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Voting Rights and the Doctrine of Corporate Entity.

Corporation A owns all the stock of corporation B. The latter is run as a subsidiary of the former. The officers of each are substantially identical. They have separate boards of directors with varying members and they maintain distinct sets of books. Their existence as separate organizations is preserved. Corporation B owns, let us say, one hundred shares of stock in corporation A. The question is, can it lawfully vote them? Could the stock held by the subsidiary corporation in the corporation controlling it, be voted upon the issue of the dissolution of the latter, for example?

The decisions at common law were in conflict as to whether a corporation had implied power to hold stock in another corporation. The English cases hold "that there is not, either by the common or statute law, anything to prohibit one trading corporation from taking or accepting shares in another trading corporation."¹ The Ohio cases, followed in many American jurisdictions, hold, on the other hand, "that one corporation cannot become the owner of any portion of the capital stock of another corporation, unless authority to become such is clearly conferred by statute."² And, says the Ohio Court, "Were this not so, one corporation, by buying up the majority of the shares of the stock of another, could take the entire management of its business, however foreign such business might be to that which the corporation so purchasing said shares was created to carry on. A banking corporation could become the operator of a railroad, or carry on the business of manufacturing, and any other corporation could engage in banking by obtaining the control of the

1. *In re Asiatic Banking Corporation*, L. R., 4 Ch. App. Cas., 252; *Canfield & Wormser's Cases on Private Corporations*, 215; *Booth v. Robinson*, 55 Md., 419, accord.

2. *Franklin Bank v. Commercial Bank*, 36 Ohio St., 350; *Canfield & Wormser's Cases*, 215; *Byrne v. Schuyler Mfg. Co.*, 65 Conn., 336; 31 Atl., 833; *People v. Chicago Gas Trust Co.*, 130 Ill., 268; 22 N. E., 798; *Woodberry v. McClurg*, 78 Miss., 831; 29 So. 514; *Holmes Mfg. Co. v. Holmes Metal Co.*, 127 N. Y., 252; 27 N. E. 831; *Easun v. Buckeye Brewing Co.*, 51 Fed., 156; *Elliott & Wormser's Illustrative Cases on Private Corporations*, 143, accord.

bank's stock."³ It might be urged that such an acquisition, as the Ohio court mentions, is *ultra vires*, not because the purchase is stock, but because the business is outside the scope of the charter of the purchasing corporation.⁴ In New York, the difficult question, and its corollary—the validity of the holding company—were put to rest by statutory enactment, which not only gives to one corporation the right to hold stock in another, but further contemplates, at least inferentially, the ownership by one corporation of the entire capital stock of another.⁵

We start, therefore, with the hypothesis that there is nothing in the written law of this state which forbids one corporation from holding even the entire capital stock of another corporation, or causes thereby the destruction of their separate corporate existence. If corporation B is a distinct legal entity from corpora-

3. *Franklin Bank v. Commercial Bank*, supra.

4. See *Hill v. Nisbet*, 100 Ind., 341; *Canfield & Wormser's Cases*, 215, Note 6. The correct test is, at common law, whether the purchase is reasonably incidental to, and consequential upon, the authorized corporate objects. This depends on the surrounding circumstances.

5. Sec. 52. **Purchase of Stock of Other Corporations.** Any stock corporation, domestic or foreign, now existing or hereafter organized, except moneyed corporations, may purchase, acquire, hold and dispose of the stocks, bonds and other evidences of indebtedness of any corporation, domestic or foreign, and issue in exchange therefor its stock, bonds or other obligations if authorized so to do by a provision in the certificate of incorporation of such stock corporation, or in any certificate amendatory thereof or supplementary thereto, filed in pursuance of law, or if the corporation whose stock is so purchased, acquired, held or disposed of, is engaged in a business similar to that of such stock corporation, or engaged in the manufacture, use or sale of the property, or in the construction or operation of works necessary or useful in the business of such stock corporation, or in which or in connection with which the manufactured articles, product or property of such stock corporation are or may be used, or is a corporation with which such stock corporation is or may be authorized to consolidate. When any such corporation shall be a stockholder in any other corporation, as herein provided, its president or other officers shall be eligible to the office of director of such corporation, the same as if they were individually stockholders therein and the corporation holding such stock shall possess and exercise in respect thereof, all the rights, powers and privileges of individual owners or holders of such stock. (Stock Corp. Law, N. Y.)

tion A, why cannot it hold stock in another corporation, namely, corporation A, and possess as incident to its ownership of the stock, the voting rights appurtenant thereto? But, on the other hand, it may be asked, how can corporation B fairly be permitted to vote its shares in corporation A, since to permit this would be tantamount to allowing corporation A to vote shares of itself owned by itself? These questions strike so deeply into the roots of corporation law that their evasion can hardly be thought of.

At the outset, let it stand admitted that a corporation cannot vote its own stock. The cases so hold, and their doctrine is in accord with the dictates of sound public policy.⁶ In fact, it is elementary that "a corporation may not vote shares of its own stock held by it, either directly or indirectly by a trustee."⁷

Conceding this, it is erroneous to affirm that it follows that corporation B cannot vote the shares of stock which it owns in corporation A. That begs the question. It assumes that corporation B and corporation A are but one entity in the eye of the law, and that, therefore, corporation A is voting shares of its own stock. Mere identity of stock ownership does not make two corporations one and the same. This last proposition, however, is by no means universally conceded. It has become increasingly the fashion of late, to urge that when the same group of associates acting with a common purpose, assumes two separate corporate organizations, the separate entity of the two organizations is a mere sham, an empty mask, and that the law may and will strip away the mask and look to the actual persons behind it.⁸ The contention is—how can a mere process of duplicate corporate christening create distinct juridical personalities, how

6. *Ex parte Holmes*, 5 Cow. (N. Y.), 426; Cook, Corps (7th Ed.), Sec. 613.

7. See the writer's paper, "The Power of a Corporation to Acquire its Own Stock," 24 *Yale Law Journal*, 177, 184, collecting the authorities.

8. This was one of the Government's chief contentions in the recent case of *United States v. Delaware, Lackawanna & Western R. Co.*, 238 U. S., 516; reversing, 213 Fed., 240. The contention was quite unnecessary.

can the law treat these corporate Dromios⁹ as other than one and the same? However plausible this argument may appear, it cannot be upheld by the courts without striking at the bed-rock principle of corporateness, namely, the existence of the corporation as a juristic person separate and distinct from its members.¹⁰ A corporation is much like an expansible symbol, for instance, a bracket in an algebraic expression; which, while treated as a unit, is nevertheless capable at any time of being expanded to show its real constituency. It is logically mandatory that the distinction between the corporation, as a legal unit, and its members, be maintained. Would even the most radical contend that the United States Steel Corporation and the Southern Pacific Railroad Company are one and the same, because, by some chance, their stockholders on a given date are identical? The proposition that two corporations are identical because their stock ownership is the same or substantially the same, is not merely unorthodox—it is revolutionary. It ignores the basic conception of corporation law.

The leading case in this country is *Button v. Hoffman*.¹¹ It was there held that the owner of all the capital stock of a corporation could not bring a replevin suit in his own name to recover certain corporate personalty, since he is not the corporation, and since "while the corporation exists he is a mere stockholder of it and nothing else." And, it is also the rule that the circumstance that the owner of all the stock is another corpora-

9. Shakespeare's Comedy of Errors, Act. V, Scene 1:

"Duke. One of these men is Genius to the other; and so of these: Which is the natural man, and which the spirit? Who decipher's them?"

"Dromio of Syracuse. I, sir, am Dromio; command him away.

"Dromio of Ephesus. I, sir, am Dromio; pray let me stay."

10. *People's Pleasure Park Co. v. Rohleder*, 109 Va., 439; 61 S. E., 794; 63 S. E., 981; *Canfield & Wormser's Cases*, 3, holding a corporation is not a "colored person," though it is admittedly "composed exclusively of negroes." The Civil Law rule is the same. La. Civ. Code, Arts. 427, 432, 435, 436. And see, *Mioton v. Del Corral*, 132 La., 730; 61 So., 771.

11. 61 Wis., 20, 20 N. W., 667; *Canfield & Wormser's Cases*, 7. Cited with approval as recently as *State v. Tacoma Ry. & Power Co.*, 61 Wash, 507; 112 Pac., 506.

tion "makes no difference in principle."¹² To the same effect are numerous authorities.¹³ This doctrine, that the most distinctive attribute of the corporate type of business organization is its existence as a legal entity distinct and apart from the stockholders, is a necessary one. Any other rule "would result in the worst sort of complication,"¹⁴ particularly where titles to property might be involved. The New York decisions are in accord, and adhere to the entity doctrine,¹⁵ unless fraud or its equivalent be proven distinctly.¹⁶ In a recent case,¹⁷ Miller, J., said:

"It is well settled that the title to corporate property is in the corporate entity and not in its stockholders (*Saranac & L. P. R. R. Co. v. Arnold*, 167 N. Y., 368; *Buffalo L. T. & S. D. Co. v. Medina Gas Co.*, 162 N. Y., 67), and, as the transfer made by Schwickart did not purport to be a corporate act, it was manifestly insufficient to transfer the corporate property, although he may have owned substantially all of the stock."

The English cases take the same point of view. Where all the shares of a German company were owned by an English company,

12. *Exchange Bank of Macon v. Macon Const. Co.*, 97 Ga., 1; 25 S. E., 326; *Canfield & Wormser's Cases*, 10, Note 3.

13. *Spencer v. Champion*, 9 Conn., 585; *Newton Mfg. Co. v. White*, 42 Ga., 148; *Hopkins v. Roseclare Lead Co.*, 72 Ill., 373; *Allemong v. Simmons*, 124 Ind., 199; *Stagg Co. v. Taylor*, 113 Ky., 709; In the Matter of Belton, 47 La. Ann., 1614; *England v. Dearborn*, 141 Mass., 590; *Ulmer v. Lime Rock R. Co.*, 98 Me., 579; *Rough v. Breitung*, 117 Mich., 48; *Baldwin v. Canfield*, 26 Minn., 43; *Central Mfg. Co. v. Montgomery*, 144 Mo. App. 494; *Monongahela Bridge Co. v. Pittsburg Tract Co.*, 196 Pa. St., 25; *Rhawn v. Furnace Co.*, 201 Pa. St., 637; *Parker v. Bethel Hotel Co.*, 96 Tenn., 252; *Aiello v. Crampton*, 201 Fed., 891; 120 C. C. A., 189. But see, *Swift v. Smith* 65 Md., 428.

14. *Gallagher v. Germania Brewing Co.*, 53 Minn., 214; 54 N. W., 1115, per Mitchell, J.

15. *Stone v. Cleveland & C. R. Co.*, 202 N. Y., 352; *Saranac R. Co. v. Arnold*, 167 N. Y. 368; *Buffalo Loan Co. v. Medina Gas Co.*, 162 N. Y., 67; *Irvine v. N. Y. Edison Co.*, 207 N. Y., 425; *Palmer v. Ring*, 113 App. Div., 643; *New York Air Brake Co. v. International Steam Pump Co.*, 64 Misc., 347.

16. *Goss & Co. v. Goss*, No. 2, 147 App. Div., 698; *Garrigues v. International Agricult. Corp.*, 159 App. Div., 877, 880, per Dowling, J.

17. *Palmer v. Ring*, 113 App. Div., 643; 99 N. Y. Supp., 290; *Canfield & Wormser's Cases*, 11, Note 3.

the court held that this fact "does not make the German company a mere alias, or a trustee, or an agent for the English company, or for the stockholders in the English company,"¹⁸ and declared that: "The German company is an existing person and a different entity from the English company." Since the commencement of the present European conflict, the English courts have made several interesting applications of the doctrine of corporate entity. Of 25,000 shares of stock of a company incorporated in England, all the shares except 2 shares were held by alien enemies, to wit, Germans. The corporation brought suit against a certain other corporation in an English court. It was held entitled to sue.¹⁹ The decision is sound. The alien enemy character of the shareholders did not alter the English domicile and citizenship of the corporation.²⁰ The decision resembles the well-known early case of *Queen v. Arnaud*.²¹ An English statute forbade the registration of any vessel owned by foreigners, "in whole or in part, directly or indirectly." A corporation chartered by England, whose chief stockholders were foreigners, sought to compel the registry of its vessel. It was held that the vessel should be registered. This may strike some persons as anomalous also, but it is quite correct.²²

From the foregoing discussion, it follows that corporation A and corporation B should be regarded by the courts as two sepa-

18. *Gramophone & Typewriter, Ltd. v. Stanley*, L. R. [1906], 2 K. B., 856 [1908], 2 K. B., 89; *Canfield & Wormser's Cases*, 39. The decision is rested on the decision of the House of Lords in *Salomon v. Salomon & Co.*, L. R. [1897], App. Cas., 22. The Supreme Judicial Court of Massachusetts recently rendered a much similar decision, *Brighton Packing Co. v. Butchers' Slaughtering & Melting Ass'n*, 211 Mass., 398; *Contra, Andres v. Morgan*, 62 Ohio St., 236.

19. *Continental Tyre & Rubber Co., Ltd., v. Diamler Co., Ltd.*, 138 L. T. J. (C. A.), 272; S. C., 138 L. T. J., 83.

20. Of course, none of the proceeds of the suit, in the event of success could be remitted to the enemy shareholders, thus avoiding giving aid to an alien enemy.

21. 9 Q. B. (Adol. & El.), 806.

22. See also, *Humphreys v. McKissock*, 140 U. S., 304; *In re Watertown Paper Co.*, 169 Fed., 252; 94 C. C. A., 528; per Noyes, J. In *McCaskill Co. v. United States*, Mr. Justice McKenna recently said: "Undoubtedly a corporation is in law, a person or entity entirely distinct from its stockholders and officers." (216 U. S., 504, 514.)

rate legal persons. They are not the same juridical entity in any sense of the word. The general rule is that the holder of the legal title to shares of stock is entitled to vote them. When the laws of the state in which a corporation is organized authorize the holding of its stock by other corporations, another corporation holding stock therein and having authority to do so, may vote the stock to the same extent as any other stockholder.²³ This is fortified in New York by the statutory provision which confers upon corporate stockholders "all the rights, powers and privileges" of individual stockholders, thus conferring the right to vote, if not expressly, at least by reasonable implication.²⁴ And, it has been held in this state that a corporation holding stock in another corporation possesses all the rights of a natural holder, including the right to vote.²⁵ Hence, corporation B, as the owner of one hundred shares of corporation A, should be entitled to vote them. Despite the ownership by corporation A of all the stock of corporation B, this is, in no respect, a voting by corporation A of shares of its own stock.^{25a}

The conclusion is, then, that corporation B may lawfully vote the one hundred shares of stock which it owns in corporation A. The corporations are distinct and separate legal entities. The fact that the shares of corporation B all belong to corporation A does not make corporation B—to paraphrase the learned English judge—"a mere alias, or a trustee, or an agent for corporation A, or for the shareholders in corporation A." Since corporation B, a distinct juristic person, has lawful title to one hundred shares of stock in corporation A, and since voting rights follow legal title, statutory prohibitions apart, it follows that corporation B is well within its rights in voting the shares which it holds of corporation A. There is nothing anomalous in this result.

23. *Rogers v. Nashville R. Co.*, 91 Fed., 299; 33 C. C. A., 517; *Davis v. U. S. Elec. Co.*, 77 Md., 35; *Oelberman v. N. Y. R. Co.*, 76 Hun, 613; 77 Hun, 332; 29 N. Y. Supp., 545.

24. N. Y. Stock Corp. Law, Sec. 52. See ante, Note 5.

25. *In re Buffalo, etc. R. Co.*, 37 N. Y. Supp., 1048.

25a. See the decision of Ex-Judge Noyes, as referee, in *Lazenby v. Int. Cotton Mills Corp., et al.* But see Vice Chancellor Pitney's decision in *O'Connor v. Int. Silver Co.*, 68 N. J. Eq., 67; affirmed on quite distinct grounds on appeal (68 N. J. Eq., 680).

It should be noted that there is no suggestion in our hypothetical case of fraud or of disregard of the public interests. It is to ignore the entire theory of separate corporate existence to declare that one corporation is identical, in the eye of the law, with another in which it holds a controlling stock interest. But this doctrine of separate existence may be carried too far, and it is properly disregarded in cases of fraud, statutory circumvention, public wrong, and like instances.²⁶ "If any general rule can be laid down, in the present state of authority, it is that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, 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."²⁷ In a recent English case, a German vessel owned by a German corporation, while sailing from Hamburg to London, was sold by telegraph on August 1, to an English corporation, controlled by the German corporation. On August 4, war was declared between Germany and England. Next day, the vessel arrived in England and was seized as a prize. The English corporation claimed that the transfer to it made the seizure illegal. The Prize Court held the seizure proper and that the claim was invalid.²⁸ The decision is sound. The transfer was not valid as it was made in contemplation of war and to avoid seizure as a prize.²⁹ Under such circumstances, the application of the doctrine of distinct corporate entity, is uncalled for. Lord Mansfield's classic rule as to the use of fictions of law is applicable:

26. See the writer's paper, "Piercing the Veil of Corporate Entity," 12 Columbia Law Review, 496.

27. *United States v. Milwaukee Refrigerator Transit Co.*, 142 Fed., 247, 255, per Sanborn, J.; *Canfield & Wormser's Cases*, 66, Note 21. The Appellate Division, First Dept., speaking through Dowling, J., said recently: "That the doctrine of corporate entity will not be allowed to stand in the way of circumventing fraud or administering justice, has been held in *Goss & Co. v. Goss*, No. 2 (147 App. Div., 698)." *Garrigues v. International Agricult. Corporation*, 159 App. Div., 877, 880. The Supreme Court of the United States takes the same position. *Linn & Lane Timber Co. v. United States*, 236 U. S., 574.

28. *The Tommi*, 59 Sol. J., 26.

29. See *The Ann Green*, 1 Gall. (U. S.), 274.

"It is a certain rule that a fiction of law shall never be contradicted, so as to defeat the end for which it was invented, but for every other purpose it may be contradicted." (*Mostyn vs. Fabriges*, Cowper, 177).

"Fictions of law hold only in respect of the rules and purposes for which they were invented; when they are urged to an intent and purpose not within the reason and policy of the fiction the other party may show the truth." (*Morris vs. Pugh*, 3 Burr, 1243).

It is often extremely difficult to draw the line. "The answer perhaps is," to quote the words of Mr. Justice Chitty, "that courts of justice ought not to be puzzled by such old scholastic questions as to where a horse's tail begins and where it ceases. You are obliged to say, 'This is a horse's tail,' at some time."³⁰ In determining when to refuse to apply the doctrine, however, it is serviceable to bear in mind that "the purpose in making all corporations is the accomplishment of some public good,"³¹ and that no rule of law or logic requires courts to employ the conception of separate corporate existence as a whitewash for corporate wrongdoing. The power of courts to frustrate wrongful devices is more than coextensive with the perverted ingenuity which devises them.

It follows that if corporation B were organized, or the stock transfer made, in our hypothetical case, solely in order to achieve certain vicious and fraudulent results, the corporate fiction might be properly disregarded, and the shares of corporation B, accordingly, could not be voted. In the absence of such proof, however, it seems clear that the shares could legally be voted.

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30. *Lavery v. Pursell* (1888), 39 Ch. Div., 508.

31. *Mills v. Williams*, 11 Ired. (N. Car.), 658.