

Michigan Law Review

Volume 37 | Issue 2

1938

CORPORATIONS - DISREGARDING CORPORATE ENTITY - FRAUD

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Recommended Citation

Collins E. Brooks, *CORPORATIONS - DISREGARDING CORPORATE ENTITY - FRAUD*, 37 MICH. L. REV. 314 (1938).

Available at: <https://repository.law.umich.edu/mlr/vol37/iss2/11>

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CORPORATIONS — DISREGARDING CORPORATE ENTITY — FRAUD — *A* and *B* purchased from plaintiffs all of the stock of defendant corporation. Prior to the transaction, and as a basis for negotiations, plaintiffs had an accountant prepare a statement of corporate assets and liabilities, which showed that the corporation was in financial difficulties. *A* and *B* acknowledged the corporate indebtedness and took over the corporation. Later, plaintiffs brought suit against the corporation on claims for salaries and advancements allegedly due them from it, which claims had not appeared on the statement of corporate liabilities. *Held*, the corporate entity would be disregarded, and plaintiffs estopped from setting up their claims against the corporation. *Paul v. University Motor Sales Co.*, 283 Mich. 587, 278 N. W. 714 (1938).

As a general rule, a corporation is regarded as a legal entity, separate and distinct from the individuals who comprise it.¹ The application of this rule in the instant case would necessitate a judgment for plaintiffs; for, strictly speaking, they in no way wronged or prejudiced the corporation by failing to exhibit their claims on the statement of liabilities. Their misrepresentation prejudiced only the purchasers of the corporate stock, who must, under the above rule, be considered as separate from the corporation, especially since they were not connected with it when the misrepresentation was made. For the same reason, plaintiffs cannot be held estopped to set up their claims against the corporation. But clearly the equities are against the plaintiffs in this situation. The liabilities of a corporation are material considerations to persons contemplating the purchase of its entire stock, particularly when the corporation has a large deficit. It is axiomatic that a corporation can act only through its agents, and since plaintiffs were the sole stockholders, *A* and *B* would seem justified in relying on their representations. The court invokes the now common exception to the general rule, that when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.² Courts in general have seemed increasingly willing to utilize this formula to justify their disregard of the corporate entity in dealing with problems of corporate law.³

¹ I FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, perm. ed., § 25 (1931); BALLANTINE, PRIVATE CORPORATIONS 8, 12 (1927).

² I FLETCHER, CYCLOPEDIA CORPORATIONS, perm. ed., § 41 (1931), and cases there cited. Perhaps the most generally accepted and cited statement of the proposition is found in *United States v. Milwaukee Refrigerator Transit Co.*, (C. C. Wis. 1905) 142 F. 247 at 255. Another leading case is *Majestic Co. v. Orpheum Circuit*, (C. C. A. 8th, 1927) 21 F. (2d) 720.

³ *J. J. McCaskill Co. v. United States*, 216 U. S. 504 at 515, 30 S. Ct. 386 (1910). The corporate entity has been disregarded in many varied situations: among them, to prevent a corporation, not otherwise entitled to it, from bringing suit into federal jurisdiction, *Lehigh Mining & Mfg. Co. v. Kelly*, 160 U. S. 327, 16 S. Ct. 307 (1895); to prevent fraud, *J. J. McCaskill Co. v. United States*, supra; to prevent defendants from avoiding the effect of a statute of limitations, *Linn & Lane Timber Co. v. United States*, 236 U. S. 574, 35 S. Ct. 440 (1915); to prevent rebates and overcharges in violation of orders of the Interstate Commerce Commission, *United States v. Milwaukee Refrigerator Transit Co.*, (C. C. Wis. 1905) 142 F. 247; to prevent evasion of the Clayton Act, *United States v. United Shoe Machinery Co.*,

Indeed, it would seem that the formula has been overworked to the extent that in some cases courts have seemed perhaps too willing⁴ to disregard the corporate entity, or "pierce the corporate veil,"⁵ apparently overlooking the fact that the corporate form of organization, with its attendant attributes, is well established in our law, and has long enjoyed the sanction and approval of the courts.⁶ It is safe to say, however, that in most instances where the theory of separate personality has been disregarded, the results have been gratifying. Certainly the principal case is one of these. For while, in a technical sense, as pointed out above, the representations of plaintiffs to the purchasers of the corporate stock cannot be said to have injured the corporation, or estopped plaintiffs as against the corporation, a strict and literal adherence to the theory of corporate entity here would constitute, in effect, judicial sanction of representations clearly false. It would represent the sort of judicial worship of legal technicalities, as opposed to the dictates of plain facts and common honesty, which has, on occasion, cast the legal profession into disrepute in the eyes of the lay public. The position of the court in the principal case seems eminently just and worthy of approval.

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(D. C. Mo. 1916) 234 F. 127; to prevent evasion of tax laws, *United States v. Barwin Realty Co.*, (D. C., N. Y. 1928) 25 F. (2d) 1003; to prevent evasion of double liability for bank stock, *Metropolitan Holding Co. v. Snyder*, (C. C. A. 8th, 1935) 79 F. (2d) 263.

⁴ It is believed that the most satisfactory position for courts to take on this issue is well illustrated by the cases of *Briggs & Co. v. Harper Clay Products Co.*, 150 Wash. 235, 272 P. 962 (1928); and *Peckett v. Wood*, (C. C. A. 3d, 1916) 234 F. 833. In the opinion of this writer, the courts were too hasty in disregarding the corporate entity in, for example, *In re Burntside Lodge*, (D. C. Minn. 1934) 7 F. Supp. 785; and *Clere Clothing Co. v. Union Trust & Savings Bank*, (C. C. A. 9th, 1915) 224 F. 363.

⁵ The phrase is taken from Wormser, "Piercing the Veil of Corporate Entity," 12 COL. L. REV. 496 (1912); his book, *THE DISREGARD OF THE CORPORATE FICTION AND ALLIED CORPORATE PROBLEMS* (1927), contains an interesting discussion of the general subject.

⁶ I FLETCHER, *CYCLOPEDIA CORPORATIONS*, perm. ed., §§ 1, 2 (1931); BAL-LANTINE, *PRIVATE CORPORATIONS* 1-5 (1927).