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The Economic Entity

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THE ECONOMIC ENTITY

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WHEN will the courts honor or dishonor the separate corporate form of each legal entity in a group of corporations, and with what consequences?

The decision cannot rest on the architect's convenience.[1] The courts give effect to the purpose of the organization.[2] The question presented must be determined by the facts.[3] The armor of the judicial conception of each constituent legal entity will be tested in three ways,[4] to wit:

(1) by the law of agency
(2) by the principles of equity, and
(3) by the doctrines of public policy.

The legal entity derives its breath of life from the sovereignty, through the medium of charter, granted under general or special statute. It should have its own government, its own board of directors, its own officers, its own assets, its own liabilities, and its own life. It may function independently, and at its peril, with other corporations.

The legal entity is an artificial person, separate and distinct from the natural (or artificial) persons who own its stock. The legal entity may not serve as a mere convenience for those who own its stock or participate in its corporate life.[5]

The simple allegation that one corporation is the "alter ego" of another corporation is not sufficient to require the Court to disregard the separate corporate form of either. Allegations of fact are essential to "pierce the corporate veil." Disregard of the separate corporate form will only be

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1. Schenley Distillers Corp. et al. v. United States et al., 326 U.S. 432, 437 (1946); Gray et al. v. Powell et al., 314 U.S. 402, 414 (1941); Davis v. Alexander et al., 269 U.S. 114, 117 (1925); Montana Power Co. v. Federal Power Comm., 185 F.2d 491 (D.C. Cir. 1950).

2. Davis v. Alexander et al., 269 U.S. 114, 117 (1925); Chicago, M. & St. P. Ry. et al. v. Minn. Civic Ass'n., 247 U.S. 490 (1918); In re Pittsburgh Rys., 155 F.2d 477 (3d Cir. 1946); Weisser et al. v. Mursam Shoe Corp. et al., 127 F.2d 344 (2d Cir. 1942); Darling Stores Corp. v. Young Realty Co., 121 F.2d 112 (8th Cir. 1941); Wabash Ry. v. American Refrigerator Transit Co. et al., 7 F.2d 335, 343, 344 (8th Cir. 1925); Luckenbach S.S. Co. et al. v. W. R. Grace & Co., 267 Fed. 676 (4th Cir. 1920); Willem Van Driel, Sr. v. Penn R.R. et al., 252 Fed. 35 (4th Cir. 1918); Lehigh Valley R.R. v. Delachesa, 145 Fed. 617 (2d Cir. 1906); Lehigh Valley R.R. v. Dupont, 128 Fed. 840 (2d Cir. 1904); Williams v. Cleveland, C., C. & St. L. Ry., 102 Mich. 537, 61 N.W. 52 (1894).

3. Ibid.

4. Dix, The Armor of the Juridical Conception, 34 Geo. L. J. 432 (1946).

5. Hillman v. Hillman Land Co. et al., 81 Cal. App. 2d 174, 183 P.2d 730, 736 (1947); Venban Estate, Inc. v. Hewlett et al., 191 Cal. 675, 676, 227 Pac. 723 (1924); Minifie et al. v. Rowley et al., 187 Cal. 481, 487, 202 Pac. 673 (1921).

permitted when necessary to prevent injustice. Mere stock ownership is not enough.[6] On the other hand it is not necessary to show that one has been misled, deceived or defrauded.[7] Intervention in the management of a legal entity, so as to make it a tool, agency, or instrumentality or to dominate it, infects the actor with liability for all obligations incurred by the legal entity or arising during such management.[8] Stock ownership is not essential.[9] To preserve the benefits of a separate corporate existence, a legal entity must have an independent life or a separate legal entity.[10]

A legal entity differs from an economic entity. The economic entity does not have any corporate charter. It is an economic choice of management. It ties in legal entities for operation in a common endeavor or enterprise. The idea behind an economic entity is joinder or merger of activity—unity of life—in the goal of the common undertaking or enterprise. In an economic entity, each legal entity has dedicated itself and its property to the success of the common undertaking.

In re *Pittsburgh Railways*[11] dealt with an economic entity, known as Pittsburgh Railways System, not in reorganization, as distinguished from Pittsburgh Railways Company, a debtor in reorganization. The System, without its own separate corporate charter, was created in 1902, by means of leases and operating agreements with a large number of corporations, called "underliers," under which their properties were operated by the debtor, Pittsburgh Railways Co., in conjunction with its own. Thereby the City of Pittsburgh and surrounding municipalities were provided with a unified system of transportation. There were over 50 underlier corporations: 36 of its underliers were known as Philadelphia underliers, because they were all directly or indirectly controlled by the debtor's

6. Norino Realty Co. v. Consolidated Abstract & Title Guaranty Co. et al., 80 Cal. App. 2d 879, 182 P.2d 593, 596 (1947).

7. In re Pittsburgh Rys., 155 F.2d 477 (3d Cir. 1946); Herman et ux v. Mobile Holmes Corp. et al., 317 Mich. 233, 26 N.W. 2d 757 (1947); Tennessee Consol. Coal Co. v. Home Ice & Coal Co. et al., 25 Tenn. App. 316, 156 S.W. 2d 454 (1941).

8. Consolidated Rock Products Co. et al. v. Du Bois, 312 U.S. 510, 524 (1941); Davis, Agent v. Alexander et al., 269 U.S. 114 (1925); Kingston Dry Dock Co. v. Lake Champlain Transp. Co., 31 F.2d 265 (2d Cir. 1929); Luckenbach S.S. Co. et al. v. W. R. Grace & Co., 267 Fed. 676 (4th Cir. 1920); Willem Van Driel, Sr. v. Pennsylvania R.R. et al., 252 Fed. 35, 37 (4th Cir. 1918); Stark Electric R.R. v. McGinty Contracting Co., 238 Fed. 657, 661-3 (6th Cir. 1917); Joseph R. Foard Co. et al. v. Maryland et al., 219 Fed. 827 (4th Cir. 1914); Dilland & Coffin Co. v. Richmond Cotton Oil Co. et al., 140 Tenn. 290, 204 S.W. 758 (1918).

9. Weisser et al. v. Mursam Shoe Corp. et al., 127 F.2d 344 (2d Cir. 1942).

10. In re Pittsburgh Rys., 155 F.2d 477 (3d Cir. 1946), cert. denied, 329 U.S. 731 (1946).

11. 155 F.2d 477 (3d Cir. 1946), cert. denied, 329 U.S. 731 (1946).

parent, Philadelphia Company, through ownership of all or majority of their stock; 9 of the underliers were known as guaranteed underliers, since they leased their property in 1902 under 900 year leases guaranteed by the Philadelphia Company, which, however, did not have stock control over these corporations. The remainder was called unguaranteed underliers for their leases were not guaranteed and Philadelphia Company did not have stock control over them. These properties were operated in such a fashion that a single route or passenger ride might involve the use of a number of the underlying corporations' properties and routes.[12] The system functioned through a series of departments all operated from one headquarters.[13]

"Ascertainment of a proper proportion of the receipts of the system as a whole to the respective contributions of the underlying companies is obviously an impossible task."[14] In 1938, the debtor filed a petition for reorganization under the Bankruptcy Act. No proceedings were filed by or against any of the underliers. Since it was necessary to preserve the economic entity of the System, and the underliers were unwilling to go into reorganization, the City of Pittsburgh petitioned the District Court to exercise jurisdiction over the underlier corporations.[15] The unguaranteed underliers conditionally joined in the prayer of the City's petition. The Philadelphia underliers in answers provided by the Philadelphia Company stated that they would go along on satisfactory assurances to the Philadelphia Company preserving any defenses which it might assert in mitigation of its liability on its guarantee to pay to the guaranteed underliers $516,422 annually, exclusive of taxes.

The guaranteed underliers moved to dismiss the petition. The Court of Appeals, however, pierced the underliers' corporate veil and granted the City's petition. In a scholarly opinion, Judge Goodrich, said:[16]

> "We shall consider the problem based on the objections of the guaranteed underliers. If it should be found that the guaranteed underliers can be included in the

12. Philadelphia Co. et al. v. Dipple et al., 312 U.S. 168, 174 (1941).

13. Brief for appellants, Jules Guggenheim et al., pp. 12, In re Pittsburgh Rys., 155 F.2d 477 (3d Cir. 1946).

14. Philadelphia Co. et al. v. Dipple et al., 312 U.S. 168, 174 (1941).

15. In its brief to the Court of Appeals, the City said, at page 3:

"If the reorganization is to be successful, it is clearly essential that it deal not only with the franchises and other street railway assets of the Debtor, but also those of the underliers."

In its Brief to the Court of Appeals, the Securities and Exchange Commission said at page 5:

"From a standpoint of investors, too, the Debtor's system is clearly a single enterprise"; and at page 6, "A reorganization for the Debtor alone, while a theoretical possibility, would solve no problems and would create many more."

16. 155 F.2d 481, 482, 485 (3d Cir. 1946).

reorganization, it seems to us that . . . all . . . corporate relatives, which are involved in the transportation of passengers in the City of Pittsburgh, can be brought in also.

"The position of these guaranteed underliers is, up to now, a very happy one. They receive about half a million dollars a year, as a return upon their leases regardless of what the system makes or loses. If there are not profits available the Philadelphia Company has to make good under its guarantee. They are not insolvent and so long as Philadelphia Company has money enough in its treasury to pay its obligations it is not likely that they will be. They do no business except that connected with the receiving of this money and the paying of it to security holders. They maintain separate books of account, have separate directors and, in fact, perform all the ritualistic acts which a careful lawyer would advise a corporation to do in order to maintain its appearance of corporate individuality. They, therefore, say with exceedingly effective formal logic: that they are not part of the debtor; that the jurisdiction of the bankruptcy court over debtor's property does not affect them; that whatever financial unhappiness those closer to the operating company than they are may have, they, themselves, are not subject to be drawn into any reorganization.

". . .

"Our conclusion is that the facts of the present case, call for the treatment of the great transportation system as one entity for purposes of reorganization; regardless of the elaborate jig-saw puzzle arrangement of all the underlying companies which have gone into it. In so concluding we emphasize the nearly half century of physical operation of this enterprise as a unit, with the interchange of movable property, routes, operating personnel and everything involved on the business side."[17]

Unity of life of corporations engaged in a common undertaking effect a merger of them, which is not defeated by a lease between them giving to the one the operation and to the other the control.[18] The real purpose is "to effect a merger of the business of the companies."[19] To "all intents

17. In his (Guggenheim et al) brief to the Court of Appeals, this author said at page 14: "The foregoing findings of fact, establish

(a) complete unity of life of debtor and underliers for forty-three years—almost half a century;

(b) that the identity of the underliers was obliterated in 1902, since which time there has been this unified system of transportation of debtor and of underliers;

(c) that when remitted to the tests of honesty and justice it is inequitable to disregard the substance and to honor the separate form of the underliers;

(d) that sacrifice of the separate underlier form is essential to defend and uphold the public interest and public policy;

(e) that control over all underliers was so complete, interference so obtrusive, that by the general rules of agency, each corporation in the system was an agent of the other in furtherance of the common enterprise—the unified system of transportation."

18. Southern Pacific Co. v. Lowe, 247 U.S. 330, 337 (1918), struck down the juridical conception of lessor and lessee and said, "While the two companies were separate legal entities, yet in fact, and for all practical purposes they were merged, the former being but a part of the latter, acting merely as its agent, and subject in all things to its proper direction and control."

19. St. Paul, M. & M. Ry. v. Western Union Tel. Co. et al., 118 Fed. 497, 511 (8th Cir. 1902).

and purposes a consolidation or merger of the two companies" is effected.[20] The choice of a lease or agreement, express or implied, or the absence of an agreement, is psychological, rather than procedural. The result is a new entity—an economic entity, as a consequence of the merger and consolidation from a business side. Where persons unite in a venture, they are partners or coadventurers with the usual consequences of liability. With natural persons, the result is called a partnership or a joint venture. With artificial persons, the result is called a merger or consolidation. The Courts have held that a merger may be effected by a lease, without stock control and without regard to domination.[21] Equity is not bound by the name the parties give to a transaction.[22] The essential idea is that as in the case of a statutory merger or a statutory consolidation, the separate corporate assets, "lock, stock and barrel", are transferred from the constituent legal entities to the new economic entity.[23] Obviously, it is understood, that the constituent legal entities should remain in a comatose condition during the operation of the arrangement with no evidence of intention on the part of the legal entities to resume the exercise of their corporate functions.[24] It matters not that the parties expressly agree to maintain their separate corporate form and provide the cost of the expense of keeping up the corporate form of each legal entity.[25]

A "Court of Equity does not take a skin-deep view of a situation. . . . It looks to the substance of the transaction, not to its mere form or color . . . and sees things as ordinary men do."[26] A court of equity will look behind the corporate screen.[27] It is interested in things, not in looks. It applies the motto: *Esse quam videri, i.e.,* to be, rather than to be seen.

The unity of life reflected by an economic entity effects an equitable merger and an equitable consolidation. The business or practical result achieved was the purpose of the parties. Equity regards the terms "merger" and "consolidate" as to "join" or "unite". Separate and distinct legal entities become little more than corporate shields, whose activities, save for such formal acts as are essential to maintain the form of the separate corporate existence, cease to exist.

20. Black v. St. Louis & S.F. R.R., 110 Mo. App. 198, 85 S.W. 96, 97 (1905).
21. See notes 19-20 supra.
22. Schumacher v. Eastern Bank & Trust Co., 52 F.2d 925, 926 (4th Cir. 1931).
23. Mills v. Central R.R., 41 N.J. Eq. 1, 2 Atl. 453 (1886).
24. St. Paul, M. & M. Ry. v. Western Union Tel. Co. et al., 118 Fed. 497, 511 (8th Cir. 1902).
25. Ibid.
26. Markovitz et al. v. Markowitz et al., 336 Pa. 122, 126, 8 Atl. 2d 36, 38 (1939).
27. Westinghouse v. Allis-Chalmers Co., 176 Fed. 362, 367 (3d Cir. 1910).

Mergers and consolidations may be classified into three groups: (1) de jure (2) de facto and (3) equitable.

A merger or consolidation which fully complies with all statutory requirements, does not present any problem, for it is *de jure*.[28] Courts of law also recognize as *de facto* a merger of corporate assets under an agreement of consolidation where the statutory requirements have not been fully satisfied.[29] In addition courts of equity are not impotent, when corporate assets of two or more corporations have been joined in unity of life. They exercise jurisdiction over such mergers and consolidations.[30] An equitable merger and consolidation arises as a natural consequence of the maxim "equity looks upon that as done which ought to be done."[31] Equity supplies the gap between strict legal rules and the realism of modern business.[32]

The rule used to be that as corporate franchises were granted by the sovereign, a corporation could be dissolved only in the statutory manner provided by the State. In response to the clamor for relief from certain corporate conduct, Courts of Equity found a potent way to deal with a situation requiring equitable treatment. No longer do courts of equity take the position, that as a corporation owes its life to the state and its statutes, that life is controlled in all aspects exclusively by the state and its statutes. A Federal Court, with its inherent equity powers may wind up, dissolve or liquidate a solvent corporation, independent of any state statute, under the court's inherent general equity powers.[33] It

28. Ashley v. Ryan, 153 U.S. 436 (1894).

29. Commonwealth v. Merchants Nat. Bank, 323 Pa. 145, 151, 152, 185 Atl. 823, 826 (1936) involved a trust company and a national bank, which consolidated their assets under an "agreement of consolidation" which the Court held to be de facto. The court said:

"What was lacking to make the consolidation de jure, was authority from the Commonwealth, pursuant to whose laws the trust company existed. . . . Though it divested itself of its property, by transfer to defendant, its franchise to be a corporation remained subject to the local law. . . . The consolidating procedure, in its Pennsylvania aspect was irregular, but certain consequences nevertheless resulted."

30. Hottenstein et al. v. York Ice Machinery Corp., 45 F. Supp. 436 (D. Del.), aff'd, 136 F.2d 944 (3d Cir. 1942); Hubbard et al. v. Jones & Laughlin Steel Corp., 42 F. Supp. 432 (W.D. Pa. 1941); Colby v. Equitable Trust Co. et al., 124 App. Div. 262, 108 N.Y. Supp. 978 (1st Dep't), aff'd, 192 N.Y. 535, 84 N.E. 1111 (1908).

31. Minnesota Mut. Ins. Co. v. McGin et al., 263 Fed. 847 (8th Cir. 1920).

32. In Helvering v. Metropolitan Edison Co., 306 U.S. 522, 525 (1928), the Court said: "The Court of Appeals reversed . . . holding that, while the transaction was not consummated under the state statute it nevertheless was under state law a de facto merger. . . ." The Court of Appeals of the Third Circuit quoting from the lower courts decision, said:

"'. . . whether a particular transaction is in reality a sale, conversion, consolidation, or merger . . . depends upon the circumstances. . . . There is no magic in the words applied to the transaction.'" 98 F.2d 807 (3d Cir. 1938).

33. Alexander et al. v. Hillman et al., 296 U.S. 222 (1935); Burnete Cod Briquette Co.

would be strange if that inherent equity power does not extend to an equitable merger and an equitable consolidation. Equity is not static.[34] An equitable dissolution does not terminate the legal existence of the corporation. Nor does an equitable merger or an equitable consolidation terminate the separate corporate form or existence of any constituent legal entity. All that remains after the intervention of equity is a shell of the separate legal entity—corporate form without substance. Equity deals with assets of the legal entity and not with the corporate charter.

Likewise equity deals with the assets and the creditors of the economic entity, disregarding the separate corporate form of each legal entity going into the economic entity resulting from the equitable merger and the equitable consolidation. The economic entity is a new entity succeeding the constituent legal entities.[35]

The courts honor the truths of reality and unmask the falsehoods of pretense. They give effect to the real purpose of the association of corporations[36] in order "to promote square dealing and effectuate justice." The "courts will ignore the fiction of the corporate entity only with caution, and when the circumstances justify it, and where it is

v. Riggs et al., 274 U.S. 298 (1927); Galdi et al. v. Jones et al., 141 F.2d 987 (2d Cir. 1944); Tower Hill-Connellsville Coke Co. v. Piedmont Coal Co. et al., 64 F.2d 781 (2d Cir.), cert. denied, 290 U.S. 675 (1933).

34. Equity may mold its relief to fit various situations: (a) failure of corporate purpose (Ross v. American Banana Co., 150 Ala. 268, 43 So. 817 (1907); (b) to make possible a sale, although insufficient time to reach and obtain stockholder assent (Arents et al. v. Blackwell's Durham Tobacco Co. et al., 101 Fed. 338 (1900), aff'd, 109 Fed. 1038 (4th Cir. 1901); (c) mining company required to close its mine (Bailbe v. Columbia Gold Mine Co. et al., 86 Ore. 1, 166 Pac. 965 (1917); (d) dissention (Schipper Bros. Coal Mining Co. v. Economy Domestic Coal Co., 277 Pa. 356, 121 Atl. 193 (1923); (e) non-exercise of corporate powers (Taylor Finance Corp. v. Oregon Logging & Timber Co., 116 Ore. 440, 241 Pac. 388 (1925); (f) misuse of statutory liquidation powers (Kavanaugh v. Kavanaugh Knitting Co. et al., 226 N.Y. 185, 195, 123 N.E. 148, 152 (1919).

35. Cf. Mercantile Howe Bank & Trust Co. v. United States et al., 96 F.2d 655, 659 (8th Cir. 1938).

36. Wabech Ry. v. American Refrigerator Transit Co. et al., 7 F.2d 335, 344 (8th Cir. 1925); see also Newark Ladder and Bracket Sales Co. et al. v. Furniture Workers Union Local 66 et al., 125 N.J. Eq. 99, 4 A. 2d 49 (1939); Rippel et al. v .Kaplus et al., 124 N.J. Eq. 303, 1 A. 2d 883 (1938); Mitschele v. Pyramid Bond & Mortgage Corp. et al., 124 N.J. Eq. 190 (1938), 1 A 2d 59 (1938); Havey v. Hofmann et al., 121 N.J. Eq. 523, 191 Atl. 756 (1933); Ross v. Pennsylvania R.R. et al., 106 N.J. Law 536, 148 Atl. 741 (1930); Floral Park Lawn Inc. v. O'Connell, 250 App. Div. 464, 294 N.Y. Supp. 991 (2d Dep't 1937); Lowendahl v. The Baltimore & Ohio R.R., 247 App. Div. 144, 287 N.Y. Supp. 62 (1st Dep't 1936); Bendan Holding Co. v. Rodner, 242 App. Div. 233, 273 N.Y. Supp. 481 (2d Dep't 1934); Pagel Horton & Co. v. Harmon Paper Co., 236 App. Div. 47, 258 N.Y. Supp. 168 (4th Dep't 1932); Monica Realty Corp. v. Bleecher, 229 App. Div. 184, 241 N.Y. Supp. 290 (1st Dep't 1930); Quaid v. Ratkowsky, 183 App. Div. 428, 170 N.Y. Supp. 812 (1st Dep't 1918).

used as a subterfuge to defeat public commerce, justify wrong, or perpetuate a fraud,"[37] and "deal with them (the corporations) as the justice of the case may require."[38]

If the facts require the conclusion that there has been an equitable merger or an equitable consolidation, resulting in an economic entity, then to promote square dealing and effectuate justice the Court will disregard the purpose of the association of corporations and saddle upon one corporation the debts of another corporation.[39]

In re *Pittsburgh Railway*[40] the underlier corporations in its economic entity known as Pittsburgh Railways System, unsuccessfully argued that their separate corporate forms should be honored for the alleged reason that the arrangement was encouraged and authorized by its legislature and by the statutes of the state of their incorporation.[41] The underliers argument based on the Pennsylvania statutes and decisions with respect to those statutes appears to have been completely ignored by the Court of Appeals, whose able opinion is silent on the subject. The argument was not made in the petition for *certiorari*. In 1920, the same Court of

37. Commerce Trust Co. et al. v. Woodbury et al., 77 F.2d 478, 487 (8th Cir. 1935).

38. United States v. Reading Company et al., 253 U.S. 26, 63 (1916).

39. The court will not be bound by a prior adjudication honoring the separate corporate form. Cf. Centmont Corporation v. Marsch, 68 F.2d 460 (1st Cir.), cert. denied, 291 U.S. 680 (1933) with Marsch v. Southern New England R.R., 230 Mass. 483, 120 N.E. 120 (1918); In re Pittsburgh Rys., 155 F.2d 477 (3d Cir. 1946), cert. denied, 329 U.S. 731 (1946) with In re Reorganization of Pittsburgh Rys. et al., 111 F.2d 932 (3d Cir. 1940), aff'd sub nom, Philadelphia Co. et al. v. Dipple et al., 312 U.S. 168 (1941).

40. 155 F.2d 477 (3d Cir. 1946).

41. The brief of the underliers, Philadelphia Co., in the Court of Appeals for the third circuit states at page 79:

"All of the underliers were duly incorporated under the laws of Pennsylvania . . . came into existence independent of any action by Philadelphia Company or the debtor."

And at page 9:

"The statutes, pursuant to which the underliers were incorporated, expressly gave to the companies the power to execute the leases . . . the succession of acts plainly indicate that the Legislature sought . . . to encourage the execution of leases.

"The general railroad act of 1870 P. L. 31, 67 P. S. 586 was construed to grant authority for the execution of leases from street railway companies to street railway companies Rafferty v. Central Traction Co. (one of the underliers in this case), 147 Pa. 579, 23 Atl. 884 (1892). This authority was confirmed by the Act of 1901 P.L. 514; 67 P.S. 1111."

And at page 10:

"The 'Traction Company Act' of 1887 P.L. 8, 15 P.S. 1892 et seq., granted authority for the execution of leases from street railway companies to traction companies. With reference to this act, in Pinkerton v. Pennsylvania Tractor Co., 193 Pa. 229, 44 Atl. 284 (1899) the Court said '. . . The title of the Act gave notice that they (traction companies) were incorporated with power to operate passenger railways, and an obvious way to do so was by lease of already existing roads.' "

Appeals, in *Allen v. Philadelphia Company*[42] recognized the separate form of the underliers in one opinion, which in effect honored the Pennsylvania statutes.[43] Twenty six years later, however, the same Court of Appeals said:

"We think that the many years of factual unity and the public necessity for the measures which will insure the proper economic foundation for the system, override the arguments for the recognition of the legal concept of the separate entity on the part of the underliers."[44]

This is a beacon for the courts and a guide for business.[45] The gap has been closed between morality and law. Business and corporations are led to the altar of morality. New and higher standards of business and corporate law are imperative in response to the demands of fair and just dealings. The courts' sense of morality and justice have been constantly expanding equitable principles and introducing life and flexibility with laws respecting business and adjusting them to morals and public policy.

The Courts have made marked changes in the judicial attitude towards

42. 265 Fed. 817 (3d Cir. 1920).

43. The court said:

"We are of opinion no such legal consequence followed as a sequence to unitary operation. . . . It is not contended that the acquisition, leasing, operative merging or operation of any or all of these companies was in itself not justified by statute. On the contrary, it is conceded that they were legal, and that due corporate statutory steps were taken to effect the same." 265 Fed. 817, 822 (3d Cir. 1920).

44. In re Pittsburgh Rys., 155 F.2d 477, 485 (3d Cir. 1946). This was called the "Pittsburgh rule" in dealing with an underlier corporation of the Erie Railroad System, in a case in which the court included Judge Stephens of 9th Circuit (New York & Rust Co. v. New York & Greenwood Lake Ry., 156 F.2d 701, 704 (3d Cir. 1946)).

45. Charles A. Edison, The Case Against Big Business, American Mercury Magazine 283 (Sept. 1944) discusses Thomas A. Edison Inc. of which he was the president. As the name indicates, this is a corporation. It conducts the business founded by the famous inventor as an individual enterprise. It produced such diverse and unrelated products as portland cement, phonographs, motion pictures, nursery furniture, magnetos, aircraft engines, and medical gases. Its expansion had reached the point where investable overhead charges offset the gain massed through massed purchases and distribution. It had grown so huge that administration costs ate into the profit. Mr. Edison said at page 285:

"In 1915 I analyzed our own company which was then 'centralized', to find out why it was in such poor health. . . . Out of all this was born what we called the divisional policy. We merely applied to business the idea behind a republic of sovereign states of limited territory, governed by competent governors and tied together for a common purpose through a Federal over-all government. . . . The plan determined upon was to dismember Thomas A. Edison, Incorporated, set up separate and complete 'states' or businesses with a man at the head of each, competent to operate all phases of this particular business and to give to this man as wide latitude as possible. Those of us who direct the affairs of the over-all company tie in the efforts of all the managers to the end that each divisional organization would in fact be along the road of general common purpose."

elevating commercial morality.[46] Much progress has been made in the treatment of the separate corporate form of the legal entity along the lines of natural justice. The moral and economic sense brings harmony between needs and rules. In consequence, a legal entity in a group of corporations—an empire of corporations—may enjoy a limited existence.

A cue to the modern judicial trend is indicated in *North American Co. v. Securities and Exchange Commission*[47] upholding the "death sentence" under, and the constitutionality of, Section 11 (b) (1) of its Public Utility Holding Company Act.[48] In an effort to avoid disintegration of its corporate empire, North America contended that its business had been acquiring, and holding for investment, securities of corporations in its group of corporations. The Supreme Court rejected this and said:

"Active intervention on North America's part in the activities of these corporations, it is true, has been of limited character. Operations and operational policies . . . have been left entirely to local management. . . . This lack of active intervention, however, is indecisive. . . . Historical ties and associations, combined with strategic holdings of stock, can on occasion serve as a potent substitute for the more obvious modes of control. . . . Domination may spring as readily from subtle or unexercised power as from arbitrary imposition of command. To conclude otherwise is to ignore the realities of intercorporate relationships."[49]

Thus it would seem that something new has been added as somewhat of an atomic weapon to pierce the armor of the juridicial conception of a legal entity in a group of corporations.[50] The Courts have held that the

46. As far back as 1765, in Pillans et al. v. Van Mierop et al., 97 Eng. Rep. 1035, 1038 (1765) Lord Mansfield laid down the rule that a promise in a business transaction was binding without any consideration. At common law there was no supporting authority for this. Lord Mansfield said: "In commercial cases amongst merchants the want of consideration is not an objection."

This was an early step to require commercial morality and to assure commercial morality in the courts. More recent instances are: a) recognition of deceit as a legal wrong, so that silence itself may constitute fraud and deception under certain circumstances. (Donovan v. Aeolian, 270 N.Y. 267, 271, 200 N.E. 815, 816 (1936)); b) extension of the doctrine of express and implied warranties. (Comment, 57 Yale L. J. 1389 (1948)); c) The efforts of the Securities and Exchange Commission and the Federal Trade Commission to induce commercial morality and to protect the fool from the knave.

47. 327 U.S. 686 (1946).

48. 49 Stat. 803, 15 U.S.C.A. 79 (1935).

49. 327 U.S. 686, 692, 693 (1946).

50. It may well be that this trend has inspired a challenge of the legal entity similar to that involved in Mansfield Journal Co. v. Federal Communications Comm., 180 F.2d 28 (D.C. Cir. 1950). In that case, the Court upheld denial to Mansfield Journal Co., for a radio broadcast station at Mansfield, Ohio, and to Loraine Journal Co., a separate corporation, for a station at Loraine, Ohio. Each journal company published a separate newspaper in its respective city. Each corporation had substantially the same stockholders and directors. While there was a radio station at Mansfield, Ohio, owned and operated by

fact that one owns all or substantially all the stock in a corporation, in the absence of domination and control, preserves the separate form of the legal entity.[51] The Courts have held, on the other hand, that domination may be so complete, interference so obtrusive, that under the law of agency, or principles of equity, or doctrines of public policy, the benefit of separate corporate form should be denied to the legal entity.[52] In such a case the absence of stock ownership need not be material.[53]

Combined or coordinated operations—in whole or in part—of the business or activities of a group of corporations, clearly results in a unity of life in the common endeavor. It is an economic arrangement of activity defining the function to be performed by each participant in the enterprise. It rests on the facts of economic life and not on the form of separate legal entity. It carries out the intended economic arrangement of the enterprise. Those who deal with the economic entity as such should not be required to examine the details of the legal structure. If outsiders were required to stop and to investigate, business and industry would halt until lawyers have had an opportunity to blueprint the legal chart. The modern policy is to aid and to expedite, not to hinder or to delay financial and commercial endeavors or activities and yet at the same time not to allow immunities from just liability. Courts have accordingly frequently exposed one corporation to the liability of another corporation

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an unrelated operator, there was no radio station at Loraine, Ohio. The Federal Communications Commission charged the Mansfield Journal with engaging in restrictive advertising practices against the existing Mansfield radio station and that the Mansfield Journal advertising contracts excluded Mansfield radio station advertisers from advertising in the Mansfield Journal. The Commission concluded that the factors which showed that the Mansfield Journal Co. was not qualified to operate a radio station at Mansfield, Ohio, also supported a conclusion that under identical ownership and control, Loraine Journal Co. was not qualified to receive a radio station license at Loraine, Ohio.

51. Berkey v. Third Ave. Ry., 244 N.Y. 84, 155 N.E. 58 (1926) (Cardozo, J.); Lehigh Valley R.R. v. Dupont, 128 Fed. 840 (2d Cir. 1904). Cf. Davis, Agent v. Alexander et al., 269 U.S. 114 (1925); Chicago M. St. P. Ry. et al. v. Minn. Civic Assn., 247 U.S. 490 (1918); Tenn. and Lane Timber Company v. United States, 236 U.S. 574 (1915).

52. Stone et al. v. Eacho, 127 F.2d 284 (4th Cir. 1942); Darling Stores Corp. v. Young Realty Co., 121 F.2d 112 (8th Cir. 1941); Trustees System Co. v. Payne et al., 65 F.2d 103, 107 (3d Cir. 1933); Central Republic Bank and Trust Co. et al. v. Caldwell et al., 58 F.2d 721 (8th Cir. 1932); Kingston Dry Dock Co. v. Lake Champlain Transp. Co., 31 F.2d 265, 267 (2d Cir. 1929); Wabash Ry. v. American Refrigerator Transit Co. et al., 7 F.2d 335, 343 (8th Cir. 1925); In re Eilers Music House, 270 Fed. 915 (9th Cir. 1921); Industrial Research Corp. v. General Motors Corp., 29 F.2d 623, 626 (N.D. Ohio 1928); Berkey v. Third Ave. Ry., 244 N.Y. 602, 155 N.E. 914 (1927).

53. In re Pittsburgh Rys., 155 F.2d 477 (3d Cir. 1946); Fourth Nat. Bank v. Portsmouth Cotton Oil Refin. Corp., 284 Fed. 718 (5th Cir. 1922).

by piercing the corporate veil and have subordinated a parent's claim to the claim of a disinterested public creditor.[54]

Both creditors and stockholders of a corporate enterprise assume some risk of failure. But, their risks are different. Stockholders are intended to lose first. In return, if the venture is successful, they share all of the profits above the debts due creditors. Creditors do not share in profits. Their sole concern is in the payment of the fixed debt due them. Hence the creditor comes first in the distribution of the assets. "To compel him to divide the assets . . . with those who at their option have all along had the power to take all the earnings is to add to the risk which he accepted."[55]

What treatment should be given to a creditor's claim acquired by a stockholder of a legal entity or of a related entity in a group of corporations or by one of the legal entities in the corporate empire? Is such a claim entitled to parity of treatment or should it be subordinated to all claims then held by the outside creditors and public security holders?

Claims asserted by management and by controlling stockholders should be subject to rigorous scrutiny for the protection of the entire community of interests, creditors as well as stockholders.[56] Their dealing

54. Davis, Agent v. Alexander et al., 269 U.S. 114 (1925); United States v. Reading Co. et al., 253 U.S. 526 (1920); Chicago M. & St. P. Ry. v. Minn. Civic Ass'n., 247 U.S. 490 (1918); Rankin v. Enigh, 218 U.S. 27 (1910); Roof et al. v. Conway et al., 133 F.2d 819 (6th Cir. 1943); N. Y. Trust Co. v. Island Oil & Transp. Corp. et al., 56 F.2d 580 (2d Cir. 1932); E. E. Gray Corp. v. Meehan, 54 F.2d 223 (1st Cir. 1931); Edward Finch Co. v. Robie, 12 F.2d 360 (8th Cir. 1926); Fourth Natl. Bank v. Portsmouth Cotton Oil Refining Corp., 284 Fed. 718 (5th Cir. 1921); Martin v. Development Co. of America, 240 Fed. 42 (9th Cir. 1917); Penn. Canal Co. et al. v. Brown et al., 235 Fed. 669 (3d Cir. 1916); Clere Clothing Co. v. Union Trust & Savings Bank, 224 Fed. 363 (9th Cir. 1915); In re Muncie Pulp. Co., 139 Fed. 546 (2d Cir. 1905); O'Brien et al. v. Champlain Construction Co. et al., 107 Fed. 338 (D. Ut. 1901); Interstate Tel. Co. v. B & O Tel. Co. et al., 51 Fed. 49 (D. Md. 1892); Burton v. Roos et al., 20 F. Supp. 75 (W. D. Texas 1937); S.G.V. Co. v. S.G.V. Co., 264 Pa. 265, 107 Atl. 721 (1919); Platt v. Bradner, 131 Wash. 573, 230 Pac. 633 (1924).

55. In re Loewers Gambrinus Brewery Co., 167 F.2d 318 (2d Cir. 1948).

56. A director, dominant or controlling stockholder, as well as the management may be fiduciaries. Pepper v. Litton, 308 U.S. 295, 306, 307 (1939). Their powers are powers in trust. What constitutes a breach of their fiduciary duty is incapable of brief cataloguing. Inadequate capitalization (Taylor et al. v. Standard Gas & Electric Co. et al., 306 U.S. 307, amended, 306 U.S. 618 (1939)); risk capital under the form of debt (Arnold v. Phillips, 117 F.2d 497 (5th Cir.), cert. denied, 313 U.S. 583 (1941)); "milking" and/or compelling large dividends (In re Commonwealth Light & Power Co. et al., 141 F.2d 734 (7th Cir. 1944)); and inadequate depreciation policy have all fallen under the interdict of the courts that the legal entity has not had an independent life commensurate with its separate corporate form.

with the entity should be subject to rigorous scrutiny. Their power to direct and to control puts them in the shoes of the entity. They cannot profit from their fiduciary status, even though they risk their own funds. The shareholders[57] or management may be unwilling to wind up the venture, even though it is in a precarious condition or in financial straits. As a condition of doing business in the corporate form, the law requires adequate risk capital for the conduct of the venture.[58]

When a claim is acquired by a corporate obligor from a public creditor who does not intend a sale or consent to a sale, the transferee does not succeed to the rights or status of the transferor creditor. Such mere transfer of the claim with title, is in truth, a cancellation and payment of the debt so far as other public security holders or creditors are concerned.[59] A purchaser of a contract obligation would be much like the purchaser of a legal entity's matured note, bond or interest coupon. Even though he pays value and buys without notice of defects or infirmities, he would not be a holder in due course.[60] The Uniform Negotiable Instrument Law at Section 58, provides that one who is not a holder in due course may nevertheless be such if he acquired from one who was himself a holder in due course. The acquisition by a corporation of its debt or obligation in any form, is considered payment. Is the rule otherwise, when that debt or obligation is acquired by its stockholder, its affiliate or its management?[61]

In *Brown v. Guarantee Trust Co.*[62] the Court directed bondholders of a water works company to present their bonds and coupons for payment thereon by the Court Clerk out of the funds then in the hands of that

57. The term "shareholder" is here used to include any equity or profit beneficiary in a venture of a group of corporations and includes the stockholders of a legal entity as well as the legal entity.

58. Consolidated Rock Products Co. et al. v. Du Bois, 312 U.S. 510 (1941); Taylor et al. v. Standard Gas & Electric Co. et al., 306 U.S. 307, amended, 306 U.S. 618 (1939); Chesapeake Stone Co. v. Holbrook, 168 Ky. 128, 181 S.W. 953 (1916); Oriental Investment Co. v. Barclay et al., 25 Tex. Cir. App. 543, 64 S.W. 80 (1901); Douglas & Shanks, Insulation From Liability Through Subsidiary Corporations, 39 Yale L.J. 193 (1929).

59. Venner v. Farmer's Loan & Trust Co., 90 Fed. 348 (6th Cir. 1898).

60. New Paddock-Hawley Co. v. Fayetteville Wagon Wood & Lumber Co. et al., 207 Fed. 786 (W.D. Ark. 1913).

61. The early case of Ketchum v. Duncan, 96 U.S. 659, 660 (1877) considered the status of interest coupons acquired by the debtor's president. The court said:

"If there were nothing else in this case, Alexander Duncan's (Debtor's president) possession of them would raise the presumption that he became the holder in the usual course of business for value, at their date, and before they became payable. The appellees claim the benefit of this presumption; but it is completely rebutted by proof that neither . . . acquired any ownership of them before they fell due."

62. 128 U.S. 403 (1888).

officer. In *Wood v. Guarantee Trust Co.*[63] the Court considered the claims filed upon 473 of such past due coupons. They had been transferred to the appellant, Wood, by Starr in payment of material used in the construction of the water works. Starr acquired these past due coupons from bondholders, with money which ought to have been applied to the payment of material. Appellee contended that the coupons have been paid. The holders had presented the coupons for payment at the offices of Starr's brokers. The water works were insolvent and defaulted in payment of interest. The Supreme Court affirmed rejection of the claims and said:[64]

> "In Ketchum v. Duncan stress was laid on these circumstances, viz: that the persons alleged to have paid the coupons had no connection with the company issuing the coupons, or interest in it: that they had repeatedly and publicly notified the holders of the bonds and coupons that the coupons were to be purchased, not paid: and that the coupons were carefully received and preserved uncancelled. In the case at bar, the conditions are radically different. Starr is essentially (that is, from a business point of view) the Water Works Company, owning as he does 19,500 of its 20,000 shares of stock. Its prosperity is manifestly his prosperity, its disaster, his disaster, and any disbursements made by it is made by him. There is, therefore, no inherent improbability, that he intended to pay the coupons, as he indeed instructed his brokers. . . . The same consideration of substantial identity between Starr and the Water Works is of great weight.
>
> "As we have already said, 'Starr was, from a business point of view, the company.'
>
> "It looks very much as if Mr. Starr had dug a pit, and was anxiously keeping the pathway to it in good order. It would be inequitable, in our opinion to allow him to bring forward these coupons as the basis of any preference over, or even coequal rights with those to whom he sold his bonds: and the plaintiff, having taken these bonds when overdue had no greater interest than he had in this respect. If the Court were to sanction such claims, the commercial securities of the world would be nullified."

From the *Wood* case, the logical conclusion is inescapable that whether the acquired claim be matured or unmatured, it is not entitled to parity with the public, where acquired or asserted by either a shareholder of the debtor legal entity or a related legal entity in a group of corporations or by one of the legal entities in the corporate group. The prosperity of the economic entity is their prosperity, its disaster is their disaster, and any disbursement made by them is made for the protection and benefit of their economic venture. Thus when treating with a corporate empire or economic entity, the transferor's intention, to effect a sale or consent to a sale of a debt, matured or unmatured, by transfer to a shareholder[65] of the group or economic entity or a constituent legal entity cannot avoid its payment and cancellation. It would be inequitable to permit a transfer

63. 128 U.S. 416 (1888).
64. Id. at 424, 425.
65. See note 57, supra.

to keep the obligation alive entitled to parity participation with other public claimants. "A parent corporation may not assume the position of creditor . . . since the assertion of a claim . . . amounts to the presentation of a claim against itself in fraud of bona fide creditors."[66] Such a question is presented in cases of insolvency.[67]

The business view becomes the judicial view. The moral and economic sense prevails over legal form. It effects harmony of needs and rules. The Courts have long recognized that an entity may have more than one parent.[68] The economic entity's parents are each legal entity in the group of corporations. The combined assets are pooled and marshalled. The stockholders of the constituent legal entities must stand aside until after all claims then held by the public are fully satisfied. Out of the surplus will then come the claims of the public who own stock and the remainder, if any, will then go to the managing or controlling stockholders.

S. G. V. Co. of Del. v. S. G. V. Co. of Pa.,[69] rejected a claim on a note asserted by one corporation against another corporation. A Delaware Holding corporation controlled and managed the business affairs of a Pennsylvania corporation. The note claim was presented in the latter's insolvency in competition with public creditors of the Pennsylvania corporation. The Court said "Any other rule would defeat justice and open the door to fraud."[70]

Those sharing in the economic entity are "more than a mere investor."[71] "There has been a unified operation."[72] The demand of this unity must control. There will not be obeissance to the doctrine of separate corporate entities irrespective of any jig-saw puzzle arrangement of all these concerns, which from the business point of view, constitute one

66. See Taylor et al. v. Standard Gas & Electric Co. et al., 96 F.2d 693 (10th Cir. 1938) (J. Bratton dissenting), rev'd, 306 U.S. 307 (1939). That Judge Bratton correctly stated the law is clear from Supreme Court Justice Roberts' opinion wherein he stated that the result of piercing the corporate veil is "to preclude the allowance of Standard's claim in any amount. The rule was much discussed in the opinion below." 306 U.S. 307, 309. In their treatise in 39 Yale L.J. 193, 196 (1929), Mr. Justice Douglas and his co-author Shanks say, "That unit should be sufficiently financed to carry the normal strain upon it."

67. Trustee System Co. v. Payne et al., 65 F.2d 103 (3d Cir. 1933); Central Republic Bank & Trust Co. v. Caldwell et al., 58 F.2d 721 (8th Cir. 1932); In re Eilers Music House, 270 Fed. 915 (9th Cir.), cert. denied, 257 U.S. 646 (1921); In re Looschen Piano Case Co., 266 Fed. 359 (3d Cir. 1920); In re Rieger, Kapner, & Altmark, 157 Fed. 609, 611 (D.C. Ohio 1907).

68. Chicago, Milwaukee & St. Paul Ry. et al. v. Minneapolis Civic and Commerce Ass'n., 247 U.S. 490 (1918).

69. 264 Pa. 265, 107 Atl. 721 (1919).

70. Id. at 267, 107 Atl. at 722.

71. North American Co. v. Securities and Exchange Comm., 327 U.S. 686 (1946).

72. Consolidated Rock Products Co. et al. v. Du Bois, 312 U.S. 510, 523 (1941).

operation and one enterprise.[73] So the Courts will treat this economic as a single unit, precisely as if it were a legal entity.[74]

As a consideration for the privilege of doing business as an entity, with limited liability, the law requires payment into the entity's pool of assets, a fund or property reasonably adequate for the venture. The unit should be sufficiently financed to carry the normal strains upon it. If adequate capital is present initially, there is no duty to advance risk capital. But if it is advanced it cannot be disguised as a loan. If attacked, the loan is looked upon with suspicion and the holder of the loan has the burden to show that it was honest and fair in all its parts.[75] The holder must not only act for the benefit of the economic entity, but in such a way as not to gain any advantage directly or indirectly, except as the law specifically allows. The law will not allow a conflict of personal interest with the public interest in the entity. When the entity's financial resources become inadequate for its business, a conflict of interest arises, for the public creditors' interest is limited to the payment of the fixed debt while the management is interested in the profits by reason of risk capital. When the entity is in financial straits or in a precarious condition and the management is unwilling to wind up the venture, all capital contributions in any form must be treated as risk capital subordinate to all publicly held claims. Otherwise it would prove its claim in competition with the public claims and gain a personal advantage which the law does not allow.[76] The failure to provide sufficient capital for the entity to be self sufficient has induced the court to declare the claim as a "debt(s) against itself."[77] Subordination or disallowance are both equitable remedies to undo the wrong resulting from control.[78]

In re *Loewers Gambrinus Brewery Co.*[79] is worthy of extended examination. A parent's claim was disallowed in competition with public claims. There were two opinions. Judge Jerome Frank said:

> "Neither the Referee nor the Judges found fraud; nor did either of them find that the debt was a sham."

Courts look back of the screen of corporate entity and consider the

73. In re Pittsburgh Rys., 155 F.2d 477 (3d Cir. 1946), (per Goodrich C. J.).

74. Berkey v. Third Ave. Ry., 244 N.Y. 602, 603, 155 N.E. 914, 915 (1927) (Cardozo, J.). See also Rankin v. Enigh, 218 U.S. 27 (1910); E.E. Gray Corp. v. Meehan, 54 F.2d 223, 226 (1st Cir. 1931); Platt v. Bradner Co., 131 Wash. 573, 230 Pac. 633 (1924).

75. Hine v. Lousterer et al., 135 Misc. 397, 408, 238 N.Y. Supp. 276, 289 (Sup. Ct. 1930).

76. Heiser v. Woodruff et al., 327 U.S. 726, 737 (1946). Cf. Prudence Realization Corp. v. Geist, 316 U.S. 89 (1942).

77. Clere Clothing Co. v. Union Trust & Savings Bank, 224 Fed. 363, 364 (9th Cir. 1915).

78. Pepper v. Litton, 308 U.S. 295 (1939).

79. 167 F.2d 318 (2d Cir. 1948).

essence and not the form in arriving at a just conclusion.[80] They have consistently "pierced the corporate veil"[81] and treated the debts of the subsidiary as the debts of the parent.[82]

Learned Hand, C.J., said, in part, in the *Loewers Gambrinus* case:

"Courts have generally held it unjust to allow a corporation to claim in insolvency upon a parity with other creditors against another corporation, when the shareholders are the same."[83]

The same is true when the shareholders of the several corporations are not the same.[84]

Continuing in his opinion, Judge Learned Hand said:

"In In re Watertown Paper Co. [169 Fed 252 (2d Cir 1909)] we held that this depended upon whether the creditor corporation was an 'adjunct' or 'agency' or 'instrumentality' of the debtor; but Taylor v. Standard Gas Co. [306 U. S. 307 (1939)] repudiated this as a test and said that the question was one of 'fraud or injustice' which left the matter wholly at large. Pepper v. Litton [308 U. S. 295 (1939)] perhaps reestablished the earlier statement by confining the doctrine to cases where its creditor corporation was 'a part of the stockholder's own enterprise.' I should not of course venture to challenge the last statement; but, taking it as it reads, it seems to me that it may be possible a little to sharpen it in application, if we can learn what reasons make it the right test, and I shall try to state these what they seem to me to be.

"Both the shareholders and the creditors in any enterprise[85] assume some risk of its failure, but therein risks are different. The shareholders start to lose first, but in return they have all the winnings above the creditors' interest, if the venture

80. E. E. Gray Corp. v. Meehan, 54 F.2d 223, 226 (1st Cir. 1931).

81. Davis v. Alexander et al., 269 U.S. 114 (1925); United States v. Reading Co. et al., 253 U.S. 26, 62, 63 (1920); Chicago, Milwaukee & St. Paul Ry. et al., v. Minn. Civic and Commerce Ass'n, 247 U.S. 490 (1918); Centmont Corp. v. Marsch, 68 F.2d 460 (1st Cir. 1933); Edward Finch Co. v. Robie, 12 F.2d 360 (8th Cir. 1926); Martin v. Development Co., 240 Fed. 42 (9th Cir. 1917); Pennsylvania Canal Co. et al. v. Brown et al., 235 Fed. 669 (3d Cir. 1910), cert. denied, 242 U.S. 646 (1917); Interstate Tel. Co. v. Baltimore & O. Tel. Co. et al., 51 Fed. 49 (D. Md. 1892); Gulf, C. & S. F. Ry. et al. v. Cities Service Co. et al., 281 Fed. 214 (D. Del. 1922); Hunter v. Baker Motor Vehicle Co., 225 Fed. 1006 (N.D. N.Y. 1915), aff'd, 238 Fed. 894 (2d Cir. 1916).

82. Rankin v. Enigh, 218 U.S. 27 (1910); Roof et al. v. Conway et al., 133 F.2d 819, 823, 824 (6th Cir. 1943); New York Trust Co. v. Island Oil & Trans. Corp. et al., 56 F.2d 580, 583 (2d Cir. 1932); Fourth Nat. Bank v. Portmouth Cotton Oil Corp., 284 Fed. 718 (5th Cir. 1922); O'Brien et al. v. Champlain Const. Co. et al., 107 Fed. 338, 339 (D. Vt. 1901). See also note 81 supra.

83. 167 F.2d 318, 319 (2d Cir. 1948).

84. In re Pittsburgh Rys., 155 F.2d 477 (3d Cir. 1946); Weisser et al. v. Mursam Shoe Corp. et al., 127 F.2d 344 (2d Cir. 1942); Darling Stores Corp. v. Young Realty Co., 121 F.2d 112 (8th Cir. 1941).

85. Obviously Judge Learned Hand refers to the enterprise of a single legal entity. But it would not change were the Court to treat with an enterprise conducted by an economic entity of two or more legal entities, except that the managing stockholders should be subordinated to the public stockholders.

is successful; on the other hand, the creditors have only their interest, but they come first in the distribution of the assets. Beneficially considered, the same persons are both creditors and shareholders, where they have organized into two corporations under a single control. If in such a case they are allowed to prove in insolvency on a parity with other creditors, as shareholders of the debtor, they can use their control to take all the winnings which may be made on their advances while the company is successful, yet they will expose themselves only to creditors' risks, if it fails. That is unfair to other creditors regardless of whether they know that the shareholders of the debtor corporations have this power through their common ownership; for every creditor rightfully assumes that his risk is measured by the collective claims of other creditors, and by creditors he understands those alone, who like him, have only a stipulated share in the profits. To compel him to divide the assets in insolvency with those who at their option have all along had power to take all the earnings, is to add to the risk which he accepted."[86]

As Judge Learned Hand so clearly indicates the corporate veil is no longer as secure as it was formerly: the cloak will be removed in the interest of justice in the absence of "instrumentality" and "adjunct".[87] In doing so fraud is not a factor. Nor is the genuineness of the debt in dispute. Judge Frank said, in his opinion:

"In the light of the recent Supreme Court decisions[88] . . . the test is whether the failure to subordinate will 'work injustice', will not 'be fair and equitable to other creditors' and will result in the violation of the rules of fair play and good conscience' ".[89]

In *Heiser v. Woodruff* et al.,[90] which Judge Frank cites, the Supreme Court said:

"A controlling stockholder of the bankrupt corporation . . . was a fiduciary for the other creditors of the corporation, and, as such, could not prove his claim in competition with the other creditors or gain from the estate every personal advantage."

Hence the rules governing fiduciary responsibility come into play on the allowance of claims asserted in competition with public claims. Claims founded on transactions of affiliated legal entities in the corporate empire are subjected to rigorous scrutiny.[91]

The relationship of the claimant with an interest in winnings above the public's interest in the venture places on the claimant the burden

86. Id. at 319, 320.

87. A discussion of "instrumentality" and "adjunct" is found in Dix, The Armor of the Juridical Conception, 34 Geo. L. J. 432 (1946).

88. Sampsell, Trustee in Bankruptcy v. Imperial Paper & Color Corp., 313 U.S. 215, 218, 219 (1941); Pepper v. Litton, 308 U.S. 295, 306-311 (1939); Taylor et al. v. Standard Gas & Electric Co. et al., 306 U.S. 307, 322 (1939).

89. 167 F.2d 318, 319 (2d Cir. 1948).

90. 327 U.S. 726, 737 (1946).

91. In re H. Hicks & Son Inc., 82 F.2d 277, 279 (2d Cir. 1936); Forbush Co. v. Bartley et al., 78 F.2d 805, 806 (10th Cir. 1935); Irving Trust Co. v. Deutsch et al., 73 F.2d 121, 124 (2d Cir. 1934).

not only to show the fairness of the transaction but to establish at least coequal recognition. The financial difficulty may be the result of inadequacy of capital.[92] Inadequacy of risk capital in a venture or economic entity is of far more vital concern to the creditors than the failure to observe the many niceties of corporate formalities upon which the debts of one legal entity are foisted upon another legal entity. It is not too much to require those interested in the winnings or profits of a legal entity or an economic entity to provide and maintain adequate risk capital, so long as the public contribution is sought or obtained.

The question of whether or not adequate risk capital has been invested arises when the entity is unable to pay the debts.[93] If such cases as *Heiser v. Woodruff* et al.,[94] *Pepper v. Litton,*[95] *Taylor v. Standard Gas & Electric Co.,* et al.,[96] *Consolidated Rock Products* et al. *v. Du Bois,*[97] mean anything, they would seem to repudiate the strictness of *Ketchum v. Duncan*[98] and to expand *Wood v. Guarantee Trust Co.,*[99] so that those interested in the profits of an economic entity and their stockholders cannot compete with any public claimants, irrespective of where or under what circumstances they acquired their claim. In other words, the claims of the public would come first, and the shareholders[100] would lose first. To conclude otherwise is to ignore the realities of the intercorporate relationship and the association of legal entities in the corporate empire or economic entity. The rule would be the same where the initial capital were sufficient and adequate for the conduct of the business so that it was self sustaining and it later developed to the management that there was insolvency as a result of operating losses.[101] If the condition of the venture is such that the shareholders[102] are willing to take the risk of a creditor's liquidation, instead of a contribution of risk capital, it is just

92. Inadequacy of capital may be caused by such things as inadequate capital contributions, or risk capital under the form of debt, or milking, or dividend paying, or insufficient depreciation. See, Comment, Inadequately Capitalized Subsidiaries, 19 U. of Chic. L. R. 872 (1952).

93. Where the debt is held by the insiders, it might be the basis of the conventional equity receivership suit.

94. 327 U.S. 726 (1946).

95. 308 U.S. 295 (1939).

96. 306 U.S. 307 (1939).

97. 312 U.S. 510 (1941).

98. 96 U.S. 659 (1877).

99. 128 U.S. 416 (1888).

100. See note 57, supra for definition of shareholder.

101. Cf. 54 Harvard Law Review 1045, 1046, 1047 (1941).

102. See note 57, supra for definition of shareholder.

as well to wind up then and there. The shareholders[103] are the only ones qualified to judge the choice. In doing so they act as fiduciaries.

If a man has a horse, he must feed the horse. If the horse is sick, he must provide sufficient veterinarian care in an endeavor to have the horse recover. If the horse dies, he must bury it.[104] If the horse dies and the man sells the cadaver, he cannot share in the proceeds in competition with the veterinarian or feed supplier or liveryman. If he has two horses functioning as a team, and he incorporates each horse separately, the situation is precisely the same. The marriage of morals and business infect one with the liabilities of another. More and more are the courts realists and not nominalists in the judicial progress along lines of natural justice and commercial morality.

Who can tell, but, that, in all cases, will the separate form of the constituent legal entities give way to the successor economic entity, in the interests of justice, or as justice requires?

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103. The shareholders-management possess sufficient knowledge of the financial condition. Securities & Exchange Commission v. Ralston Purina Co., 200 F.2d 85 (8th Cir. 1952).

104. Berle and Means, The Modern Corporation and Private Property, 66.