Corporations: De Facto and De Jure: Statutory Requirements: One Man Corporations

Vernon X. Miller

Follow this and additional works at: http://scholarship.law.marquette.edu/mulr

Part of the Law Commons

Repository Citation
Vernon X. Miller, Corporations: De Facto and De Jure: Statutory Requirements: One Man Corporations, 18 Marq. L. Rev. 48 (1933). Available at: http://scholarship.law.marquette.edu/mulr/vol18/iss1/4

This Article is brought to you for free and open access by the Journals at Marquette Law Scholarly Commons. It has been accepted for inclusion in Marquette Law Review by an authorized administrator of Marquette Law Scholarly Commons. For more information, please contact megan.obrien@marquette.edu.
NOTES

CORPORATIONS—DE FACTO AND DE JURE—STATUTORY REQUIREMENTS—ONE MAN CORPORATIONS.—The classic statement of the law on de facto and de jure corporations is easy to lay down and seems easy to comprehend. The organizers can create a de jure corporation when they do exactly what the legislature has prescribed. The state cannot prevent the exercise of corporate privileges by a de jure corporation. De facto corporations may lose their corporate privileges if the state chooses to act, but, until the state does step in, they are corporations, they are legal entities. What one has to be able to show to make out this de facto status, when the organizers have not done exactly what the statutes seem to have required, is a law providing for incorporation, an attempt in good faith to incorporate under that law, and corporate user. Perhaps all of these facts cannot be shown, but either one or both parties in the particular law suit may be estopped to deny the corporate existence of the alleged corporation. Moreover, corporate existence ought not be attacked collaterally.

To accept this statement as an outline of the law on de facto and de jure corporations is to make the matter of “laying down the law” too easy, and to make the matter of “applying the law” too difficult. The courts are considering a series of problems in these cases. Any sort of analysis that is too simple is no analysis at all.

Business corporations are created for various reasons of convenience and necessity. They are created to give those interested in carrying on the particular business the privilege of a limited personal responsibility for firm obligations, to let the organizers and their successors in interest act as a unit for the protection of group interests during the course of litigation, and incidentally to let them act as an entity for the purpose of executing conveyances, papers, and all more or less formal documents. The exercise and enjoyment of these and other corporate privileges may be questioned in any number of situations. Most of them can be classified into several well recognized categories. The

1 In many states business associates do not have to form a corporation to be able to execute effective conveyances in the group name. The Uniform Partnership Act provides that conveyances may be made to and by the firm in the firm name where the business is unincorporated. Sec. 123.05, Wis. Stats. In those states where the Uniform Act is in the statutes and in a case which concerns the effect to be given to a conveyance executed in the firm name, any inquiry into corporate status may be unnecessary. But see Patterson v. Ford, (Wash., 1932) 8 P. (2d) 1006. The Uniform Act has not been adopted in Washington.

2 In the text above no analysis is made of those cases where a business enterprise, as such, is brought into court as a party defendant and is said to be estopped to deny its corporate existence. Apparently the idea behind this statement of rule is that the group ought not escape any responsibility to pay for what it has received, or to pay for any injury it has caused, when it has purported to be a corporate enterprise. That approach suggests unnecessary difficulties. That the assets of the firm will be within the reach of firm creditors is understood whether the firm is incorporated or unincorporated. That any particular claim will be satisfied out of firm assets follows as a matter of
NOTES

privilege of limited liability may be denied to those interested in the particular enterprise, or the privilege to appear as a party plaintiff, or the power to execute effective conveyances, may be denied to the group, as such, because no articles of incorporation have been executed and filed or recorded as the statutes in the state prescribe. Recognition of these privileges and powers may be refused by the courts because in the particular jurisdiction no domestic corporation can exercise all of its powers until it has accumulated a certain portion of its capital or carried out its formal organization to some prescribed point. Perhaps recognition will be refused in the particular case because the corporation, created as such, having accumulated enough capital and finished the formal organizing of its board of directors, has failed to exercise its franchises as prescribed by statute or judicial policy.

To be more specific: The general incorporation laws in most jurisdictions require that articles of incorporation be executed in some more or less formal fashion, and that they be filed or recorded in one or more public places within the state. If the articles have been drawn up, if the desired information is set out, if the preliminary petition has been presented to the proper official for approval, where that is required by statute, and if the papers are on record in at least one of the places specified by statute, a corporation is created. The articles may not have course. To say that a creditor, in order to get relief, must show a corporation "by estoppel" when there is no corporation "in fact" is unnecessary as well as absurd. The active supposed "stockholders" of the unincorporated firm are responsible for the firm's obligations. But the court will let the firm creditors reach the firm's assets as in the case of any unincorporated business. To be able to get this relief it is not necessary that the firm creditors be in a position to reduce their claims to judgment against the firm in the firm name. The procedural difficulties can be readily ironed out as they are where the suit is brought against a business that purports to be and is a partnership. See Stangarone v. Jacobs, 188 Wis. 20, 205 N.W. 318 (1925). Cf. In re Johnson-Hart Co., 34 F. (2d) 183 (D. Ct., Minn., 1929). Cf. Frawley v. Tenafly Transportation Co., 95 N.J.L. 405, 113 Atl. 242, 22 A.L.R. 369 (1921), where there was no corporation when the tort was committed, but where the corporation was created by the time of the lawsuit and the action was brought and judgment entered against the corporation, and see Tiernan v. Savin Rock Realty Co., 115 Conn. 473, 162 Atl. 11 (1932), where, after the individual's death, the court chose to administer the assets of the firm through a receiver apart from the assets of the individual in order to protect firm creditors, although there probably was no corporation.

3 Sections 180.01, 180.02, Wis. Stats.

4 Too much emphasis cannot be placed upon the simplicity of the standards set by the courts in these cases, informal execution of the articles and recording or filing in one of the public places as required by statute. It is difficult to discover whether the subsequent correcting of the improper execution or filing has any effect upon the courts' decisions. Certainly they seem to make no point of it as a necessary step. Where the groups were able to show that they had met the standards set by the courts, see Newcomb-Endicott Co. v. Fee, 167 Mich. 574, 133 N.W. 540 (1911); Inter-Ocean Newspaper Co. v. Robertson, 296 Ill. 92, 129 N.E. 523 (1920); Wilkin Grain Co. v. Monroe County Co-op. Ass'n, 208 Ia. 921, 223 N.W. 899 (1929); Refsnes v. Myers, 164 Wash. 205, 2
been formally executed and may not have been recorded or filed everywhere and exactly as the statutes seem to have required. The corporation may not be a de jure corporation. Theoretically the state may be able to prevent the members' exercising in the future the privileges and powers incident to the corporate form, but there is a corporation. It may still have to satisfy other statutory requirements in the way of raising capital and completing its formal organization to give complete protection to the members of the group, but when it has done that, the fact that the organizers originally have failed to draw up and file or record the articles in strict compliance with the statutes, will not prevent the corporation's carrying on business with the power to sue and

P. (2d) 656 (1931). Where the courts found that the organizers had not done enough to comply with the statutory requirements, see Baker v. Bates-Street Shirt Store, 6 F. (2d) 854 (C.C.A., 1st, 1925); Harris v. Ashdown Potato Curing Ass'n, 171 Ark. 399, 284 S.W. 755 (1926); A. W. Mendenhall Co. v. Booher, 48 S.W. (2d) 120 (Mo. App., 1932); H. J. Hughes v. Farmers Union Produce Co., 110 Neb. 736, 194 N.W. 872, 37 A.L.R. 1314 (1923). Every supposed stockholder in the unincorporated enterprise is not responsible personally for firm obligations. Only those who have been actively interested in the success or failure of the business can be held responsible as partners. Baker v. Bates-Street Shirt Store, supra.

The matter of de facto status is sometimes raised in workmen's compensation cases. A stockholder can be an employee within the classification under the statute, but there may be some doubt in the particular jurisdiction as to whether a partner can come within the protection of the law. When the courts deal with the matter of corporate status in these cases they use the same language technic and apparently classify the groups concerned as corporations or not as in the usual limited liability cases. Whether the approach to the problems concerned in both lines of cases should be the same may well be questioned. See Ebeling v. Independent Rural Tel. Co., (Minn., 1933) 246 N.W. 373; Munter v. Ideal Êtreless Laundry, 241 N.Y. S. 411, 229 App. Div. 56 (1930); Missing Link Coal Co. v. Postowa, 139 Okla. 75, 281 Pac. 223 (1929).

The Wisconsin case, Bergeron v. Hobbes, 96 Wis. 641, 71 N.W. 1056, 65 A.S.R. 85 (1897), is out of line with the usual run of cases. In that case the court held the members to an unlimited personal responsibility to certain group creditors. The articles of incorporation had been properly drawn. They had been recorded with the local official but they had not been filed with him as the statutes literally required. The case has never been followed in Wisconsin. The court subsequently got around it in Stochum v. Head, 105 Wis. 431, 81 N.W. 673, 50 L.R.A. 324 (1900). There the court conceded that the stockholders might escape a personal responsibility to the firm creditors although they had failed to execute the articles literally as required by statute, provided they had not led the particular customer to rely upon their personal credit. There is plenty of dicta and some decisions in other kinds of cases that there can be a corporation in this state although the articles are not executed and recorded or filed exactly as prescribed by statute. Franke v. Mann, 106 Wis 118, 81 N.W. 1014, 48 L.R.A. 856 (1900); Gilman v. Druse, 111 Wis. 400, 87 N.W. 557 (1901); Miller v. Milwaukee Odd Fellows Temple, Inc., 206 Wis. 547, 240 N.W. 193 (1932). Cf. Sec. 180.35, Wis. Stats., the curative act. The court, in any event, would probably do by judicial decision what the legislature has hoped to accomplish by statute.
NOTES

to convey, and with the privilege of a limited financial responsibility as incident to a stockholder's membership in the group.

Perhaps some particular creditor has looked at the records in the locality where the company is carrying on its business. He does that before he extends credit to it. He sees no papers on record there because the organizers have never filed any papers with any local official. He believes that the active stockholders are carrying on the business as partners. Perhaps in this kind of case the creditor can reach the personal and unlimited responsibility of the active or interested stockholders in the event that the business, as such, cannot satisfy his claim. He has been dealing with a corporation, what the court would call a de facto corporation. In the particular instance the enjoyment of one of the privileges incident to the corporate form would not be available to some of the stockholders.5

It seems obvious that, if the law under which the articles have been executed and filed is beyond the power of the legislature to enact, there can be no corporation. Whether the company can be allowed to exercise some or all of the usual corporate privileges may, however, depend upon the reason the court gives for holding the particular legislation to be beyond the power of the legislature to enact.6 Perhaps the legislature has failed to observe a specific constitutional prohibition aimed at the creating of this kind of corporation. Any attempted incorporation under such an act would be without effect. Perhaps the legislature has gone beyond some constitutional limitation more general in its scope. The court does not feel that this provision was directed primarily against the carrying on of this particular business by a corporate body. Perhaps the court will give some protection, in the way of recognizing, for example, their limited personal responsibility for existing claims against the firm, to those who have purported to create a corporation and to carry on business under the legislature's authorization.

The legislature may require that the company created under the general laws raise a certain share of its authorized capital7 or complete its

---

5 Here is a case where the court may well talk about estoppel. In the particular instance the individual defendant may be estopped to assert a privilege usually incident to membership in the corporate group. That is what the court evidently had in mind in Slocum v. Head, 105 Wis. 431, 81 N.W. 673, 50 L.R.A. 324 (1900). Cf. Marshall-Wells Co. v. Kramlich, 46 Ida. 355, 267 Pac. 611 (1928). This estoppel idea may work against the creditor. Where the obligation is incurred while the group is still unincorporated a particular creditor may be restricted to satisfaction for his claim out of firm assets because of some implied or express understanding between the parties when the claim arose. Tisch Auto Supply Co. v. Nelson, 222 Mich. 196, 192 N.W. 600 (1923). The procedural difficulties are eliminated when the group subsequently becomes incorporated. Judgment may then be entered against the corporation.

6 Cf. Clark v. American Cannel Coal Co., 165 Ind. 213, 73 N.E. 1083 (1905), and Building etc. Ass'n. v. Chamberlain, 4 S.D. 271, 56 N.W. 897 (1893).

formal organization under the articles and by-laws before it can begin to exercise corporate privileges. That does not mean that there is no corporation if the company fails to meet these statutory requirements.

Third party creditors may bring it into court. Conveyances executed in its name will be effective. Until it meets these additional requirements, however, the members cannot exercise all their corporate privileges.

After the articles are regularly executed and filed, after the prescribed capital is raised, and the company has begun to carry on business, the officers may fail to file the annual reports as required by statute. The secretary of state, or some other administrative official, strikes its name from the records. The company still carries on business. Is it a corporation? Are its stockholders personally responsible to company creditors? Can the company sue for relief in the courts? Are conveyances or formal instruments executed in its name, thereafter, effective as such? Certainly the company itself, even in the event of reinstatement on the public records, and probably third parties, cannot challenge the effectiveness of any conveyance executed while the company was in default. Will the company be recognized as party plaintiff as long as its name is stricken from the records? Probably not. The court may wish to force the company to comply with the statutory requirements. Will the stockholders who are actively promoting the business be held personally responsible for group obligations assumed during the period of the company's default? That is a question for each court to decide as a matter of policy when the occasion arises. The decision will depend upon the extent to which the court feels those en-

---

8 Cf. Butler Paper Co. v. Cleveland, 220 Ill. 128, 77 N.E. 99, 110 A.S.R. 230 (1906), where the scope of the Illinois statute is discussed. Without some statute to fall back upon the court will not require any formal set up of the corporate organization before the group will be allowed to exercise its corporate privileges. Industrial Bldg. & Loan Ass'n v. Williams, 131 Okla, 167, 268 Pac. 228 (1928).


12 Sec. 180.08, Wis. Stats.

13 West Park Realty Co. v. Porth, 192 Wis. 307, 212 N.W. 651 (1929).


15 See Werner v. Hearst, 177 N.Y. 63, 69 N.E. 221 (1903), where the plaintiff, whose claim was for tort, and against the corporation, was denied relief against a stockholder, although the company was in default under the statute when the plaintiff was injured. Cf. Bonfils v. Hayes, 70 Colo. 336, 201 Pac. 677 (1921), where the plaintiff, whose claim was also in tort, was allowed to reach the personal responsibility of the active stockholders. The corporation had failed to get a "renewal certificate" after its twenty years of authorized life had expired. That the group subsequently acted in time to get the renewal was not enough to protect the stockholders against this claim for a tort committed when the company was in default.
gaged in the enterprise should be penalized for their failure to see that the corporation had complied with the regulatory laws.

Perhaps the company is a one-man or a family corporation. Perhaps it was created to insure this one man a limited personal responsibility for undertakings he might wish to assume in this particular enterprise. The articles have been drawn up as prescribed and by the required number of incorporators. They have been filed and recorded. All the stock has been issued and all the subscriptions have been paid. The one man holds all the shares of stock but two. Relatives of the principal stockholder hold these two shares that they may qualify as nominal directors. There are no stockholders’ meetings. There are no directors’ meetings. Any records of such are made up as a matter of form. There is a corporation, but is there any corporate “user”? It is suggested here that there is. The courts have generally recognized that one or two men under the corporate form can get the benefit of a limited personal responsibility in carrying on a business enterprise. It is only where those one or two men fail to keep the assets of the enterprise separate and apart from their own personal assets that creditors of the firm can reach through the corporation to the individuals.

To summarize: The organizers want to create a corporation that they may enjoy certain privileges. They must purport to do what the legislature has prescribed as necessary in the creating of a corporation. Just how closely they must follow the statutes prescribing the form the articles should have, and what the incorporators should do to put them on record, is for the court in each jurisdiction to decide as each case arises. When the organizers have done enough to satisfy the court there is a corporation. Any set of articles containing the information required, executed even informally, when made a matter of public record in one of the places specified in the statute, will usually be enough to convince the court that the organizers have satisfied the statutory “creating” requirements. The exercise of the privileges usually recognized as incident to the corporate form may be denied to the members of a particular corporation until it has complied with other regulations of the legislature, as to the amount of capital to be raised, the completing of its formal organization, and perhaps, the making of annual reports. When all of the stock gets into the hands of one or two stockholders the corporation does not automatically disappear. The sole stockholder is not personally responsible for firm obligations.

VERNON X. MILLER*

*Professor of Law, Marquette University.

16 Midwest Air Filters Pacific, Inc. v. Finn, 201 Cal. 587, 258 Pac. 382 (1927); Sun River Stock & Land Co. v. Montana Trust & Savings Bank, 81 Mont. 222, 262 Pac. 1039 (1928); Elenkrieg v. Siebrecht, 238 N.Y. 254, 144 N.E. 519 (1924); Sayres v. Navillus Oil Co., 41 S.W. (2d) 505 (Tex. Civ. App., 1931). Where the corporation in question is organized by another corporation who becomes the sole interested stockholder in the first, see Cannon Manufacturing Co., v. Cudahy Packing Co., 267 U.S. 333, 45 Sup. Ct. 250, 69 L. Ed. 634 (1925). The case positively holds that such a corporation is entitled to recognition unless it can be shown that it was created by the stockholding corporation to let that corporation escape some regulatory requirement. See Notes, 17 Marquette Law Rev. 280 (1933).

17 Donovan v. Purtell, 216 Ill. 629, 75 N.E. 334 (1905). See Midwest Air Filters Pacific, Inc. v. Finn, supra, note 16.