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Corporations—Liability of Parent for Subsidiary's Debts

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in question. The mere fact that an item is not yet legally due and payable does not mean that it may be ignored as a liability.[15]

Judge Desmond, in a partial dissent, concurs as to the adjustment for taxes but disagrees with the revised valuation of the inventory. His position is based upon a strict interpretation of "book value" as the figures actually shown on the books. It would seem, however, that basic fairness to the parties as well as sound accounting procedure would require an adjustment to be made of the large discrepancy existing between the physical and the estimated inventory.

Liability of Parent For Subsidiary's Debts

In an action by a trustee in bankruptcy of an insolvent subsidiary corporation to compel the parent corporation to meet the obligations of its wholly-owned non-profit subsidiary, judgment was given for defendant.[16]

Defendant is a corporation organized to obtain low cost housing for its stockholders. In order to erect houses on the property it owned, defendant organized a subsidiary corporation to do the contracting and construction work. The subsidiary was to sell at cost the houses it erected to the defendant, who would sell the completed house and lot to one of its stockholders. In 1949, two years after its creation, the subsidiary fell into a difficult financial position, and its creditors took over the management of the business under an extension agreement. Almost four years later the subsidiary was adjudicated a bankrupt. Subsequently the trustee in bankruptcy brought this action.

The exact situations which make a parent corporation liable for the debts of its wholly owned subsidiary seem never to have been specifically designated. Professor Ballantine has said, "Unfortunately it does not seem possible to lay down any definite test as to when the usual immunity of the stockholder should be disregarded."[17] Certainly the court will disregard the separate entity if there has been fraud or misrepresentation or an illegal purpose.[18] As to what constitutes fraud, there is no simple definition. Intent to defraud creditors does not seem to be an essential element.[19] If the subsidiary had insufficient capitalization to operate its

15. *U. S. v. Anderson*, 269 U. S. 422 (1926).
16. *Bartle v. Home Owners Cooperative*, 309 N. Y. 103, 127 N. E. 832 (1955).
17. Ballantine, *Separate Entity of Parent and Subsidiary Corporations*, 14 CAL L. REV. 12, 15 (1925).
18. *Ibid.* See also Douglas and Shanks, *Insulation from Liability through Subsidiary Corporations*, 39 YALE L. J. 193.
19. "It should not be necessary that an actual intent to freeze out creditors appear in order to impose liability." LATTY, SUBSIDIARIES AND AFFILIATED CORPORATIONS, 140 (1936).

business,[20] or if it operated as the "puppet" of a parent which managed all of its affairs,[21] that will be enough to cause the court to pierce the corporate veil. Similarly, if the parent receives any distribution of profits or assets in its position as stockholder before the debts of the subsidiary are paid, this will make the parent liable.[22]

The precise question of the instant case seems to be one of first impression in New York. The subsidiary corporation was apparently given sufficient capital on which to operate. Furthermore, the parent contributed, after the subsidiary's incorporation, additional funds at least equal to the original capital in an attempt to bolster the failing subsidiary. The only indication of fraud, if any, is the bare fact that the subsidiary was designed to operate on a non-profit basis.

The dissent, although it stated that the fact of non-profit operation constituted a fraud, relied on authority based upon examples of insufficient capitalization.[23] The majority did not specifically state that the lack of profits did not constitute fraud, but made the general statement that there was no fraud. The majority was justified in its holding, since it would seem that the creditors should have no interest in the profits if the corporation was organized with sufficient capital to maintain the business under normal conditions. However, the decision does not seem to set up a precedent of any significance, since the majority decision depends upon the fact of fraud rather than the law of fraud.

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20. *Joseph R. Foard Co. v. State of Maryland*, 219 Fed. 827 (2nd Cir. 1914); *Luckenbach S. S. Co. v. W. R. Grace & Co.*, 267 Fed. 676 (4th Cir. 1920).
21. *S. G. V. Co. of Del. v. S. G. V. Co of Pa.*, 264 Pa. 265, 107 Atl. 721 (1919).
22. *Natelson v. A. B. L. Holding Co.*, 260 N. Y. 233, 183 N. E. 373 (1932).
23. The dissent cited no cases on the principle, but referred to LATTY, *op. cit. supra note 4*. The reference was to Latty's section on insufficient capitalization, and the fact that some of the subsidiaries were designed to be non-profit was secondary in those cases.