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CORPORATIONS—DISREGARD OF SEPARATE ENTITIES—SUBSIDIARY CORPORATION AN INSTRUMENTALITY OF THE PARENT—Defendant corporation had an excess of assets over liabilities, but its ratio of current assets to current liabilities had declined below the then normal banking credit requirement of two to one. In order to avoid acknowledgment of commercial insolvency due to inability to meet obligations maturing in the near future, defendant organized a subsidiary corporation to take over the sales end of the enterprise, transferring to the subsidiary sufficient current assets to give it the required banking ratio with regard to the liabilities assumed by the subsidiary consisting of bank obligations and some of the current bills payable of the defendant. The acknowledged purpose of forming the subsidiary was to improve defendant's credit situation. Defendant owned all of the capital stock of the subsidiary, and the officers and directors of both were the same. Their businesses were, however, kept distinct in so far as corporate formalities were concerned, except for the fact that parent and subsidiary occupied the same office. Defendant's financial condition failed to improve and a receiver was appointed to take over its affairs. This action was brought to extend the receivership to the subsidiary. *Held*, extension of the receivership granted so as to include the subsidiary, it being but an instrumentality of the defendant because it could only improve the credit situation of defendant, the purpose for which it was formed, if that were its status. Further, that as to creditors other than the banks, this was a blind which prevented them from taking action to get security for they had not been given notice of a preference required by the law of the state and were not in possession of facts giving them any knowledge as to the purpose or manner of forming the subsidiary. *Woodbury v. Pickering Lumber Co.*, (D. C. Mo. 1933) 10 F. Supp. 761.

As a general rule a corporation is treated as an entity separate and distinct from its stockholders, and this view has been followed where the corporation is a subsidiary of another corporation which is the sole stockholder.[1] The parent

[1] Ballantine, "Parent and Subsidiary Corporations," 14 CAL. L. REV. 12, 20 (1925); Button v. Hoffman, 61 Wis. 20, 20 N. W. 667 (1884); Berry v. Old South Engraving Co., 283 Mass. 441, 186 N. E. 601 (1933); Martin v. Development Co. of America, (C. C. A. 9th, 1917) 240 F. 42; and see cases collected in 1 A. L. R. 610 (1919).

and subsidiary may, however, be treated as constituting but a single entity where the latter can be said to be but an "agency," "instrumentality," or "adjunct" of the former.[2] To indicate the status of the subsidiary in this manner is to state merely the result; yet the courts have not been altogether clear as to the standards on which they predicate this conclusion.[3] It is generally recognized that such control as is exercised in the capacity of stockholder and which inheres in that status will not be sufficient to assimilate the subsidiary to the parent.[4] Nor is it sufficient that the directors and officers of the parent also serve in the same capacities with regard to the subsidiary.[5] In fact, such control as has been adverted to may be said to be the common factor which must exist before a problem can arise as to whether or not the subsidiary is an "instrumentality" of the parent rather than a separate entity.[6] Since the effect of disregarding the corporate entity is to cast liability back on stockholders who, by the law, are given the privilege of acquiring immunity through the corporate form, the basis for this action should be a domination of the subsidiary in a form other than the usual stockholder control.[7] Some courts have gone further and have held, in effect, that the fact that one corporation is a subsidiary of another is sufficient basis for disregarding their separate existence.[8] In finding domination beyond stockholder control, the courts have looked to certain evidentiary facts which alone or in combination show such domination.[9] Among such facts as have been held to be determinative are: the failure to observe strictly the formalities of corporate action,[10] the commingling of accounts,[11] the direct control of the subsidiary by

[2] 1 FLETCHER, CORPORATIONS, perm. ed., § 43 (1931); 1 A. L. R. 611, 612 (1919); 39 A. L. R. 1071 (1925); 4 MINN. L. REV. 219, 220 (1920).

[3] Douglas and Shanks, "Insulation From Liability Through Subsidiary Corporations," 39 YALE L. J. 193 at 195 (1929); 31 HARV. L. REV. 894 (1918).

[4] Douglas and Shanks, "Insulation from Liability through Subsidiary Corporations," 39 YALE L. J. 193 at 196 (1929); Owl Fumigating Corp. v. California Cyanide Co., Inc., (C. C. A. 3rd, 1929) 30 F. (2d) 812; Pullman's Palace Car Co. v. Missouri Pacific Ry., 115 U. S. 587, 6 S. Ct. 194 (1885); 32 HARV. L. REV. 424 (1919).

[5] McKay v. Savery Hotel Co., 184 Iowa 260, 168 N. W. 295 (1918); Majestic Co. v. Orpheum Circuit, (C. C. A. 8th, 1927) 21 F. (2d) 720; Pittsburgh Reflector Co. v. Dwyer & Rhodes Co., 173 Wash. 552, 23 P. (2d) 1114 (1933); Perry v. Ohio Valley Electric Ry., 70 W. Va. 697, 74 S. E. 993 (1912).

[6] Pittsburgh & B. Co. v. Duncan, (C. C. A. 6th, 1916) 232 F. 584; POWELL, PARENT AND SUBSIDIARY CORPORATIONS, § 6(a) (1931); Berkey v. Third Avenue Railway, 244 N. Y. 84, 155 N. E. 58 (1926); 4 MINN. L. REV. 219 at 222 (1920).

[7] See note 4, supra.

[8] Industrial Research Corp. v. General Motors Corp., (D. C. Ohio, 1928) 29 F. (2d) 623. Such an approach is erroneous for it fails to recognize the legitimate purpose of incorporation—the creation of an entity which may act "for" its stockholders without imposing upon them liability for its acts. See 32 HARV. L. REV. 424-428 (1919), and In re Watertown Paper Co., (C. C. A. 2d, 1909) 169 F. 252.

[9] See note 6, supra.

[10] In re Muncie Pulp Co., (C. C. A. 2d, 1905) 139 F. 546; S. G. V. Co. v. S. G. V. Co., 264 Pa. 265, 107 A. 721 (1919); Interstate Telephone Co. v. Baltimore & O. Tel. Co., (C. C. Md. 1892) 51 F. 49.

[11] Joseph R. Foard Co. v. State, (C. C. A. 4th, 1914) 219 F. 827; In re Muncie

the parent through managers,[12] the inadequate financing of a subsidiary to carry out its functions,[13] and the parent's treating the property of the subsidiary as its own.[14] The principal case looks to the purpose for which the subsidiary was formed in arriving at the conclusion that it was but an "instrumentality" of the parent. The reasoning of the court is that the purpose of organizing the subsidary was to improve the credit situation of the defendant; the only way the subsidiary could accomplish this purpose was as an "instrumentality" of the parent; hence, the subsidiary is a mere "instrumentality."[15] It does not appear that the subsidiary was to get loans and turn over the money thus obtained to defendant. This would seem to be the essential fact upon which domination other than stockholder control could be based and, unless it existed, the decision of the court on this point is at least questionable.[16]

C. F. H.

Pulp Co., (C. C. A. 2d, 1905) 139 F. 546. But see In re Watertown Paper Co., (C. C. A. 2d, 1909) 169 F. 252, where no separate books were kept, but the parent kept separate account in its books as to the subsidiary. Held to be distinct entities.

[12] Costan v. Manila Elec. Co., (C. C. A. 2d, 1928) 24 F. (2d) 383; Chicago, M. & St. P. Ry. v. Minn. Civic Assn., 247 U. S. 490, 38 S. Ct. 553 (1918).

[13] Luckenbach S. S. Co. v. W. R. Grace & Co., (C. C. A. 4th, 1920) 267 F. 676.

[14] Edward Finch Co. v. Robie, (C. C. A. 8th, 1926) 12 F. (2d) 360.

[15] The court, 10 F. Supp. at 766, does use language which suggests that part of the basis for its decision may have been a failure to keep the entities distinct and separate so that notice of their exact situation might be given the public and the creditors. The court said: "It is true that the subsidiary operated with such signs and indicia as to acquaint the public with the circumstance that it was operating the sales department of the defendant, but this did not advise the public whether such operation was as agent or as owner and, if the owner, as to what assets of defendant, if any, had been transferred to it and the terms of the transfer. Although not intended, yet the result of the operation was to serve as a blind as against all creditors who might otherwise have been moved to demand security upon their claims."

[16] The decision on this point was affirmed on appeal in Commerce Trust Co. v. Woodbury, (C. C. A. 8th, 1935) 77 F. (2d) 478, but the court placed its decision on different grounds from the district court. It placed its chief emphasis on the fact that the president of the parent had the power to remove any officer or director of the subsidiary without cause or notice and to dominate and control the performance of its contracts. The manner in which such power was conferred and whether it was to be exercised in his capacity as president of the parent or the subsidiary, the court does not discuss. Upon these facts would seem to depend the soundness of the decision of the circuit court.