THE INCIDENTS OF IRREGULAR INCORPORATION.

In a recent number of this Magazine[1] the writer called attention to certain fundamental questions in regard to the legal status of corporations upon which the authorities are divided. Among the problems at that time referred to as illustrations of the conflict of authority, were those which arise when a number of persons engage in business under corporate form but without complying with all the formalities prescribed by the law under which they are associated. Can a creditor who has dealt with these persons as a corporation take advantage of the defect in organization and treat the associates as partners? What shall be said of a case in which, for the sake of gaining a limited liability, a business man complies with the *letter* of a corporation law, but not with its *spirit*, by associating with himself the requisite number of "men of straw," thus obtaining a charter in pursuance of an attempt to put a corporate name between himself and his creditors? Can those who, with intent to form a corporation, engage in business before the corporate charter is obtained, subsequently escape personal liability for debts contracted before the grant of the charter, in virtue of their unexecuted intention to become a corporation? Again, can a corporation when sued upon one of its obligations set up the irregularity of its own organization as a defence to the suit? If, as a plaintiff, the corporation sues to enforce an obligation, is it liable to be met with a defence based upon the irregularity of its organization? Questions such as these are of such great practical importance that we cannot long rest satisfied with the doubtful answers given to them by the courts. The commercial world has a right to demand that our legal doctrines shall be more definite.

As a modest contribution to the cause of uniformity the following considerations are submitted to the profession. In submitting them, it is not improper to suggest that much of

[1] Vol. 2, N. S. (May, 1895), p. 296.

the confusion found in the reported decisions results from a failure to treat the problem in its entirety. There is a tendency to deal with the case which happens to be before the court as if it presented an isolated question, to be answered independently of other questions which are rarely akin to it. Again, it may be suggested that much of the criticism which has been indulged in at the expense of the courts has been an unintelligent and, in some instances, a perverse criticism. The House of Lords, in *Broderip* v. *Salomon*,[1] has recently decided, in the case of one who had abused the privilege of limited liability offered by the Companies Acts, while keeping within the letter of the statutes, that there are no means of legally ascertaining the motives and intentions of persons forming limited liability companies under those enactments. At the time of the rendering of a different decision in the court below, the New York *Times* called attention to the judgment as an instance of "actual and substantial justice enforced by British Courts without regard to any narrow technicalities that would seem to interfere with such justice." The writer of an interesting editorial in a recent issue of that journal expresses the opinion that this tribute of praise was "premature." He can "recall no single American case in which a deliberate scheme for seizing assets and avoiding payment has so completely succeeded in this country," and he observes that "if this abuse be not corrected 'limited liability' under English law must be changed to 'unlimited authority to cheat.'" While such a criticism has the value which belongs to protest and expostulation, it is not as helpful as it would be if it had undertaken to dispose of the reasons advanced by the House of Lords for the decision and to suggest a more satisfactory line along which future development might take place. Finally, it seems to the writer that something has been lost by the failure of the courts to face a problem which is believed to be by far the most important of those which obstruct the path of the student of corporation law. The problem concerns our common law tendency to undertake the

[1] The House of Lords, in so deciding, reversed the decision of the Court of Appeal as reported in L. R. Ch. [1895] 323. This case will be discussed n a sequel to the present article.

adjustment of the relations between corporations and the state in suits between the corporations and private citizens. If a corporation is sued upon its contract, instead of treating the case as if it arose between individuals, we complicate the question of rights under the contract by raising the inquiry as to the corporate power of the corporation to make such an agreement as that which the court is asked to enforce. Why? "Because public policy demands that corporate activity shall be confined within well-defined limits." If this is the dictum of public policy, why subject the unfortunate individual who has contracted with the corporation to the trouble and loss incident to a vindication in his suit of the rights of an outraged public? If the state really has a restriction which it is important to enforce, why not deal with the corporation directly in a proceeding instituted for the very purpose? The law of *ultra vires* would then become exclusively a branch of public law, and *ultra vires* cases would be, as they ought to be, cases in which the state is a party and the corporation a defendant. We are gradually coming to the conclusion that the business of supervising corporations and their operations is primarily a legislative and executive matter and not a judicial one. We are electing boards of railroad commissioners. We are creating insurance departments with insurance commissioners to preside over them. We have banking departments and examiners to exercise visitatorial functions. Why not carry out this excellent modern development to its legitimate conclusion and suffer the question of abuse of corporate power to be raised only in proceedings instituted by the state at the instance of the appropriate officer? Undoubtedly, the economic as well as the legal tendency is in this direction. The discussion of the limits of corporate power in suits to which individuals are parties has not been on the whole a creditable chapter in the development of our jurisprudence.

Not only in regard to the exercise of corporate power but also as respects questions of irregularity of organization, this great problem of the policy of the state is constantly presenting itself for solution. Why complicate the litigation to which John Doe is a party by discussing the difficult ques-

tion whether or not his adversary, the corporation, has satisfactorily discharged its duties to the state? If John Doe dealt with the corporation as such, let us decide the case upon the assumption that we have before us a corporation *de jure*. Let us not say with some courts that John Doe is "estopped to deny that his adversary is a corporation." In order that good may come, we must not do the very serious evil, which is involved in using the term "estoppel" with reference to a case from which certain necessary elements of an estoppel are absent. Let us rather be bold enough to recognize that commercial necessity has crystallized into a rule of law, and that when John Doe enters into a contract with those who are trading under corporate form, it will be taken to be a term of his contract that the associates shall be held to a limited liability only. If it is objected that in this way irregular bodies will be spawned upon the public and that individuals without a charter and freed from the burdens of corporate taxation will be enabled to claim the benefit of limited liability, the answer is obviously a simple one. Make the laws relating to the formation of corporations as strict as you please. Place as many safe-guards as you will around the exercise of corporate franchises. Punish the usurpation of corporate power without a charter as severely as the exigencies of the situation demand. Do not rest content with a judgment of ouster. If necessary, subject to fine and imprisonment those who attempt to rob the state of a portion of its prerogative. But do not work injustice to John Doe or to the associates with whom he has gone to law, by obscuring the issues raised between them through the introduction into the litigation of a consideration of the relation between the associates and the state.

In the following pages it is proposed briefly to summarize the answers given by the courts to the problems of irregular incorporation mentioned above. A subsequent paper will be devoted to an attempt to exhibit the operation of the suggested theory, which, in effect, banishes the learning of *de facto* corporations from the realm of private litigation.

I.

A SURVEY OF THE DECISIONS.

If we look into the books we find that problems of irregular organization have grouped themselves, roughly, into four classes: (1) Cases in which associates are resisting a claim preferred against them as partners; (2) Cases in which the alleged corporation, or one of its members, is seeking to escape liability by setting up a defect in organization; (3) Cases in which a defendant is seeking to escape liability to a corporation by setting up irregularites in its organization; (4) Cases in which the question is whether irregularities in the organization of joint-stock companies will subject the associates to general partnership liability.

1. *Cases in which associates are resisting a claim preferred against them as partners.*

The exemption from general partnership liability may be claimed either (a) in virtue of a limitation imposed by contract, or (b) in virtue of a charter obtained by the associates *after* their business dealings with the plaintiff had begun, or (c) in virtue of a charter obtained *before* the cause of action sued upon arose.

(a.) B., C. and D. are general partners. They contract a debt to A., A. agreeing to look only to the partnership property in satisfaction of his claim. In such a case the limitation will be held valid and A. will have no right of recourse to the separate property of the associates.[1]

(b.) Where the charter is obtained after the associates have begun business dealings with the plaintiff, it may be that the debt in suit was contracted pending an unexecuted intention to become incorporated or it may have been contracted after the granting of the charter. In the latter case the result may be affected by the regularity or irregularity of organization under the charter.

B., C. and D. associate themselves together with the intention of obtaining a charter. They begin business and contract a debt to A. Afterwards the charter is obtained, but A. sues

[1] Brown *v.* Slate Co., 134 Mass. 590, 1883. See also Lindley on Companies, 246, and cases there cited.

one or more of the associates to enforce a general partnership liability. Judgment for A.[1]

B., C. and D. engage in business as general partners. A. deals with them as such, giving them credit and receiving payment from time to time. The associates procure a charter of incorporation and regularly organize thereunder. Afterwards a debt is contracted to A., who sues B., C. and D. as partners. According to a dictum in *Martin* v. *Fewell*, *supra*, A. cannot recover if he had actual notice of the incorporation. Otherwise he can. *Quære*, upon the theory of notice, whether compliance with the requirements of a general corporation law is not constructive notice, in all jurisdictions in which advertisement and recording are essential?

B., C. and D. engage in business as general partners. A. deals with them as such, giving them credit and receiving payment from time to time. The associates procure a charter of incorporation and irregularly organize thereunder. Afterwards a debt is contracted to A. who sues B., C. and D. as partners. If, in spite of the irregularities, there is a law under which incorporation might be effected, a *bona fide* attempt to organize under that law and a user of its privileges, the organization will be treated as a *de facto* corporation and A. cannot recover.[2]

(c.) Where the debt in suit was contracted after the obtaining of a charter and the plaintiff subsequently discovers irregularities in the organization, the question arises whether he can treat the charter as a nullity and hold the defendants liable as general partners. In such cases it may be that the charter was granted by special act or that organization was sought to be effected under a general law. In either case it may be that no law is proved to exist under which organization could be effected, or that the law is unconstitutional, or that the organization under the law has been defective and has not been followed by user, or that the organization, though defective, has been followed by user.

[1] Martin *v.* Fewell, 79 Mo. 401, 1883; Eliot *v.* Himrod, 108 Pa. 569, 1885 (*dictum*).

[2] Eliot *v.* Himrod, *supra* (*dictum*). The theory of *de facto* corporations will be discussed presently.

B., C. and D. obtain a special act of incorporation. There is a defect in the act or in the organization under it, or both. A. deals with the association after organization. He subsequently discovers the irregularity and sues B., C. and D. as partners. He cannot recover. The reason for the decision is thus stated by Parsons:[1] "A *de facto* is an illegal corporation, because the incorporation was not effected according to law. The color of authority for the existence of such a corporation is derived from tradition. When the franchise was a direct grant made by the Executive or Legislative department, the charter was deemed the act of a co-ordinate branch of the Government and, in deference to the Political Power, was treated as a judgment which could not be impeached collaterally."

B., C. and D., attempt to organize under a general law, but fail to comply with certain formalities. They do business as a corporation and contract a debt to A., who seeks to enforce partnership liability against them. A. is entitled to recover.[2] This decision is thus explained by Parsons[3]:— "The prohibition by Constitution of special grants and the statutory regulation of incorporation has made it subject to judicial cognizance and has changed the character of incorporation from a Public to a private transaction. The incorporation has become and is now the act of the incorporators. In cases of incorporation under general statutes the Executive department of the Government is powerless to prevent the incorporation. Its action is purely ministerial . . . The corporator, like the special partner, claims exemption from the full measure of the liability which, by the common law, attaches to his acts . . . In each case immunity must be proved, for it is a universal principle that he who claims a special privilege must make out the exception upon which he relies. The burden of proof rests upon him and is the condition of his right. If the law has prescribed the requisites, nothing short of compliance with the requisites of the law will be sufficient to establish the exceptional privileges."

[1] Partnership (James Parsons) p. 24.
[2] Paterson *v.* Arnold, 45 Pa. 410, 1863.
[3] P. 24.

B., C. and D. attempt to organize as before. The organization under the general law is defective and A., a subsequent creditor, sues the associates as partners. A. cannot recover.[1] The reason given for the decision is the practical inconvenience of subjecting stockholders to the risk of partnership liability. If it is objected[2] that hardship proves too much, since at the common law a partner was charged even if he took no part in the business, the answer is that the rule of partnership is not adapted to the modern form of commercial and industrial activity of which the corporation is a type.

B., C. and D. go through the forms of corporate organization and do business as a corporation. At the end of twenty-one years, A., a creditor, sues the associates as partners and calls upon them to prove their charter as a condition of immunity from personal liability. The lapse of time relieves the associates from the obligation of proving their charter.[3]

B., C. and D. do business in corporate form and hold themselves out as a corporation. A. deals with the organization, which becomes indebted to him and he brings suit against B., C. and D. as partners. A. fails to prove that the defendants are a partnership by contract or by holding out. It is conceded, however, that they have traded together as co-proprietors of the property and business. They point to no general law under which they could be incorporated and prove no special act erecting them into a corporation. Upon this state of the evidence, judgment is entered for the defendants.[4] *Quære*, in view of this decision, as to what becomes of the common law theory that the burden rests upon joint traders to prove the existence of the privilege in virtue of which they claim immunity from personal liability?[5]

[1] Cochran *v.* Arnold, 58 Pa. 399, 1868, (overruling Paterson *v.* Arnold, *supra.*)

[2] Parsons, P. 24.

[3] White *v.* State, 69 Ind. 273, 1879 (*semble*). This was a criminal proceeding for a trespass committed upon land held in the corporate name. The defence was that the so-called corporation had no valid charter. The court was of opinion that after the lapse of twenty-five years the question of corporate existence could not be raised except by the State.

[4] Hallstead's Appeal, 157 Pa. 59, 1893.

[5] See Luckombe *v.* Ashton, 2 Fos. & Fin. 705; Greenwood's Case, 3 De G. M. & G. 459.

B., C. and D. organize a corporation under a law which A., a subsequent creditor, seeks to have declared unconstitutional. The statute is pronounced unconstitutional, and A. is permitted to hold the associates liable as general partners.[1]

B., C. and D. irregularly organize under a valid law. A. deals with them as a corporation, but subsequently sues them as individuals. Provided that there has been user and that the irregularity did not occur with reference to an essential prescription of the statute, A. is held not to be entitled to recover. What statutory prescriptions are and what are not essential is often a difficult and disputable question of fact. What constitutes user in a particular case is also a question likely to give trouble.[2]

Provided the irregularity is not "so great as to be fatal" and provided there has been user, the denial of A.'s right to recover from the associates as partners is based upon different grounds in different jurisdictions. In Pennsylvania and in many other States, the basis of the decision was, at first, the hardship which would result from any other rule.[3] In a Massachusetts case, decided in 1851, the doctrine that the associates are liable as partners was said to be "quite novel and somewhat startling."[4] Morawetz argues that if corporators are charged as partners in a *de facto* corporation, the members of a *de jure* corporation must also be charged as partners as respects its *ultra vires* acts. Parsons answers that those agents of a corporation who unite in making or authorizing an *ultra vires* contract are personally liable, but that the other members of the corporation are not liable, because, on principles of agency, no corporate obligation is created. When a tort is not incident to the business defined by the charter, it stands upon the footing

[1] Harriman *v.* Southam, 16 Ind. 190, 1861 (*semble*); Heaston *v.* Railroad Co., 16 Ind. 275, 1861 (*semble*). The theory of such cases is that where power is conferred by statute the plaintiff is estopped by his contract from raising the question of the regularity of its exercise. *Aliter* where the statute, being invalid, confers no power.

[2] See, for example, Methodist Church *v.* Pickett, 19 New York, 482, 1859; Railroad Company *v.* Cary, 26 New York, 75, 1862—especially the dissenting opinion of Allen, J.; and Kaiser *v.* Bank, 56 Iowa, 104, 1881.

[3] Cochran *v.* Arnold, *supra*.

[4] Bigelow, J., in Fay *v.* Noble, 7 Cushing, 188.

of an *ultra vires* contract. If it is incident to the business, the corporation is charged, but the tort feasor is subject to an ultimate liability to reimburse the corporation. "The abuse by the agent of his authority charges the principal because the authority exists. The act of a person who has no authority charges him because he is a principal." In New Jersey and elsewhere A. is said to be *estopped* to deny that B., C. and D. are a corporation. "The company was a corporation *de facto* and the plaintiffs who contracted with it cannot be permitted to deny the legality of its existence. The State alone can call that in question."[1] This seems to be a sound conclusion, but it is difficult to find in the case the elements of an estoppel. Since in such a case, it is the associates who are alleging the estoppel (if any exists), it is sometimes argued that knowledge of the existence of the charter on the part of the plaintiff is essential to the validity of the defence. In the absence of proof of any such knowledge the Supreme Court of Pennsylvania have said of a plaintiff that he was amply justified in dealing with the associates as partners, and he was, therefore, entitled to hold them liable as such. This was said in a case in which an essential prescription of the corporation act (recording of the charter) had been disregarded; but the court remarked "it may be conceded that had plaintiff dealt with defendants as a corporation, he would have been estopped from claiming against them in any other capacity, even though they failed to record their charter."[2]

When we glance back over the cases which range themselves in the first of the classes under discussion, we perceive that associates who are sued as partners may assert an immunity from individual liability if they can point to an express contract by which the plaintiff has agreed to confine his right of recourse to the common property or fund. We further perceive that the associates (in the absence of any express contract) can successfully assert this immunity wherever it appears that the associates held themselves out as a corporation and

[1] Stout *v.* Zulick, 48 N. J. Law, 599, 1886.
[2] Guckert *v.* Hacke, 159 Pa. 303, 1893.

dealt with the plaintiff on that basis. This last proposition, however, must be qualified by the statement that in most jurisdictions the burden rests upon the associates to show the existence of a valid law under which they might be incorporated and a *bona fide* assumption and exercise of corporate privileges, as if in virtue of such incorporation. The difficulty and confusion which exist in the cases arise chiefly from the impossibility of making satisfactory generalizations in regard to what constitutes a colorable compliance with statutory requirements and what amounts to a user of corporate privileges. If it were not for these troublesome modifications it might be said that, as between the parties to an ordinary commercial transaction, the law will recognize the possibility of "incorporation by conduct"—working out the rights and liabilities of all private parties in interest as if no vexed question remained to be settled between the associates and the state. The most weighty reason assigned for insisting upon the preservation of the "troublesome modifications" above referred to, is the reason that in this way alone can safeguards and restrictions be placed upon the exercise of the valuable franchises and privileges which are in the gift of the state. The validity of this reason must be considered hereafter.

2. *Cases in which the alleged corporation or one of its members is seeking to escape liability by setting up a defect in organization.*

Cases belonging to this class may be grouped under two subdivisions; (a) cases in which the corporation is named as defendant in the suit, and (b) those in which an individual is named as defendant, his liability to the plaintiff depending upon his membership in the corporation in question.

(a) A. brought suit against B., an alleged corporation, upon certain promissory notes purporting to be the notes of B. B.'s defence was that there was a material and deliberate misstatement of fact in the recorded certificate of organization required by the general law, that the legal prescription in respect to publication had not been complied with, and that, in taking its name, B. had violated another provision of the act by adopting a name identical with that of a then

existing corporation. Judgment for A. Of the first defence the court said that B. was estopped by the record; of the second, it was observed that "however this omission might have affected the corporation had they been plaintiffs, . . . we think the corporation cannot set it up as a defect in their organization to defeat a recovery against them;" and of the third, it was remarked that, as regards the creditors of the company, an omission to comply with the terms of the statute would furnish no defence. "Objections like these are certainly not to be favored when made by a company holding themselves out as a corporation and contracting liabilities as such."[1]

(b) A. brought an action of contract against the X. Co. The defendant was defaulted, and B. and others were summoned as stockholders in pursuance of certain provisions of the law imposing upon the stockholders of manufacturing corporations a liability for the corporate debts. It was contended on behalf of B. that the X. Co. had no legal existence inasmuch as no articles of agreement as required by the statute had ever been entered into. Judgment for B. "It is not a case of defective organization under a charter or act of incorporation nor of erroneous proceedings after the necessary steps were taken in the assumption of corporate powers, but there is an absolute want of proof that any corporation was ever called into being which had the power of contracting debts or of rendering persons liable therefor as stockholders."[2]

The X. Co., alleged to have been incorporated under an act for the incorporation of ocean steamship companies, gave promissory notes to A. Subsequently, B. became a stockholder in the company. Thereafter A. recovered judgment upon the notes in a suit against X., but failed to obtain satisfaction out of the corporate treasury. He then sought to enforce a statutory liability against B. to an amount equal to the stock held by him. B.'s defence was that 10 per cent. of the capital stock was not paid in, although the act required such payment. The X. Co. had elected officers, opened an

[1] Dooley v. Cheshire Glass Co., 15 Gray, 494, 1860.
[2] Utley *v.* Union Tool Co., 11 Gray, 139, 1858.

office and had gone into actual operation as a corporation. Judgment for A. The Court reasoned that if A. had broken his contract and had been sued by the corporation, a defence based upon the non-existence of the corporation would have been sufficiently answered by a production of the certificate which had been filed and proof of user (if not of user alone). "When its corporate existence had been thus established, the plaintiffs would not have been permitted to prove, as a defence for them, the facts relied upon by the defendant for the familiar reason that the right of a corporation to sue cannot be inquired into collaterally." [1]

The net result of the cases belonging to this class seems to be that under no circumstances can the corporation set up its own irregularities by way of defence and that in no case can an individual member of a corporation deny the corporate existence where, if he were sued as a general partner, he would be entitled to assert an immunity from individual liability. The former result is simple and satisfactory. A similar remark would be applicable to the latter result if the general conditions of immunity from unlimited liability were simplified in accordance with the suggestions put forth above.

3. Cases in which a defendant is seeking to escape liability to a corporation plaintiff by setting up irregularities in its organization.

Cases falling within this class may be separated into two subordinate classes; (a.) cases in which the corporation is suing a stranger to its organization, and (b.) those in which the corporation is suing one of its own members upon a contract of membership or of subscription.

(a.) B. contracted to make and deliver certain coaches to A., an alleged corporation. B. broke his contract and A. brought suit. B.'s defence was that there had been a failure to pay into the corporate treasury 10 per cent. of the capital stock as prescribed by the act. A. produced a regular certificate of incorporation and introduced evidence of user. Judgment for A.[2]

[1] Eaton *v.* Aspinwall, 19 New York, 119, 1859.

[2] Eaton *v.* Aspinwall, 19 New York, 119, 1859 (*dictum*).

A. did business under corporate form, and purported to have complied with the requirements of the general law. B. gave A. a promissory note, and after B.'s death A. sued B.'s executor upon the note. Judgment for A. "The plaintiff being a corporation *de facto*, and the defendant having contracted with it as such, the legality of its organization cannot be impeached by him when sued upon his contract."[1]

(b.) A., a religious corporation, sued B. to recover a subscription towards rebuilding the plaintiff's church. There was a general law authorizing the incorporation of churches at the date of A.'s organization. At the trial A. gave in evidence a certificate which was claimed by the defendant to be defective, in that it did not show compliance with the terms of the act. A. also introduced evidence for the purpose of establishing user. Judgment for A. "It has been repeatedly held that as against all persons who have entered into contracts with bodies assuming to act in a corporate capacity, it is sufficient for such bodies to show themselves to be corporations *de facto*. This cannot be done by simply showing that they have acted as corporations for any period of time, however long. Two things are necessary to be shown in order to establish the existence of a corporation *de facto*, viz: 1. The existence of a charter or some law under which the corporation with the powers assumed might lawfully be created; and, 2. A user by the party to the suit of the rights claimed to be conferred by such charter or law." A majority of the court were of opinion that defects in the certificate were "only available in behalf of the sovereign power of the State," and that the evidence introduced was sufficient to establish the fact of user. Two of the court, without committing themselves upon either of these points, were of opinion that the certificate was in fact sufficient.[2]

A. purported to be a corporation organized under a general law. B. became a subscriber to its capital stock and paid an instalment thereon. B. died and his administrator failed to

[1] Bank *v.* McDonald, 130 Mass. 264, 1881. See also Appleton Insurance Co. *v.* Jesser, 5 Allen, 446, 1862; Commissioner of Douglas *v.* Bolles, 94 U. S. 104, 1876.

[2] Methodist Church *v.* Pickett, 19 New York, 482, 1859.

pay subsequent calls. A. sued the administrator, who defended on the ground that A.'s organization was defective in that the affidavit annexed to the articles of association did not contain a certain allegation required by the statute. Judgment for A. A majority of the court concurred in an opinion which contained this language: "I am of opinion that under this and similar general acts for the formation of corporations, if the papers filed, by which the corporation is sought to be created are colorable, but so defective that in a proceeding upon the part of the State against it, it would for that reason be dissolved, yet by acts of user under such an organization it becomes a corporation *de facto*, and no advantage can be taken of such defect in its constitution collaterally by any person." Two judges dissented; one expressed no opinion.[1]

B. signed an agreement of subscription to the stock of A. The court construed the agreement as a contract to pay the amount of the subscription to a corporation to be thereafter organized and brought into existence. A. sued B. upon the agreement. It appeared that the certificate of incorporation had never been filed in the office of the Secretary of State as required by statute. Judgment for B. "The contract was in legal effect that the defendant would take and pay for the stock subscribed for in case the organization should be perfected and the corporation brought into legal existence and not otherwise." "The filing of the certificate in the office of the Secretary of State is an indispensable pre-requisite to the legal existence of the corporation."[2]

A survey of the cases belonging to this class seems to indicate that in almost every instance the corporation will be permitted to recover if it has a *de facto* existence. Here, again, we are met with the difficulty of determining in a given case what amounts to colorable compliance with the provisions of a statute and what amounts to user. The exceptional case, represented in the above outline by *Indianapolis Furnace Co.* v. *Herkimer*, is the case in which the formation of a corporation is a condition of the defendant's liability. In such a case

[1] Buffalo R. R. Co. *v.* Carey, 26 New York, 75, 1862.

[2] Indianapolis Furnace Co. *v.* Herkimer, 46 Indiana, 142, 1874.

there must be a regular and valid organization or the defendant will never be liable. The reason given is that under such circumstances "the rule of estoppel does not apply," as it would in case of a contract with an existing corporation. It has been seen that, even in the case of an existing corporation, the elements of estoppel are lacking in such a transaction, and, therefore, the reason assigned in cases of the kind under consideration is peculiarly unsatisfactory.

4. *Cases in which the question is whether irregularities in the organization of joint stock companies will subject the associates to general partnership liability.*

In view of the fact that statutes have been passed in a multitude of jurisdictions authorizing the formation of joint stock companies with limited liability, the question was certain to arise as to whether a stockholder in case of irregular organization could set up the defence that the company had acquired a *de facto* existence. On looking into the books, we find that this question was definitely raised in at least one case and that the court answered it in the negative. The writer has not found any extended discussion of the principles which should underlie such a decision. It might be argued that, in the case of the corporation, the test of its existence is the creation of a legal entity by the state, whereas in the case of a joint-stock company, there is no entity separate and apart from the members that compose the association. On the basis of this distinction, it might be contended that where, in consequence of the acts of the corporators, a plaintiff has shown his willingness to make a contract with the entity, he can never recover on that contract against any one but the entity—which, for the purposes of private litigation, will be taken to exist, although its existence might be disputed by the state. On the other hand, in the case of the joint-stock company, it might be said the plaintiff has made no contract with an entity, but has contracted directly with the individuals who compose the company, although, for convenience, they have acted with a common name. In this view, the plaintiff would be entitled to enforce against them whatever liability attaches by law to contracts made by them—and this liability is unlimited liabil-

ity, unless the members have satisfied the conditions upon which immunity is offered by the State. It would follow that there is no room for the conception of *de facto* existence in the case of a joint-stock company, because, even when the "company" exists *de jure*, it has no existence apart from the members which compose it. This argument is somewhat weakened by the consideration that, in equity, the civil law theory is universally followed to the extent that, in the case of the ordinary partnership, the "firm" is treated as an entity distinct from its members.[1] This conception of the firm is gaining ground even in the courts of common law,[2] and in proportion to the definiteness with which it is accepted, the difficulty of making a theoretical distinction between the corporation and the joint-stock company steadily increases. The explanation above suggested, however, is probably a correct explanation from the historical point of view. Whether any useful purpose is subserved by maintaining a distinction between joint-stock companies and corporations is a question which seems to be least open to discussion. If, in the onward sweep of legal development, the distinction is obliterated, it seems to be quite certain that the results of irregular organization in the case of joint-stock companies will be assimilated to the results reached in the case of corporations, and not *vice versa*.

The case referred to as deciding that there can be no such thing as a *de facto* joint stock company is *Eliot* v. *Himrod*.[3] In this case A. brought suit on two notes given by B. and C. for money borrowed. To defeat recovery, B. and C. alleged that prior to the giving of the notes they had formed a partnership association or joint-stock company under the Pennsylvania Act of Legislature of June 2, 1874. It appeared that there had been a failure on the part of B. and C. to comply with the requirements of the statute in certain essential particulars. They had, however, conducted the business for a considerable period of time and they contended that the

[1] Jessel, M. R., in Pooley *v.* Driver, 5 Ch. D. 458, 476, 1877.

[2] Brewer, J., in Cross *v.* Burlington National Bank, 17 Kan. 336, 340, 1876; Barret, J., in Walker *v.* Wait, 50 Vt. 668, 1878; Cooley, J., in Robertson *v.* Corsett, 39 Mich. 777, 784, 1878.

[3] 108 Pa. 569, 1885.

existence of the partnership association could not therefore be inquired into collaterally. "The formation of a limited partnership," said the court, "is materially different from the creation of a corporation. Such association is treated in the statute as a partnership, which, upon the performance of certain acts, shall possess specified rights and immunities. In contemplation that the association may consist of many members, for convenience it is clothed with many of the features and powers of a corporation, such as the right to sue and be sued, grant and receive, in the association name. But no man can purchase the interest of a member and participate in the subsequent business, unless by a vote of the majority of the members in number and value of their interests. No charter is granted to the persons who record their statement. When they are sued for debt and claim immunity founded on such statement, it is competent for the plaintiff either to point to a fatal defect on its face, or to prove that an essential requisite, though formally stated, is falsely stated."[1] It will be perceived that the court here points to the *delectus personarum* as distinguishing the joint-stock company from the corporation. There have been, however, corporations the shares of which were not generally transferrable and joint-stock companies where the *delectus personarum* did not exist.

We have now completed our survey of typical decisions upon the subject of irregular organization. We find them complicated not only by the existence of the distinction, just discussed, between corporations and joint-stock companies, but by the presence of the vexed question as to what constitutes colorable compliance with statutory requirements and what constitutes user of corporate privileges. We notice a

[1] The scope of this article does not include a discussion of the interpretation placed by the courts upon the statutes which exist in several States authorizing the creation of limited or special partnerships in which one or more of the members is liable only to the extent of his contribution. Such a statute is the Pennsylvania Act of March 21, 1836. The necessity of strict compliance with the terms of this statute has been emphasized in a series of cases in the Supreme Court of Pennsylvania, culminating in the somewhat startling decisions in Fourth Street National Bank *v.* Whitaker, 170 Pa. 297, 1895, and Blumenthal Bros. & Co. *v.* Whitaker, 170 Pa. 309, 1895.

marked tendency, in the case of alleged corporations, to confine the plaintiff in his recovery to the corporate fund and, where the corporation is suing, to preclude the defendant from taking refuge behind an irregularity in the plaintiff's organization. Have the limits of the tendency been reached? Can the courts safely go farther than they have gone in this direction? Is there a tenable theory upon which the difficulties which we now experience may be eliminated from private litigation? It is proposed to attempt to answer these questions in a subsequent article.

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