

# Piercing the Corporate Veil in Illinois

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that the extension of equity's jurisdiction into the criminal field violates fundamental distinctions between criminal and civil courts intrinsic to our system of jurisprudence.<sup>67</sup>

The concomitant advantages and disadvantages inherent in the granting of injunctive relief should be analyzed by the reader in the light of the following statement made in reference to, and contemporary with, the *Debs* case:

It is indeed true that by the weight of authority the jurisdiction [of a court of equity] is not ousted merely because, as in the case of a public nuisance, the threatened act may be the subject of an indictment. But the foundation of the jurisdiction over public nuisances, as of all jurisdiction in equity, is the greater efficacy of the equitable remedy. . . . Jurisdiction in equity is for the adjudication of civil rights. Preliminary injunctions are to preserve the subject of litigation in status quo and prevent irreparable injury during the pendency of the suit. The mere fact that the act enjoined is criminal may not oust the jurisdiction of the Court, since every crime involves also an infraction of civil rights. But to justify the interference of a court of equity by preliminary or by perpetual injunction, it must be shown that the injunction will prevent some threatened injury for which the law affords no adequate relief. An injunction against destroying property by violence or similar offense against the criminal law accomplishes no such result. . . . Courts of equity cannot with propriety or safety extend their jurisdiction, under the guise of protecting property, by issuing decrees imposing merely cumulative prohibitions against that which the criminal law already forbids, in order summarily to try and punish offenders for acts in violation of these prohibitions.

If the course thus followed can be supported, the principles of equity jurisprudence have received an important extension which may render "government by injunction" more than a mere epithet.<sup>68</sup>

<sup>67</sup> Ralston, *Government by Injunction*, 5 *Corn. L. Q.* 424 (1920).

<sup>68</sup> Dunbar, *Government by Injunction*, 13 *L.Q. Rev.* 347, 356, et seq. (1897).

## PIERCING THE CORPORATE VEIL IN ILLINOIS

The legal fiction that corporations are entities, separate and distinct from their stockholders, has enjoyed judicial sanction since the inception of corporate recognition.<sup>1</sup> As is the case with many legal principles, a policy of too-strict adherence to the corporate-entity theory by the courts would result in injustice.

To be specific: cases arise wherein an individual incorporates with the avowed purpose of avoiding contractual or statutory obligations. In his corporate capacity he proceeds upon a course of conduct which, if taken by an individual, would result in civil liability for damages, or criminal prosecution.<sup>2</sup> This individual is obviously acting unlawfully, or in a man-

<sup>1</sup> *Superior Coal Co. v. Department of Finance*, 377 Ill. 282, 36 N.E. 2d 354 (1942).

<sup>2</sup> E.g., *Relago Rosin Products Co. v. National Casein Co.*, 321 Ill. App. 159, 52 N.E. 2d 322 (1944), wherein it was held that evidence showing shipment of goods from plaintiff to defendant, in the name of a dummy corporation, constituted a prima facie case against defendant for the price of the goods shipped.

ner which is contrary to public policy; but he cannot be judicially "reached" unless the court divests him of his corporate "shell," and treats him as an individual, subject to the law applicable to individuals.

Thus, in an appropriate case, and in furtherance of the ends of justice, a corporation and the individual or individuals owning all its stock and assets will be treated as identical, the corporate entity being disregarded where used as a cloak or cover for fraud or illegality.<sup>3</sup>

This judicial process has come to be known as "piercing the corporate veil," or alternatively, "disregarding corporate existence," or "looking to substance rather than form."

The objective here is to present the status of the law as enunciated in Illinois decisions, in regard to the above-stated legal principle. Illinois cases on point will be examined in an effort to illustrate what the courts did in relation to different sets of facts, and the theory underlying their action will be analyzed. However, before determining when the courts will pierce the corporate veil, it will be well to ascertain the situations in which they have refused to do so.

Obviously, corporate existence will not be disregarded when to do so would constitute a fraud. As was stated in *Central Trust Co. v. Calumet Co.*,<sup>4</sup> two corporations having virtually the same stockholders will not be considered as one entity for the purpose of enabling one of them to "avoid payment of an honest debt."<sup>5</sup> There was cause to apply this principle again when, in a 1942 case,<sup>6</sup> the parent corporation, a railway company, and its wholly-owned subsidiary, a coal company which furnished the entire output of its mines to the parent corporation, had utilized separate corporate forms for forty years, during which time the subsidiary had gained financial and economic advantage as a result. It was here held that the subsidiary could not demand that its separate corporate existence be disregarded so as to relieve itself from taxes under the Retailers Occupation Tax Act on sales of coal to the parent corporation.

When there is an attempt to determine incidental matters between outside parties not connected with or helpful in the determination of the judicial question in issue, the corporate veil will not be pierced. This was substantiated where a petition in bankruptcy court sought adjudication of a controversy between the alleged beneficial bondholders of bonds of the debtor-subsiary, and the corporation by which the subsidiary was owned, with no hope of benefit to the debtor's estate. The court applied the above-stated principle in refusing to disregard the corporate entities.<sup>7</sup>

<sup>3</sup> 13 Am. Jur., Corporations § 7 (1938).

<sup>4</sup> 260 Ill. App. 410 (1931).

<sup>5</sup> *Ibid.*, at 418.

<sup>6</sup> *Superior Coal Co. v. Department of Finance*, 377 Ill. 282, 36 N.E. 2d 354 (1942).

<sup>7</sup> *In re Lubliner & Trintz Theatres*, 100 F. 2d 646 (C.A. 7th, 1938).

In addition to the type of case where to ignore corporate existence would be tantamount to fraud, or where an adjudication in the nature of a declaratory judgment is asked, there have been several isolated instances wherein Illinois courts, upon being requested to pierce a corporate veil, have refused to do so. One such instance occurred in 1917, where it was held that merely because two corporations had the same president and the same secretary, and that one of the corporations, a construction company, agreed to pay for work done by delivering stock of another corporation, did not prove that the two corporations are the same, nor that one is dummy for the other, and that what one does, the other really does also.<sup>8</sup>

In a proceeding to reorganize a utility which had acquired property from a corporation, the people who owned virtually all of the corporation's stock claimed a vendor's lien on the property. Said stockholders asked that their corporate identity be disregarded and the transaction viewed as a sale of property by stockholders. The court, in disallowing the request, said that there were no circumstances which would justify a disregard for corporate existence.<sup>9</sup>

*McDermott v. ABC Oil Burner Sales Corporation*<sup>10</sup> presented an unusual problem. An oil burner *manufacturing* corporation and the defendant *sales* corporation were owned and operated by the same people. Plaintiff attempted to hold the two corporations jointly liable for property damaged in his home when a burner was installed by the sales corporation. The court, in refusing to recognize the two companies as one, said that "a corporation is an entity separate and distinct from its stockholders and from other corporations with which it may be connected."<sup>11</sup>

Where a corporation changed its name, and a few days later a charter was issued to a newly organized corporation in the previous name of the corporation that changed its name, there were thereafter two separate entities, and the holder of an agreement by the original corporation promising to pay a certain sum of money could not maintain an action against the newly-formed corporation to recover on the agreement.<sup>12</sup>

In a 1949 case, an individual proprietor of a business executed a chattel mortgage to a judgment creditor without informing said creditor, or the public, that he had organized a corporation wholly-owned by him, and at about the same time transferred business property to the corporation by mere book entries, without notifying the mortgagee or complying with the Bulk Sales Act. It was held that such transfer would not bind the mortgagee, and the separate entity of the corporation must be recognized,

<sup>8</sup> *Seymour v. Woodstock & Sycamore Traction Co.*, 281 Ill. 84, 117 N.E. 729 (1917).

<sup>9</sup> *In re Commonwealth Light & Power Co.*, 86 F. 2d 474 (C.A. 7th, 1937).

<sup>10</sup> 266 Ill. App. 115 (1932).

<sup>11</sup> *Ibid.*, at 120.

<sup>12</sup> *Ernest Freeman & Co. v. Robert G. Regan Co.*, 332 Ill. App. 637, 76 N.E. 2d 514 (1947).

so that the mortgage was not a voidable transfer in the corporation's bankruptcy.<sup>13</sup>

Turning from a discussion of the cases wherein the corporate veil was not pierced, the type of situation prompting the Illinois courts to take opposite action will now be considered. These situations fall within four basic classifications, wherein Illinois courts have consistently looked to substance rather than form, and disregarded corporate existence.

#### THE OBLIGATION-AVOIDANCE CASES

Cases in which corporate veils are pierced with more regularity than any other type are what may be termed the obligation-avoidance cases, viz., those in which the incorporator has incorporated for the sole purpose of avoiding a just obligation.

In a relatively early decision, a fraudulent conveyance of property by the debtor-partnership to a corporation prior to the general assignment for the benefit of creditors was held ineffectual and inoperative as against a judgment creditor attempting to impeach it.<sup>14</sup> In a case where the defendant treated a corporation, wholly-owned by him and his family, as a sole proprietorship, and held it out to creditors as such, defendant could not defend on the basis of corporation when sued on a note signed by him in the course of business.<sup>15</sup> It was held that where the owner of all capital stock of a corporation dealt with realty as his own in agreeing to have the corporation convey the realty to a third party, equity would look at substance and not form, and would not permit the third party to avoid any clear equity arising from the agreement between him and the stockholder merely because legal titles came from the corporation and not from the stockholder personally.<sup>16</sup> Similar cases arising in 1934<sup>17</sup> and 1949<sup>18</sup> are in support of the above decisions; and most recently, in a 1952 case involving an attempt to garnish a bank account which allegedly had been transferred by the primary debtor to another corporation, the two corporations were held to be one and the same, thus preventing the primary debtor from disclaiming the bank account as his own.<sup>19</sup>

<sup>13</sup> *In re Le Maire Cosmetic Co.*, 174 F. 2d 749 (C.A. 7th, 1949).

<sup>14</sup> *Hinkley v. Reed*, 182 Ill. 440, 55 N.E. 337 (1898).

<sup>15</sup> *Aurora Daily News Co. v. Frazier*, 157 Ill. App. 456 (1910).

<sup>16</sup> *Kelly v. Lehmann*, 297 Ill. 33, 130 N.E. 375 (1921).

<sup>17</sup> *Illinois Interior Finish Co. v. Poenie*, 277 Ill. App. 554 (1934).

<sup>18</sup> *Dishinger v. Bon Air Catering*, 336 Ill. App. 557, 565, 84 N.E. 2d 562, 566 (1949), wherein the court declared: ". . . [I]nasmuch as it appears that the cause of the defendant corporation is presented so as to protect and advance the interest of William R. Johnson, who is the motivating force behind the defense, he will be deemed a party in the broad connotation of the term, and will be bound by the orders entered in these proceedings."

<sup>19</sup> *Kuttner & Kuttner v. Career Studios*, 345 Ill. App. 504, 104 N.E. 2d 122 (1952).

## THE PATENT INFRINGEMENT CASES

Four recent decisions have shown a propensity on the part of Illinois courts to disregard corporate existence where infringement of patents or copyrights is involved. In the first of these cases, the defendant corporation was using a subsidiary corporation to infringe upon the plaintiff's patent.<sup>20</sup> It was declared that the fiction of corporate entity may be disregarded where one corporation is the mere "instrumentality or adjunct" of another corporation. This rule was followed in a 1953 decision,<sup>21</sup> and given additional support by two cases decided in 1956. In one, a corporation was formed for the purpose of publishing a songbook which infringed upon plaintiff's copyright. Here, the defendant, who controlled the corporation, was held personally liable.<sup>22</sup> In the other case, the defendant, after terminating its distributorship for the patent owner, continued to operate for the sole purpose of infringing and practicing unfair competition. The wrongdoer was not allowed the protection of the corporate veil, but was rather held "one and the same" as the corporation, and thus, personally liable.<sup>23</sup>

## THE VIOLATION OF STATUTE OR INJUNCTION CASES

Apparently, where a corporation is formed in order to evade a statute or a court order, that corporation's existence will be disregarded by an Illinois court called upon to do so. In *1242 Lake Shore Drive Bldg. Corp. v. Hughes*, a group of persons formed a syndicate for the purpose of obtaining land and erecting an apartment building on the co-operative plan.<sup>24</sup> They organized a corporation which issued all of its stock to the syndicate and took title to the land as well as to the building subsequently erected. The corporation was not allowed to contend that its annual franchise tax on stated capital and paid-in surplus under the Business Corporation Act should be fixed only on the value of the land without the building, because, under the co-operative plan, it issued a long-term lease with a nom-

<sup>20</sup> *Detroit Motor Appliance Co. v. General Motors Corp.*, 5 F. Supp. 27 (E.D. Ill., 1933).

<sup>21</sup> *S.O.S. v. Bolta Co.*, 117 F. Supp. 59 (N.D. Ill., 1953). The court here held that the fiction of separate capacities is ". . . not applicable where stock ownership has been resorted to, not for the purpose of participating in the affairs of a corporation in the normal and usual manner, but for the purpose as in this case of controlling a subsidiary company so that it may be used as a mere agency or instrumentality of the owning company. . . ."

<sup>22</sup> *Whitol v. Wells*, 231 F. 2d 550 (C.A. 7th, 1956).

<sup>23</sup> *Powder Power Tool Co. v. Powder Actuated Tool Co.*, 230 F. 2d 409 (C.A. 7th, 1956).

<sup>24</sup> 369 Ill. 476, 479, 17 N.E. 2d 38, 39 (1938). Here it was stated by the court that "where the corporate form has been used to circumvent a statute the corporate entity will be disregarded in the interest of justice. . . ." And ". . . courts will view schemes of this nature with care in order to prevent evasion of . . . duties imposed by the state."

inal rental to the syndicate, which assigned portions of the lease to ultimate purchasers of stock. The corporation was held to have received in exchange for its stock the completed building as well as the land, and the tax should be based on the value of both. In this case it was stated that courts, in order to prevent corporate evasion of statutory or constitutional duties, will view with care corporate setups whereby the corporation appears to avoid such obligation.

In 1945, a case arose wherein one corporation marketed petroleum products and another operated a fleet of tank cars, both corporations being owned in the same proportion and by the same stockholders and having, with minor differences, the same officers and directors.<sup>25</sup> The two corporations were considered as one, and their respective stockholders were treated as the same for the purpose of applying a statute prohibiting all rebates, concessions, or discriminations in respect to transportation of property in interstate commerce by common carrier.

*Bigelow v. RKO Radio Pictures*<sup>26</sup> was a case involving violation of an injunction. The defendant corporation had been enjoined from running a motion picture for more than two weeks in a given territory. A theater owned by a wholly-owned subsidiary of the defendant violated the terms of the injunction, and the violation was imputed to the defendant, i.e., the court refused to recognize the separation of entity between the defendant and the wholly-owned subsidiary.

#### THE LEASE ASSIGNMENT CASES

Although the final area is a limited one, it is one in which the Illinois courts have indicated a willingness to pierce the corporate veil. It is the area wherein a lessor places a provision in a lease against assignment or subleasing without the lessor's consent. Later, the lessee incorporates. Query: does the incorporation constitute an unauthorized assignment of the lease by the unincorporated lessee to the lessee-corporation? Two recent Illinois cases, one in 1948<sup>27</sup> and one in 1949,<sup>28</sup> wherein lessors urged this theory to dispossess their lessees, have answered in the negative. Rather, the court will look to substance instead of form and hold that the individual lessees are the same as the corporate lessees.<sup>29</sup>

<sup>25</sup> *Ohio Tank Car Co. v. Keith Railway Equipment Co.*, 148 F. 2d 4 (C.A. 7th, 1945).

<sup>26</sup> 170 F. 2d 783 (C.A. 7th, 1948).

<sup>27</sup> *Earp v. Schmitz*, 334 Ill. App. 382, 388, 79 N.E. 2d 637, 639 (1948), where it was decided that: "Plaintiffs have not been misled in any way by the formation of the corporation. They dealt with Schmitz individually. There was no change in the business after the corporation was formed." On this theory, the court held the corporation and the stockholder to be one and the same.

<sup>28</sup> *Liberty National Bank of Chicago v. Pollack*, 337 Ill. App. 385, 85 N.E. 2d 855 (1949).

<sup>29</sup> *Ibid.*

## CONCLUSION

In deciding whether or not a corporate veil should be pierced, it would be well for the courts to pay heed to Ballantine's caveat:

The problems involved, however, are to be solved not by "disregarding" the corporate personality, but by a study of the just and reasonable limitations upon the exercise of the privilege of separate corporate capacity under particular circumstances in view of its proper use and functions. If the separate corporate capacity is perverted to dishonest uses, as to evade obligations or statutory restrictions, the courts will interpose to avoid the abuse.<sup>30</sup>

Mechanical application of a formula in determining whether or not the corporate veil should be pierced is inherently dangerous. For there is no general formula to fit all cases, such as "alter-ego" or instrumentality. Each situation must be considered by the court on its merits.

As Mr. Justice Cardozo observed in a case involving substantially the same considerations:

The problem is still enveloped in the mists of metaphor. Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it. We say at times that the corporate entity will be ignored when the parent corporation operates a business through a subsidiary which is characterized as an "alias" or a "dummy." All this is well enough if the picturesqueness of the epithets does not lead us to forget that the essential term to be defined is the act of operation. . . . The logical consistency of a juridical conception will indeed be sacrificed at times, when the sacrifice is essential to the end that some accepted public-policy may be defended or upheld. This is so, for illustration, though agency in any proper sense is lacking, where the attempted separation between parent and subsidiary will work a fraud upon the law. . . . At such times unity is ascribed to parts which, at least for many purposes, retain an independent life, for the reason that only thus can we overcome a perversion of the privilege to do business in a corporate form.<sup>31</sup>

It may thus be concluded that the use of the entity privilege of separate capacities in Illinois is at all time subject to limitations of an equitable nature to prevent the privilege from being exercised or asserted for illegal, fraudulent, or unfair purposes by those claiming under it; and the courts of law or equity will step in to prevent its abuse as the situation, and justice, may require.

<sup>30</sup> Ballantine, *Corporations* § 122 (2d Ed., 1946).

<sup>31</sup> *Berkey v. Third Avenue Railway Co.*, 244 N.Y. 84, 155 N.E. 58, 61 (1926).

#### THE PROPOSED JUDICIAL ARTICLE: AN ESCAPE FROM ANACHRONISM

Much has been written about the proposed judicial amendment to the Illinois Constitution in regard to the election of judges, but only a paucity of writing has been devoted to the ever-increasing need to change the