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Corporations - Sale of Assets - Restrictive Covenants

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but which were proven to be uncollectible to the extent of at least $108,232.

On June 16, 1931, the date when the deposits were accepted, the bank's investments in bonds were carried on the books at a figure which the state contended was $88,099 in excess of their realizable value. This value was arrived at by taking current market quotations. The plaintiff in error claimed that this was not the proper basis, and introduced testimony on the fixing of intrinsic or true value by plant valuation, average earnings, management, and other elements. It was further claimed that fictitious prices for securities are frequently created by various means, and that in view of the present depression a reasonable time to liquidate the list of bonds would be upwards of three years. This testimony, it was held, was admissible but not conclusive proof; likewise, market quotations from standard publications was undoubtedly evidence bearing on the question of the real value of the bonds although it was not conclusive. It was then said, if "because of current economic or financial conditions, which during the time permissible for liquidation affect the saleability of securities, their market value is not in conformity with their intrinsic value, then all that can, after all, be realized therefor is the market value. That alone, under such circumstances, may constitute the reliable although not the conclusive criterion as to the realizable value."

This test for the valuation of securities is a severe one for bankers under current deflated values. The net worth of a bank is generally small in proportion to its total resources. This net worth might easily be wiped out by a sharp fall in current quotations and other losses and the banker who knowingly keeps open for business thereafter makes himself liable to criminal prosecution. The court carefully considered the problems of the banker but also kept in mind the duty to depositors and to the state at large.

H. L. KUNZE.*

CORPORATIONS—SALE OF ASSETS—RESTRICTIVE COVENANTS. Defendants were stockholders and officers of a corporation whose assets and good will were purchased by plaintiff, Defendants agreed not to engage in competition with plaintiff; but were allowed to accept employment with competitors of plaintiff in any capacity. Defendants organized B corporation, in which they, with one other, who had come in with full knowledge, owned all the stock, elected themselves officers, and entered into competition with plaintiff. Action to restrain defendants and B corporation from violating the restrictive covenant.

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HELD: Defendants must cause B corporation to cease business and be immediately dissolved, General Bronze Corp. v, Schmeling et al. (Wis. 1932) 243 N.W. 469.

Theoretically it was not the defendants who were competing with the plaintiff, but the corporation organized by them. Such corporation has a distinct existence, separate from that of its stockholders *and directors*. People's Pleasure Park Co. v. Rohleder (1908) 109 Va. 439, 63 SE 981. The corporation, being an entity sepraate from defendants, was not bound by the restrictive covenant. The legal entity theory should be firmly and consistently applied, since it has been affirmed by both legislatures and courts.

However, when the corporate entity cloaks a fraud, particularly when it would permit a person to evade a legal obligation, it is disregarded by the courts who proceed to treat directly with the individuals behind it. Milwaukee Toy Co. v. Industrial Comm. (1930) 203 Wis. 493, 234 NW 748; U. S. v. Mil. Refrigerator Transit Co. (1905) 142 Fed. 247, 145 Fed. 1007; Higgins v. Cal. Petrol. & C. Co., et al. (1905) 147 Cal. 363, 81 Pac. 1070; Donovan v. Purtell (1905) 216 Ill. 629, 75 NE 334; (1926) 39 Harvard L. R. 652; (1932) 45 Harvard L.R. 580; Wormser, *Disregard of the Corporate Fiction and Allied Corporate Problems,* Chap. II.

In the instant case the restraining clause was held valid; the defendants were bound by it. To allow them to evade this obligation by competing with plaintiff under the guise of a corporation could not be permitted. cf. 7 Thompson on Corporations 5445.

Few cases were found in which a similar controversy was determined by the courts. In Anderson v. Truitt (1930) 158 Md. 193, 148 A. 223 the defendants attempted to get out of a restrictive covenant similar to the one under discussion by having their daughters organize a corporation with funds advanced by the defendants and hold most of the stock, while the defendants, husband and wife, proceeded to run the business. An action was brought to restrain the defendants from so competing; no relief was granted because of wrong party plaintiff. But the court did say that the defendants were violating the covenant and would be restrained if the action were properly brought.

In Kramer et al. v. Old et al. (1896) 119 NC 1, 25 SE 813, the facts were substantially the same as in the instant case, the same relief was sought. The court held there was a violation of the restrictive covenant, but made a point not to dash aside utterly the theory of corporate entity by enjoying merely the individuals, who were competing wrongfully, forcing them to withdraw, and not the corporation itself even though those same individuals had organized it. In that case there were other stockholders than the defendants.

The judgment in the instant case likewise does not enjoin the corporation itself even though it was a party to the action, but operates upon the defendants, restraining them from directly or indirectly owning or controlling any interest or investing any money or property in any partnership, firm, corporation, or other form of business organization in competition with plaintiff (their right to accept employment with competitors in any capacity merely allowed them to become hired workers, not in any way sharing in the profits of the business. cf. *Words and Phrases,* 3d Series, Vol. 3, p. 248.), and ordering them to cause defendant corporation to cease from the transaction of business and be dissolved immediately. To that extent the theory of corporate entity is restrained. That the injunction does go farther than the one in the North Carolina case is justified by the circumstances. However, it is very probable that if there were other stockholders in B corporation, who had come in unaware of the circumstances of its organization, the court would not have ordered a dissolution but allowed it to continue, and merely directed the defendants to relinquish their interests. Whether the corporation could remain in business if the defendants disobeyed the injunction by putting it out of their power to cause it to be dissolved, through a sale of their stock to purchasers in good faith, remains in doubt.

But aside from the question of whether an enjoining of the corporation itself would, by completely identifying the corporation and the individuals, be unnecessarily inconsistent with the entity theory, as Professor Canfield seems to say in his essay in 17 Columbia L.R. 128 (1917) at page 138, it can be safely said that as a general rule an obligor on a contract cannot evade his contractual obligation through the instrumentality of a corporation which he formed for the very purpose of evading that obligation.

The Wisconsin decision squares with principles of justice, and is in line with the tendency of courts to be rather impatient with legal fictions and niceties of logic when they threaten to distort reality.

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