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## Actions by a Sole Stockholder of a Corporation

Julius E. Kovacs\*

IN DISCUSSING A SOLE SHAREHOLDER'S personal action for injuries to his corporation we are merely touching upon one phase or area of the law of the "one man corporation."<sup>1</sup> To properly discuss this particular phase, it is necessary to briefly illustrate the corporate entity concept as it distinguishes between the corporation and its shareholders. A quotation from Judge Sanborn in *United States v. Milwaukee Refrigerator Transit Co.*<sup>2</sup> is appropriate for this purpose.

If any general rule can be laid down, in the present state of authority, it is that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.

The corporate entity concept is generally accepted<sup>3</sup> and the acquisition of all the stock by one person ordinarily is not enough to cause a court to disregard it;<sup>4</sup> there must be some fraudulent purpose shown.<sup>5</sup> A Kentucky case, however, held that the acquisition of all the stock by one person put the corporation in a state of suspension until other shareholders were admitted.<sup>6</sup>

In the case of *In re Bush's Estate*<sup>7</sup> the corporate entity was preserved after the death of the corporation's sole stockholder. The testator (sole stockholder) had formed a corporation to

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<sup>1</sup> See Fuller, *The Incorporated Individual: A Study of The One-Man Company*, 51 Harv. L. Rev. 1373 (1938).

<sup>2</sup> 142 F. 247, 255 (E. D. Wis. 1905).

<sup>3</sup> 1 Oleck, *Modern Corporation Law*, 40, 42, 58 (1958, with 1965 supp.).

<sup>4</sup> *Ibid*, page 45; *Lober v. Canadian Pac. Ry. Co.*, 151 F. 2d 758 (8th Cir. 1945); *Roof v. Conway*, 133 F. 2d 819 (6th Cir. 1943); *City of Holland v. Holland City Gas Co.*, 257 F. 679 (6th Cir. 1919); *Hollywood Cleaning and Pressing Co. v. Hollywood Laundry Service, Inc.*, 217 Cal. 124, 17 P. 2d 709 (1932).

<sup>5</sup> *Mayo v. Pioneer Bank and Trust Co.*, 270 F. 2d 823, 830 (5th Cir. 1959), rehearing denied 274 F. 2d 320 (5th Cir. 1960); *In Re Clarke's Will*, 204 Minn. 574, 578, 284 N.W. 876 (1939).

<sup>6</sup> *Russell Lumber and Supply Co. v. First Nat. Bank of Russell*, 262 Ky. 388, 90 S.W. 2d 372 (1936).

<sup>7</sup> 124 Misc. 674, 209 N. Y. S. 776 (Surr. Ct. 1925); see also 51 Harv. L. Rev. 1399 (1938); *Burnet v. Commonwealth Improvement Co.*, 287 U. S. 415, 53 S. Ct. 198, 77 L. Ed. 393 (1932).

carry out his financial affairs. In his will he attempted to bequeath shares of stock of a company owned by his own corporation, to a specific beneficiary. The contention was that the bequest would fail since the intended gift was corporation property rather than the shareholder's individual property. After the death of the testator the corporation was dissolved and the gift sustained.

The syllabus of the court in *Fidelity Trust Co. v. Vonder Roest*<sup>8</sup> reads as follows:

Testator gave his estate to a trustee to pay the income to his son for ten years, then the principal; over if the son dies within ten years. By codicil he devised to the son certain real property, title to which was in a corporation of which the testator owned all the capital stock; held, a. the corporation fiction may not be disregarded and the legal title does not pass by the codicil; b. the trustee will effectuate the testator's intention by causing the corporation to convey the property (and the case then said)

. . . stockholders have neither legal nor equitable estate in the property of the corporation.

A sole stockholder's personal action for damages arising out of fraud upon his corporation was dismissed as not stating a cause of action in a suit against a third party;<sup>9</sup> and the general rule that the corporate entity will be preserved, even when all the stock is owned by the same person,<sup>10</sup> usually is upheld.

The doctrine of corporate entity appears to be a legal theory introduced for convenience only; the doctrine exists separate and apart from the persons composing it.<sup>11</sup> Whenever justice demands, however the corporate entity can be set aside or disregarded and the corporation and its stockholders treated as one and the same.<sup>12</sup>

In *Telis v. Telis* the court regarded the corporate entity as a sham and pierced the corporate veil in order to allow dower to the wife. This case was distinguished in *Frank v. Frank's Inc.*, where dower was *not* permitted in corporate property as there

<sup>8</sup> 1 Oleck, *op. cit. supra* note 3, at p. 54, citing: *Fidelity Union Trust Co. v. Vonder Roest*, 113 N. J. Eq. 368, 166 A. 918 (1933).

<sup>9</sup> *Box v. Roberts*, 112 Colo. 234, 148 P. 2d 810 (1944).

<sup>10</sup> *Supra*, note 4.

<sup>11</sup> *Western Battery & Supply Co. v. Hazelett Storage Battery Co.*, 61 F. 2d 220 (8th Cir. 1932) cert. denied 288 U. S. 608, 53 S. Ct. 399, 77 L. Ed. 982, (1932).

<sup>12</sup> *First Nat. Bank v. Winchester*, 119 Ala. 168, 24 So. 351 (1898); *D. N. & E. Walter & Co. v. Zuckerman*, 214 Cal. 418, 6 P. 2d 251, 79 A. L. R. 329 (1931).

had not been sufficient fraud committed on the wife to permit her to disregard the corporate entity.<sup>13</sup>

Generally, the corporation represents its stockholders in all matters pertaining to corporate business. The wrongs committed against the corporation give rise to actions by the corporation and not by the individual stockholder. Therefore, an action based on a corporate right must be maintained by the corporation and in the corporate name. The exceptions to the rule are mainly based on situations where the corporation refuses to enforce the right or is incapable of doing so. Courts of equity, in their discretion, may permit the shareholder or shareholders to bring the suit in substitution of the corporate right of action.<sup>14</sup>

A sole shareholder recently was permitted to bring a malicious prosecution action against a third person in his own name, where the wrong done, if any, was to the corporation. The court treated him as the *alter ego* of the company.<sup>15</sup> This case seems to have taken a different approach in applying the *alter ego* concept. The court cited *Chicago-Crawford Currency Exchange v. Thillens, Inc.*<sup>16</sup> as a leading case and its authority for applying the *alter ego* concept. This particular case applied the *alter ego* theory in order to strip away the protection of fraud by legal entity; specifically, to permit attack on the sole shareholder who formed the corporation for fraudulent and illegal purposes.

Similarly, in *Donovan v. Purtell*,<sup>17</sup> the court treated the sole shareholder of a corporation as the *alter ego* of the corporation, saying:

In such cases as this the courts will not permit themselves to be blinded or deceived by mere forms of law, but, regardless of the fictions, will deal with the substance of the transactions involved as if the corporate agency did not exist and as the justice of the case may require.

It seems that the courts will usually apply this so-called *alter ego* concept whenever justice demands or whenever the equities of the case require it.<sup>18</sup> The obvious case is where the

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<sup>13</sup> *Telis v. Telis*, 132 N. J. Eq. 25, 26 A. 2d 249 (1942); *Frank v. Frank's Inc.*, 9 N. J. 218, 87 A. 2d 724 (1952).

<sup>14</sup> 19 Am. Jur. 2d, 61-62.

<sup>15</sup> *Caspers v. Chicago Real Estate Board*, 58 Ill. App. 2d 113, 206 N.E. 2d 787 (1965).

<sup>16</sup> 48 Ill. App. 2d 366, 373, 199 N.E. 2d 295, 299 (1964).

<sup>17</sup> 216 Ill. 629, 75 N.E. 334 (1905).

<sup>18</sup> *Erickson-Hellekson-Vye Co. v. A. Wells Co.*, 217 Minn. 361, 15 N.W. 2d 162, 459 (1944).

courts are attempting to reach the sole shareholder in his individual capacity in order to hold him liable to a third person in a situation where it appears that the corporation was formed merely as a front or protection for some illegal or wrongful purpose. If we accept this as the general rule, then it would appear that the *Caspers v. Chicago Real Estate Board*<sup>19</sup> is an unusual application of this rule.

Based on the legal fact that the corporation is usually regarded as a distinct legal entity, it (as an entity) takes and holds title to its own property, manages its business through its agents, makes its own contracts, conveys its own property, etcetera. If the corporation makes a contract, ordinarily all the rights accruing under the contract are the rights of the corporation and not of the individual stockholders,<sup>20</sup> even if all of the stock is owned by the same individual.<sup>21</sup>

In a common shareholder (derivative) action, not specifically a sole shareholder individual action, there are certain conditions which must be shown to exist before suit can be brought by the individual stockholder. He must show (1) an existing cause of action in favor of the corporation; (2) refusal, express or implied, of the corporation to sue; and generally (3) an injury in effect to the stockholder. There is some authority that if a shareholder can control the wrongdoing officer, he must exhaust this remedy first.<sup>22</sup>

The conditions mentioned in the above paragraph, which must be met prior to bringing a shareholder's suit, do not necessarily apply to a sole shareholder. The problem would seem to be academic, since in most cases, the sole shareholder would retain complete control over the board of directors and officers, and dealings of the corporation in general. An act not agreeable to him conceivably might prove detrimental to the other individual or individuals involved.<sup>23</sup>

In *Malcom v. Stondall Land and Investment Company*, a sole stockholder's suit to quiet title to certain land, brought in his individual capacity, was not permitted. The action was held to be that of the corporation. The corporation must appear itself,

<sup>19</sup> *Supra*, note 15.

<sup>20</sup> 1 Oleck, *Modern Corporation Law*, ch. 12 (1958, with 1965 supp.); 13 Fletcher, *Cyclopedia of Corporations*, 398 (1961).

<sup>21</sup> *Button v. Hoffman*, 61 Wis. 20, 20 N.W. 667 (1884); Oleck, *supra* at p. 434.

<sup>22</sup> 13 Fletcher, *op. cit. supra* note 20, at 398.

<sup>23</sup> Writer's opinion based upon cases.

as such, and plead, "or there may be neither suit nor defense."<sup>24</sup> The reasoning of the court is that a majority or sole stockholder controls the corporation, and defense and prosecution of any litigation involving it does not have to be made in a stockholders' action to protect the interests of the corporation. A court of equity will deny such relief, as the remedy within the corporation itself is adequate.<sup>25</sup>

A holding similar to the one in the *Malcom* case, above, was made in *Lockhart v. Moore*.<sup>26</sup> This was an action by a sole stockholder to set aside a conveyance of all the corporate property, based on the contention that the sale was made without authority. The court held that the action could not be maintained by a sole shareholder, and that she could call a shareholders' meeting after requesting the officers to bring suit, elect new officers, and have a resolution passed authorizing institution of a suit by the corporation.

The fact that a shareholder owns all or practically all the stock of a corporation does not permit him to sue as an individual on a wrong done to the corporation.<sup>27</sup> A sole stockholder's action for damages grounded on deceit and fraud was dismissed on demurrer; the wrong done to the corporation could only be redressed in an action by the corporation and not by the individual stockholder.<sup>28</sup> Wrongs done to the corporation which give rise to a corporate cause of action, must, in most cases, be brought by the corporation in the corporate name.<sup>29</sup> A number of cases illustrate the law in this particular area, along with the few exceptions to the general rule.

A case which is often cited is *Green v. Victor Talking Machine Co.*,<sup>30</sup> where a sole stockholder's attempt to recover damages for tortious injury to a corporation, as distinguished from injuries to the stockholder, could not be maintained in his individual capacity and name, despite resulting depreciation of his stock's value.

<sup>24</sup> 129 Mont. 142, 284 P. 2d 258 (1955).

<sup>25</sup> Ibid.

<sup>26</sup> 25 Tenn. App. 456, 159 S.W. 2d 438, 58 A. L. R. 2d 789 (1941).

<sup>27</sup> *Liken v. Shaffer*, 64 F. Supp. 432 (N. D. Iowa 1946).

<sup>28</sup> *Green v. Victor Talking Mach. Co.*, 24 F. 2d 378, 59 A. L. R. 1091 (2d Cir. 1928).

<sup>29</sup> 19 Am. Jur. 2d 61.

<sup>30</sup> *Green v. Victor Talking Mach. Co.*, *supra* note 28.

A complaint by a sole shareholder for damages caused to him by the wrongful acts of defendants in interfering with corporate reorganization proceedings which he, as president of the corporation had instituted, was properly dismissed for failure to state a cause of action. Since the wrong was to the corporation, and not to the individual shareholder, an action for redress would have to be an action by and for the corporation.<sup>31</sup>

In an action for damages for failure to carry out the terms of a contract, the sole holder of all the capital stock was barred from recovery. The court followed the accepted rule that an individual shareholder or any number of shareholders "haven't the right to sue in their own names or in the corporate name, either at law or in equity, to recover damages to corporate property."<sup>32</sup> The action, being that of the corporation, must be brought by and in the corporate name rather than by a single shareholder.<sup>33</sup>

Damage allegedly caused by third parties to a sole stockholder by fraudulently inducing him to surrender corporate machinery and merchandise was held to be damage to the corporation and actionable by the corporation only.<sup>34</sup>

In *Skouras Theatres Corp. v. Radio-Keith-Orpheum Corp.*,<sup>35</sup> a sole shareholder who was injured by alleged monopolistic practices was prevented from suing in the stead of the corporation. Even where the intent was to cause injury to the sole stockholder, by inducing his employees to leave their employment, and for disclosing confidential information regarding the corporation's credit, the sole shareholder was prevented from bringing the action.<sup>36</sup>

An action by a sole shareholder as an individual to recover the value of assets allegedly converted by the defendant failed, as the wrong was to the corporation and not to the individual stockholder.<sup>37</sup>

As we have seen in the preceding cases, sole shareholders

<sup>31</sup> *Cromelin v. Fulcher*, 192 F. 2d 40 (5th Cir. 1951).

<sup>32</sup> *Mioton v. Del Corral*, 132 La. 730, 61 So. 771 (1913).

<sup>33</sup> *Ibid.*

<sup>34</sup> *Brodsky v. Frank*, 342 Ill. 110, 173 N.E. 775, 777 (1930).

<sup>35</sup> 193 F. Supp. 401 (S. D. N. Y. 1961).

<sup>36</sup> *Green v. Victor Talking Mach. Co.*, *supra* note 28.

<sup>37</sup> *Henry v. General Motors Corporation*, 236 F. Supp. 854 (N. D. N. Y. 1964) *aff'd* per curiam 339 F. 2d 887 (2d Cir. 1964); Also, see *Sadler v. Pure Oil Co.*, 172 S. C. 220, 173 S.E. 640 (1934) dealing with overcharge.

do not have the right to maintain an action in their own name or in the corporate name. For recovery of damages to corporate property an action must be brought by and in the name of the corporation.<sup>38</sup>

It is generally accepted that a claim by a sole stockholder as a creditor of a corporation will be honored even after sale of the corporation, where such claim appeared on the books at the time of the sale.<sup>39</sup>

Also, where the sole shareholder kept accurate financial records and adequately capitalized the corporation, he was permitted to share in the proceeds when the corporation became insolvent;<sup>40</sup> his claim as a sole shareholder cannot be challenged successfully on the ground that he is the sole shareholder and thus the *alter ego* of the company.<sup>41</sup>

In *Meyerson v. Franklin Knitting Mills*,<sup>42</sup> the sole stockholder was permitted to bring an action for breach of agreement to sell goods and to extend credit to the corporation against a previous shareholder, as the cause of action was in favor of the purchaser and not in the corporation.

Where a stockholder became owner of all the stock by purchasing the remaining interest of the corporation, along with the company's good will, the court allowed him to bring an injunction suit against the sellers for breach of the agreement.<sup>43</sup>

A fairly recent New York case permitted a trustee, who was also the sole shareholder, to have a third person enjoined from attempting to exercise powers of directors or officers and from interfering with his inspection of the corporate records where he was also a president and director of the corporation.<sup>44</sup>

<sup>38</sup> *Mente & Co., Inc., v. Louisiana State Rice Milling Co., Inc.*, 176 La. 476, 146 So. 28 (1933).

<sup>39</sup> *Kniese v. Fairfax Incline R. Co.*, 96 Cal. App. 427, 274 P. 382 (1929), cited in *Silk, One Man Corporations—Scope and Limitations*, 100 U. Pa. L. Rev. 853 (1952); *H. Remington and Son Pulp and Paper Co. v. Caswell*, 126 App. Div. 142, 110 N. Y. Supp. 556 (1908).

<sup>40</sup> *Wheeler v. Smith*, 30 F. 2d 59 (9th Cir. 1929); *Salomon v. Salomon L. R.* (1897) App. Cas. 22 (1896).

<sup>41</sup> *Salomon v. Salomon*, *ibid*; *Vennerbeck and Clase Co. v. Juergens Jewelry Co.*, 53 R. I. 135, 164 A. 509 (1933); *Kniese v. Fairfax Incline R. Co.*, *supra* note 39.

<sup>42</sup> 185 App. Div. 458, 172 N. Y. Supp. 773 (1918).

<sup>43</sup> *Komow v. Simplex Cloth-Cutting Mach. Co., Inc.*, 109 Misc. 358, 179 N. Y. Supp. 682 (Sup. Ct. 1919).

<sup>44</sup> *Sire Plan, Inc., v. Mintzer*, 38 Misc. 2d 920, 237 N. Y. S. 2d 123 (Sup. Ct. 1963).



A decision which caused much controversy was in *Park Terrace, Inc. v. Phoenix Indemnity Company*,<sup>45</sup> which held that a sole stockholder must bring an action against a third party in his own name, rather than in the corporation name, when the corporation is "dormant and inactive." The decisions made are his (sole shareholder) decisions rather than those of the corporation, and the action is also his. "He will not be permitted to use the corporation of which he is the sole beneficial owner, to cloak his action as an individual." But that decision is no longer law. The North Carolina general statute<sup>46</sup> more or less overruled this case, and the import of the statute can best be noted in paragraphs c. and d. of this particular statute.

No. 55-3.1 (c) Any action heretofore taken by or on behalf of a corporation or a purported corporation and which might have been invalid, defective, or ineffective solely in consequence of the ownership of all the shares of the corporation or purported corporation by one person or by two persons is hereby declared to be valid and effective.

(d) If any corporation or purported corporation might have been considered dormant or inactive solely in consequence of the acquisition heretofore of all its shares by one or by two persons, such corporation or purported corporation is hereby declared to have had uninterrupted existence and to have possessed uninterrupted capacity to act as a corporation.

### *Conclusion*

As pointed out in the cases cited, the law regarding sole shareholders' actions appears to be very clear. In most cases the corporate wrong can only be redressed by the corporation itself and in the corporate name. The few exceptions which have been mentioned appear to have been allowed in good conscience by courts of equity, with each case being decided on its own merits. While other areas of the law are constantly changing, the law with respect to sole shareholders' actions has remained stable, with no indications that any changes will take place in the immediate future.

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<sup>45</sup> 243 N. C. 595, 91 S.E. 2d 584 (1956).

<sup>46</sup> No. Car. Gen. Stats. § 55-3.1.