties, and such presumptions may be expressly negated in the transaction. Is it not a fair assumption to say that the intent which may be presumed from a transaction involving a purported corporation is that the limited corporate liability is being extended by the obligor and being accepted by the obligee? This, of course, involves the proposition that to invoke successfully the estoppel doctrine there must be a clear holding out of the corporation by the obligors and a recognition of the group as such by the obligees.<sup>40</sup> Professor Carpenter<sup>41</sup> advocates the contrary view, as does Professor Lewisohn.<sup>42</sup> It is Professor Carpenter's contention that the nature of stockholders' liability is limited and, in the absence of considerations of public policy, a corporate result should be reached no matter how defective the organization may be. Turning to those elements of policy which may defeat this conclusion he sees no real reason based on policy whereby to hold the stockholder. "The only substantial objection to treating the insufficiently incorporated association as a corpora-

<sup>39</sup> Warren, *Collateral Attack* (1907) 21 HARV. L. REV. 312.

<sup>40</sup> *Slocum v. Head*; *American Rad. Co. v. Kinneary*; n. 29 above.

<sup>41</sup> Carpenter, *Are Stockholders of Defective Corporations Liable as Partners?* (1923) 8 MINN. L. REV. 409.

<sup>42</sup> Lewisohn, *Liability of Associates in Defectively Incorporated Associations* (1915) 13 MICH. L. REV. 271.

tion is the possibility of fraud and imposition upon the persons who have dealt with it. . . . Subject to safeguard against the abuse of immunity from individual liability, persons should be as free to associate themselves into corporations by contract as to form partnerships." However, the fact which seems to have escaped Professor Carpenter's notice is that the courts, by a denial of corporate existence where the de facto requisites have not been met, are attempting to create that very safeguard against abuse of limited liability of which he speaks.

Professor Dodd<sup>43</sup> in an illuminating article contends very vigorously that the "less than de facto corporation" must be considered a partnership and he attempts to prove his point upon the basis of the principles of the Uniform Partnership Acts. But Professor Magruder<sup>44</sup> with equal vigor refutes the contention. So, with the academicians in the field of Corporations disowning this type of business group and the scholastics in the field of Partnerships denying its rightful presence in their preserves, the unfortunate legal waif finds meagre welcome. In fact one is reminded of the lines in one of Countee Cullen's "Epitaphs."

" . . . poor soul . . . ,  
 God and Satan are arguing  
 Which shall take you, which repel,  
 God wants no discord in his Heaven,  
 And Satan has enough in Hell."

In endeavoring to arrive at a workable rule by which the problem of liability of a fatally defective organization may be resolved, a common sense approach will indicate several factors of which account must be taken. The corporation with its limitation of personal liability is one of the economic institutions to which a great deal of the progress and advancement of our present day capitalistic system may be attributed. Investors do not want to subject their whole fortunes to the exploitation of a new venture. Furthermore creditors are not unfamiliar with the type of liability to which they may have resort when they deal with a business group that purports to be a corporation. If we are to say that associates who hold themselves out as a corporation are estopped to deny that corporate existence, we thereby permit the creditor to get at the group assets despite the defectiveness of its incorporation. In this event the creditor is faced with the problem of determining the value of the credit of the group and the extent to which their group assets can bear the

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<sup>43</sup> Dodd, *Stockholders in Defective Corporations* (1927) 40 HARV. L. REV. 521.

<sup>44</sup> Magruder, *Partnership Liability of Stockholders in Defective Corporations* (1927) 40 HARV. L. REV. 733.

burden of the obligation which he may thrust upon them. It is submitted that this is no more or less than any creditor must do to protect himself in dealing with any debtor. The statement of Judge Brewer, in *Gartside Coal Co. v. Maxwell*, is pregnant with good sense. "I think the true rule to be this: that where persons knowingly and fraudulently assume a corporate existence, or pretend to have a corporate existence, they can be held liable as individuals; but where they are acting in good faith . . . and where the corporation assumes to transact business for a series of years and the assumed corporate existence is not challenged by the state, then they cannot be held liable as partners."

It is therefore submitted that a denial of corporate existence should not be permitted for the purpose of imposing partnership liability on stockholders in respect to contractual claims no matter how fatal the defect in the corporate organization where there has been a formation of an association as a corporation in good faith and for a legitimate business enterprise, provided that the pseudo-corporation clearly purports to be a corporation and that the party dealing with it cannot show that for valid reasons, he did not deal with it as such.

Such a rule will lead to no injustice towards the creditor because he can inspect the credit of the group with which he deals, and furthermore it will obviate a contrary doctrine which is harsh, unjust, and discordant with sound economic considerations.

A. W. PETCHAFT, '33.

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#### WHAT REMARKS BY A LAWYER IN HIS OPENING STATEMENT ARE PREJUDICIAL?

Procedural law does not normally present such an interesting field for debate on conflicting views as does substantive law. But the state of the law on such a question as, what remarks by counsel in his opening statement will be prejudicial, is often of far more practical importance to a lawyer than the status of some question of substantive law, because a particular question of substantive law may not arise in more than one of a thousand cases while the trial of every case before a jury includes an opening statement by each party which may make a lasting impression on the jury. The cases dealing with the problem evince a notable absence of clear thinking, precise terminology and consistent application of principles to similar fact-situations. Textbooks dealing with the subject of trials generally enunciate the proposition that the opening statement of counsel should