

IRREGULAR ASSOCIATIONS.

PART II.

It was suggested in the first part of this article that, in strictness, incorporation has to do with *modes of action* and not with *consequences of action*. The corporation problem as presented at common law concerns the right of associates to act in the common name and to sue in it, their amenability to suits instituted against them in that name and their right to receive and make in that name conveyances of property real and personal. The idea that incorporation has of itself an effect upon *liability* for acts done is of late development. Our corporation law would probably be sounder and would certainly be simpler if such an idea had found no place in it.

Suppose that A, B, and C, an unincorporated group, make a contract in their common name with E, F, and G, a similar group. E, F, and G break the contract and A, B, and C bring suit in their common name against E, F, and G in their common name. Two questions of course arise: first, whether a contract thus made is enforceable; and, second, whether the suit may be maintained otherwise than in the name of the individual plaintiffs against the individual defendants. We are accustomed to make two mistakes in attempting a solution of such problems as these. First, we say that both questions must be answered in the negative unless both groups are "incorporated." Second, we assume that if these questions could be answered in the affirmative it would necessarily follow that the associates must possess additional rights and privileges to those directly involved, on the theory that there are certain "corporate rights" which are always found together. Now a careful reading of the books shows that both these views are mistaken. The right to contract in a common name and to sue in it was a right which existed at common law in the case of many groups not incorporated.¹ Moreover, it sometimes happened that unin-

¹ See the case cited in the introduction to Kyd on Corporations of "the *Abbot of Burgh's men*" v. "*Prince Edward's men*," in 44 Hen.

corporated associates were recognized as having one privilege which we call corporate without possessing others.²

If, therefore, when a problem arises respecting the right to act in a common name we consider merely the reasonableness of recognizing the right so to act under the circumstances of the particular case, we shall have both principle and authority on our side. We may, in a given case, conclude that the existence of the right should be recognized even if the associates are not incorporated. Obviously, therefore, the right may sometimes be conceded to exist even if they are irregularly incorporated. If we successively enumerate the familiar privileges of collective action the question may arise as to when the point is reached, at which we can say that the associates are knit together like members of a single body,—*i.e.*, are *incorporated*. The answer is that they become incorporated when, and only when, the possibility of individual action has been eliminated and action to bind the group can be taken only by official representatives acting in the common name.³ The corporation, in other words, is any group organized strictly on representative principles. Whether such organization will be sanctioned without state license is really an economic and not a legal question.

With this further statement of the point of view from which these articles are written, we resume the orderly consideration of the points at issue.

II. THE RIGHT TO ACT IN THE COMMON NAME.—Problems under this head may arise in various ways. A plaintiff may seek to question the right of associates regularly incor-

III (1259). Kyd says of this case (p. 12) that it is a proof "that the capacity of contracting in a collective capacity was not, in ancient times, confined to a corporation." Kyd wrote in 1794.

²"If the king grant to the men of Islington that they shall be discharged of toll, this incorporates them to the purpose of being quit of toll, though it does not enable them to purchase land, etc.," 21 Ed. IV, 59 (1482), cited by Kyd, p. 9, who in the course of his interesting "Introduction" mentions several other instances of the same conception.

³This, it is submitted, is the essential legal conception of a corporation. What kind of group is meant when the term "corporation" occurs in a given statute is of course merely a problem of interpretation. No two legislatures may have the same conception.

porated to do an act alleged to be beyond the scope of the charter; and such plaintiff may be either a stranger or himself a member of the group. If a stranger, he has no greater rights than any other citizen and must proceed by application to the attorney-general. If he is a stockholder, he has certain additional rights which it is not within the scope of this paper to discuss.

On the other hand a plaintiff may challenge the right of the associates to do any corporate act whatever on the ground that their organization is irregular. This is the problem which in this place it is proposed to consider. Here again the plaintiff may be either a stranger or himself an associate.

In cases of this class the right to take advantage of irregularities is uniformly denied. Obviously the estoppel and contract theories are not available as grounds of decision. Hence it has been usual to invoke the collateral attack doctrine or to dispose of the plaintiff's contention by the mere statement that the associates are a corporation *de facto*. To rest the decision upon the latter statement is, as has been pointed out already, to give a name to a conclusion, but not to make an explanation of it. If it is conceded to be unwise to inquire in private litigation into the right of the associates to act in corporate form, the ultimate reason for the rule must be found in the recognition of incorporation attained by private act and without state aid. To say that associates have actually attained incorporation when they have organized an unlicensed corporation is not only intelligible, but it is the only really satisfactory explanation of the result. If it be suggested that the result is satisfactorily explained by the usual reference to the collateral attack rule, the answer is that to invoke that rule is (as in the case of the appeal to the corporation *de facto*) merely to shut off inquiry by repeating a name. To say that the right of associates to act in a certain way cannot be inquired into except at the instance of the state is merely to assert a conclusion. If the reason is asked for refusing to make the inquiry, the answer must proceed on one of the two following lines: (1) The associates *have the right*; they are either entitled to continue to

exercise it or they are not; if they are, the case is disposed of; if they are not, the only effective way to control their conduct is to institute a proceeding to deprive them of their right because of its irregular acquisition; hence the refusal to make the inquiry in a litigation in which the issue is too narrow, in that only the relations of the plaintiff and the associates can be adjusted and not those between the associates and the public. (2) Or the associates have *not* the right which they claim; but the usurpation of it does not affect the plaintiff more than it does any other citizen of the community; hence the refusal to make the inquiry in a litigation in which there is no good reason for allowing the plaintiff to volunteer as a representative of the public. It will be noted, however, that this latter answer fails to take account of the case in which the plaintiff is peculiarly affected by the usurpation complained of, a case, for example, analogous to the cases in which a single citizen is permitted to sue for the abatement of a public nuisance.

It is conceived that no reason can be given for refusing to inquire into the regularity of the organization excepting one or the other of the reasons above suggested. Turning now to the cases in which the right of associates to act in a certain way has been questioned, we find that in many of the cases plaintiffs have been met by one or the other of the two answers just given, while in the other cases the courts have shown a willingness to inquire into the authority of the associates to act in the manner in question. An attentive consideration of the difference between the cases in which the inquiry will and those in which it will not be made will show the difference between the two to be this—that where the right asserted by the associates is one which is not an incident of incorporation the associates must show a clear title to it by compliance with the conditions of the grant; whereas if the right in question is an ordinary incident of incorporation, irregularity in corporate organization is not material. The distinction, then, is between rights which are and rights which are not incident to corporate organization. As already pointed out, incorporation (properly speaking) concerns only the *modes* of representative

action—suing and being sued in a common name, contracting, conveying property and receiving conveyances of property in that name, making by-laws, using a common seal, etc. It is clear, therefore, that irregularity of organization affords to a private plaintiff no ground upon which to enjoin the associates from taking corporate action merely because of their alleged lack of right to act in corporate form. This it will be perceived is a result entirely consistent with the idea that incorporation may be attained by private act and without state aid. A plaintiff who undertakes to make an objection based upon the form in which the associates act should accordingly be met by the first of the two answers outlined above: he should be told that the associates have in virtue of their organization attained the right to act in the mode in question, and that the only way in which they can be deprived of such right is by a proceeding instituted for that purpose by the state.

Far different is the situation which presents itself when associates irregularly organized claim under a charter or general law a right which is not ordinarily an incident of incorporation. Reasons have been given above for the view that the limitation of liability is a right or privilege which ought not to be regarded as incident to incorporation, but it is conceded that the law is the other way. There are, however, a number of rights which confessedly do not belong to associates merely because they incorporate. The right of eminent domain is the most important of them. Suppose that the associates are irregularly organized and that they undertake to condemn private property for their corporate use, a stranger who asks a court of equity to enjoin the associates will indeed be met by the second of the two answers given above; that is to say, he will be told that he is not entitled to equitable relief, for he is not affected by the usurpation more than every other member of the public and there is no reason for allowing him to volunteer as a representative of the community. A property owner, however, whose property the associates propose to take should unquestionably be allowed to enjoin their action on the ground

that they have not satisfied the conditions upon which the state has granted them the right.⁴

The conclusion just reached respecting the difference between cases in which regularity of organization will and those in which it will not be inquired into is most significant, because the conclusion is consistent with the theory that mere incorporation (that is, a right to act in corporate form) may be attained without state aid, but that the exercise of certain other and greater rights is not within the reach of associates except upon compliance by them with statutory conditions.

If now it be supposed that a number of associates irregularly organize themselves in corporate form under a statute which purports to confer not only the right to corporate organization but also the right of eminent domain, it will follow that non-compliance with the statutory conditions will not prevent the associates from attaining incorporation *de facto* (for this they can gain by private act), but will prevent them from exercising the right of eminent domain as against a plaintiff who would be specially affected by their act. It will accordingly be seen that in such a case it is strictly proper to say that the associates have obtained absolutely no rights whatever under the statute and that their incorporation has resulted from private act. From this analysis an important practical conclusion results. It is this: that, inasmuch as the associates have not satisfied the terms of the statutory grant they can be enjoined from acting under it, *but that inasmuch as they have in fact become incorporated the plaintiff can establish his right and their liability only by proceeding against them in corporate form.* In other words, the plaintiff cannot ignore the fact of incorporation and sue the associates in their individual names. This discrimination is conceived to be the true basis of the decision in the well-known case of *Attorney-General v. Stevens et al.*⁵ In that case the attorney-general at the request of a property-owner filed an information in equity against a number

⁴ *Railroad Co. v. Sullivan*, 5 Ohio St. 276 (1855); *Atkinson v. Railroad Co.*, 15 Ohio St. 21 (1864).

⁵ *Saxton* (N. J.), 369 (1831).

of individuals to restrain them from erecting a bridge over a navigable stream. Among the grounds on which the relator's contention was based were the following: that the defendants, though purporting to be a corporation, had organized irregularly under their charter and that certain prescriptions of the charter respecting the filing of a survey and location of the defendants' railroad had not been complied with. The chancellor refused the injunction. In so far as the basis of the complaint against the associates was that they were irregularly organized he gave substantially the answer suggested above as the first of the two reasons why an inquiry into the irregularities should be refused: "The corporation," he said, "is now organized, and if acting without authority, is liable to be brought at any time before a competent tribunal in a mode the legality of which cannot, as I apprehend, be questioned." While conceding that the unauthorized erection of a bridge across a navigable stream was a public nuisance which should be enjoined at the information of the attorney-general, he pointed out that in order to grant an injunction against the defendants as individuals it would be necessary for him to ignore the fact that they were *de facto* incorporated. He used this language: "The information in this case seeks to avoid that principle. It does not bring the company into court and proceed against them as duly incorporated, but it proceeds against certain individuals, and sets up that the Camden and Amboy Railroad and Transportation Company, under which those individuals claim to act, has not and never had legal existence, that the stock was never subscribed for according to law, and that all subsequent proceedings are void." Here is a clear recognition of the correctness of the view stated above to the effect that where associates have in fact attained incorporation a plaintiff can challenge their exercise of a right which they have failed to obtain only by proceeding against them in corporate form and not by undertaking to ignore their incorporation and to proceed against them as individuals. The situation is the same as if a corporation were regularly organized and a question were raised respecting the possession by the associates of

the right of eminent domain. In such a case it has been held that an action of ejectment will lie in favor of one whose land the associates have occupied without chartered warrant.⁶ The decision in *Attorney-General v. Stevens* is therefore a precedent for a refusal to ignore *de facto* corporate existence, but it is not an authority for the proposition that the courts will not inquire into the existence or non-existence of the right of eminent domain.⁷

The importance of the distinction between questions relating to formal action in the common name and those concerning the existence or non-existence of substantial rights is a distinction of the utmost importance. Had it always been recognized, much of the confusion in the cases would have been avoided. Let it be supposed that associates who have organized either regularly or irregularly claim the right to do an act not ordinarily incident to incorporation—as, for example, the right to occupy a public highway with tracks. An abutting owner ought not to be permitted to question the right to act in the common name or to raise any other question which concerns merely the *mode* in which action is to be taken. Neither ought he to be permitted to show that the associates who have received a grant from the state have rendered themselves liable to have a forfeiture declared. The state is not a party to the proceeding and it will be futile to try a forfeiture issue in a case in which no decree of forfeiture can be pronounced. On the other hand, the abutting owner ought to be permitted to

⁶ *Phillips v. Dunkirk, etc., R. R. Co.*, 78 Pa. 177 (1875).

⁷ *Attorney-General v. Stevens* was followed with approval in *National Docks R. R. Co. v. Central R. R. Co.*, 32 N. J. Eq. 755 (1880). In this case the plaintiff sought to restrain the defendant from exercising the right of eminent domain in such manner as to build its road across the plaintiff's tracks. The chancellor had granted an injunction "not because this corporation threatens to assail any rights of the complainants which, if lawfully organized, it would not be permitted to invade, but because it is a corporation *de facto* merely and not *de jure*." On appeal the court were of opinion that the injunction could not be maintained upon this ground and proceeded to consider the other reasons alleged in support of it, among others the contention that the general railroad act was unconstitutional and that the right of eminent domain could not be delegated. It is clearly implied in the opinion that if either of these contentions could be made good the plaintiff would be entitled to an injunction. The court were, however, with the defendant on both points and the injunction was dissolved.

show that as a matter of substance the associates never received a grant of the right to lay tracks upon the highway in question or that the grant has expired by its own limitation. As a matter of fact, the confusion of the distinct questions of form and substance has in many cases led to a denial of the standing of the plaintiff to object to the action of the associates and the cases have been disposed of by the statement that no question respecting corporate action can be raised in a collateral proceeding.

The mischief resulting from such a rule led the Pennsylvania Legislature to pass the Act of June 19, 1871 (P. L. 1361). The act provides that in all proceedings in courts of law or equity in which it is alleged that the rights or franchises of other corporations are injured or invaded by any corporation claiming a right to do the act from which such injury results it shall be the duty of the court in which such proceedings are had to examine, inquire, and ascertain whether such corporation does in fact possess the right and franchise to do such injurious act, and if such right or franchise has not been conferred upon such corporation such courts, if exercising equitable power, shall by injunction restrain such injurious acts." This act having been passed, an attempt was at once made to ignore the distinction under discussion by going to the other extreme and construing the act as giving to a plaintiff the right to raise every question which could be raised in a proceeding instituted by the state. Fortunately the court refused to adopt this view of the statute and in *Western Penna R. R. Co.'s Appeals*⁸ made precisely the distinction above suggested. "The Act of 1871," said the court, "contemplates nothing more than that it shall be made to appear from the charter that the corporation has the power to do the particular act in controversy and which involves some right of the contestant, but when we get beyond this we assume something with which we have no business in a collateral proceeding: we assume to assert the rights of a third party, the commonwealth." This was said in a case in which an

⁸ 104 Pa. 399 (1883).

attempt was made to restrain the defendant from crossing the plaintiff's tracks at grade for the reason that the defendant associates, though confessedly once possessing the right to lay tracks beyond the plaintiff's line, were alleged to have laid themselves open to a declaration of forfeiture by reason of non-user. In a subsequent decision⁹ the Supreme Court approved an able opinion of Endlich, J., in the court below in the course of which he observed, "The standing then of the defendant company to call upon the court under the Act of 1871 to inquire into the power of the plaintiff corporation to do that which it prays to be permitted to do here must be given by the fact that that act would constitute an injury to the private rights of the defendant, not by the fact that it may involve danger to the public or wrong to the city of Reading." Consistently with this view it has been held that the plaintiff has no standing except where there is a direct interference with his rights and that a chancellor will not inquire into the defendant's authority where the plaintiff's grievance is merely a diminution of traffic or other consequential injury.¹⁰

Subsequent to these decisions the very question was presented to the Supreme Court of Pennsylvania which is involved in the suppositious case just put—namely, the question of the right of an abutting owner to challenge the right of a manufacturing corporation without the power of eminent domain to maintain railroad tracks upon a highway. The court held that the plaintiff had under the Act of 1871 a standing to compel the removal.¹¹

Summing up the discussion of the topic under consideration, the following conclusions may be stated: that in no case will a court either of law or equity inquire at the instance of a private citizen into the right of associates to act in corporate form; that in no case will a court of equity, even at the instance of the attorney-general, inquire into the right of associates to act in corporate form; that either a court of law or a court of equity will at the instance of a private

⁹ *Penna., etc., R. R. v. P. and R. R. R.*, 160 Pa. 277, 1894.

¹⁰ *Penna. R. R. v. Street Rwy. Co.*, 176 Pa. 559 (1896).

¹¹ *Hopkins v. Catasauqua Mfg. Co. et al.*, 180 Pa. 199 (1897).

citizen inquire whether or not associates possess the substantive right to do acts directly affecting the interest of the plaintiff; and that where a statute exists expressly recognizing the right of a court to inquire into the authority for corporate action it will be so construed as to limit the inquiry to questions of substance as distinguished from questions of form; and, in the case of substantial rights, to an investigation only of their acquisition by the associates and not to a consideration of whether the associates have rendered themselves liable to a judgment of forfeiture.

III. THE RIGHT TO SUE IN THE COMMON NAME.—It is a rule of common law procedure that the plaintiffs, no matter how numerous, must appear upon the record in their own names. It is only in equity that one is permitted to sue as the representative of a class. In the case of partners the rule requires that the name of each partner shall appear, followed by the formula "trading as A & B." The right to adopt for purposes of litigation a single name which may be placed upon the record with the same legal effect as if the names of all the associates were set out at length is a right which is regarded as an incident of incorporation. While the right to a common name is undoubtedly a valuable right, it might well be regarded as one attainable without public consent. It is natural, therefore, to find in the case of irregularly organized associations that the courts rarely if ever permit a defendant to defeat recovery by questioning the right of the associates to sue in the common name. It is, of course, true that the courts have not explicitly recognized the situation as involving the right of associates to attain incorporation by their own act. Just as in the other cases which have been considered, the attempt has been made to explain the result by reference to collateral attack, estoppel, or contract. On this head the contract theory is the favorite with the courts. If by his contract the defendant has recognized the associates as organized under a common name, they may bring suit in that name and he will not be permitted to defeat recovery. It is sometimes intimated that the use of the common name in the contract is evidence of the existence of a corporation. Thus where

a defendant made a promissory note in favor of the "Cincinnati Type Foundry Company" it was held that a verdict and judgment for the plaintiff would be sustained though there was no other evidence than the note itself. "In this class of cases," said the court, "it would seem, after all, that the courts have proceeded upon a rule of evidence rather than the strict doctrine of estoppel. They have treated the contract with a party by a name implying corporation really as evidence of the existence of the corporation more than as an estoppel to disprove such fact." In a subsequent part of the opinion the court adds: "This doctrine of estoppel as applied to contracts with corporations needs further examination; but it is not important in this case and we shall not here pursue it. The decision of this case will rest upon another ground."¹² Obviously there is no question of estoppel in such a situation. As for the contract theory, it may be said to be both too broad and too narrow. It is too broad: because no reason can be given why one who has made a contract with partners in a firm name should not be liable to suit by them in that name; but such is not the law.¹³ It is too narrow: in that it does not suffice to explain cases in which associates irregularly organized are permitted to bring suit in their common name against a tort-feasor.¹⁴

An interesting phase of the question presented itself in *Stoutimore v. Clark*.¹⁵ B and others gave a promissory note to "the Missouri City Savings Bank." Upon B's failure to pay, judgment was entered upon the note in favor of the bank. A, the holder of a lien on B's land, filed a bill in order to compel a sale for the satisfaction of the lien. The bank was made a defendant by order of the court and set up the lien of the judgment. C, a co-defendant, holder of another lien, sought by cross

¹² *Jones v. Cincinnati Type Foundry Co.*, 14 Ind. 89 (1860).

¹³ *Rex v. Harrison*, 8 T. R. 508 (1800).

¹⁴ See, for example, the *Stockton, etc., Co. v. The Stockton, etc., R. R. Co.*, 45 Cal. 680 (1873), where a corporation *de facto* was permitted to maintain an action in the common name against one who had trespassed upon common property.

¹⁵ 70 Mo. 471 (1879).

bill to impeach the validity of the lien of the bank on the ground that the bank had not been regularly incorporated. The court upheld the lien of the bank. There was here no basis for alleging an estoppel. It might have been said that B, by contracting with the associates in the common name, had impliedly agreed that they might sue him in it. Though C was not a party to the contract, yet if B was bound, the judgment was valid and C could not complain. Or it might have been said that incorporation had in fact been attained in spite of irregularity and that the right to sue in the common name was an incident of incorporation. The court, however, preferred to say that in the suit upon the note B would have been "estopped" from disputing the corporate existence and that therefore the judgment was valid. This is, in substance, the contract theory. The court also thought that as C had derived his rights from B subsequent to the bank's judgment he could have no better position than B. This suggestion seems to have been superfluous; for as the judgment was valid, its lien was effective against all the world. The result reached is undoubtedly sound. That B could not have made defence on the ground that suit was brought in the common name is clear from the authorities. "The plaintiff," said the court in *Bank v. McDonald*,¹⁶ "being a corporation *de facto*, and the defendant having contracted with it as such, the legality of the organization cannot be impeached by him when sued upon his contract."

A class of cases is sometimes confused with the cases under discussion which in reality involve a different question. Let it be supposed that B promises to take and pay for shares in a corporation thereafter to be formed and that (on some one of the theories already discussed) he is afterwards sued by the associates in their common name. The question is whether he may defend on the ground that the organization is irregular. Here, it will be perceived, the objection goes deeper than a mere dilatory defence which denies the right to sue in the common name. If this were

¹⁶ 130 Mass. 264 (1881).

the only point involved, B's defence should not be permitted. The substantial question, however, is whether the associates who are suing for B's contribution have performed the conditions of the contract. If the organization is irregular, the people, through the attorney-general, may forfeit the charter and destroy or impair the value of the common property. Until the associates have formed an invulnerable organization they have not performed their part of the contract. A covenant to settle property upon a female relative when married might well be construed as contemplating a licensed marriage, regularly contracted. A refusal to convey where mere cohabitation and reputation had made a *de facto* marriage should not be regarded as a breach of the covenant. Yet such a case is far weaker than the one under consideration. Here the question does not concern the status of another, but the status which the defendant will himself occupy if compelled to perform the contract. It is as if B, under contract of marriage, were sued for breach of promise by the plaintiff, who had offered to cohabit with B but had declined to obtain a license and submit to a marriage ceremony. It is clear that B would not be liable.

Without always clearly stating the principle, the cases as a rule permit the subscriber to defend on the ground of irregularity. "That contract," it was said in *Indianapolis Furnace Co. v. Herkimer*,¹⁷ "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 court here distinguished between contracts with existing corporations and those in which future incorporation is contemplated. "The ground upon which a party who has contracted with a corporation as such is estopped to deny its existence is, that by his contract he has recognized the existence of the corporation." It is often said, as is implied in the language just quoted, that if the contract is with an existing corporation the defendant may not set up the irregularity of its organization as a defence

¹⁷ 46 Ind. 142 (1873).

to an action upon his subscription. If, as has been seen, the objection goes merely to the right to sue in the common name, this statement is sound. It is submitted, however, that if B subscribes to the stock of an existing corporation and subsequently discovers that its charter is vulnerable he should be permitted to resist payment, just as in the case of subscriptions made prior to organization.¹⁸

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(To be concluded.)

¹⁸The remaining topics—Amenability to Suit in the Common Name, Conveying and Receiving Title to Property, and the Effect of Irregularities Upon the Relation of Associates *inter se*—will be discussed in a third and final article.