

Chapter 30

Corporations

Like the limited partnership, the corporate form of business organization owes its existence to statutory law. New York was the first state to enact a corporate statute, in 1811, with other states following soon thereafter. Today, every state has enacted a business corporation statute, with about two-thirds of the states basing their business corporation law on the **Model Business Corporation Act (MBCA) of 1950**.

This chapter will discuss the unique character of the corporation, types of corporations, how to form and dissolve a corporation, and how to manage this type of business.

30.1 The Corporation as an Entity

Unlike sole proprietorships and traditional common law general partnerships (both discussed in [Chapter 28](http://content.thuzelearning.com/books/AUBUS670.12.2/sections/ch28#ch28) <http://content.thuzelearning.com/books/AUBUS670.12.2/sections/ch28#ch28>), a **corporation** is viewed as a separate entity from its owners. The law grants a corporation status as an **artificial being** much like a person for most purposes. This means that the corporation has certain rights and responsibilities not traditionally enjoyed by other business organizations. As an artificial being, a corporation has the right to own property in its own name, borrow or lend money, and sue and be sued, and it is entitled to the protection of most laws, the same as natural persons. On the other hand, like a natural person, a corporation must pay taxes (although at a lesser rate than individuals) and can be found guilty of crimes for which the punishment is a fine. In addition, a corporation can be set up to enjoy perpetual existence, unlike sole proprietorships and partnerships, which may be dissolved upon the death or incapacity of the sole proprietor or of a general partner.

The limited liability offered by a corporation to its owners is its greatest appeal. Because a corporation is deemed to be an entity separate from its owners, the owners of a corporation (its **stockholders**) are *not* personally liable for corporate debts beyond their investment in the company. All that a **shareholder** risks in purchasing a share of stock is the money paid for its purchase. On the other hand, stockholders pay a premium for this protection. Corporations pay taxes in their own right, including federal income taxes as well as state income taxes, where applicable. This means that the profits of the corporation are subject to **double taxation**: The corporation pays income taxes on corporate profits, and then the shareholders pay personal income taxes on corporate profits distributed to them as **dividends**. Some maintain that the taxation is in fact "triple" because shareholders also pay taxes on capital gains realized from the sale of their stock.

30.2 Classification of Corporations

Corporations are commonly classified in accordance with their purpose, the nature of their activities, and their ownership.

Public and Private Corporations

The corporate form serves both private and public interests equally well. **Public corporations** are organized by federal, state, or local governments in order to carry out necessary public services. Municipalities, such as cities and towns, are often organized as public corporations, as are companies entrusted with the administration of public services. **Private corporations**, on the other hand, are organized by private individuals to carry out private business.

For-Profit and Nonprofit Corporations

Corporations can be created for profit and nonprofit purposes. Public corporations are by nature nonprofit entities, since their purpose is not to make money but rather to advance the public good in some way. Private corporations, on the other hand, can be either for-profit or nonprofit, depending on their purpose. A **nonprofit corporation** is one that is organized for the purpose of achieving some artistic, humanitarian, or philanthropic purpose or rendering a public service, as opposed to a **for-profit corporation**, or a traditional business, which is organized to make a profit. Like **Chapter S corporations** (discussed below), nonprofit corporations are exempt from having to pay federal income taxes (as well as state and local income taxes in states that assess these).

Domestic, Foreign, and Alien Corporations

Corporations are classified as domestic, foreign, or alien depending on where they were organized and where they do business. Like limited partnerships, corporations are deemed to be **domestic corporations** in one state only: where they originally filed their **Articles of Incorporation**. In all other states, they are **foreign corporations**—once they file the correct paperwork, that is. Corporations organized under the laws of another country are considered **alien corporations** when they do business anywhere in the United States. As is true of limited partnerships, corporations wishing to transact business in a state other than that of their incorporation must register with the secretary of state in each such state. The address of a registered office in the state and the name and address of a **registered agent** of the corporation for the state must be provided to the secretary of state as part of the registration process and accompanied by the appropriate fee.

Closely Held and Publicly Traded Corporations

A **closely held corporation** is one whose shares are not traded to the general public in any stock exchange. Rather, the stock is usually only available to the owners, who may be a small group of people or a family. Such corporations are usually (but not always) small companies owned by a few investors. A **publicly traded company**, on the other hand, is one whose shares are traded in any stock exchange.

Professional Corporations

Professional corporations (PCs) are for-profit corporations organized to provide a professional service. Physicians, lawyers, architects, accountants, and engineers are but a few of the professions whose members commonly form PCs. A PC must have the words *Professional Corporation* (or the letters *PC*) following the corporate name instead of the normal words or abbreviations appended to corporate names (e.g., *Corp., Inc., Co.,* or *Ltd.*).

Chapter S (Subchapter S) Corporations

The greatest disadvantage of organizing a business as a corporation is the double taxation to which corporate profits are subject. The Internal Revenue Code (IRC), however, grants a tax exemption to small business corporations, which can qualify as S corporations, also called subchapter S corporations. This is because the S corporation rules are contained in Subchapter S of Chapter 1 of the Internal Revenue Code (IRC).

To qualify, the business must be "a small business corporation for which an election under section 1362(a) is in effect for such year." Under IRC § 1361(b)(1), in order to qualify as an S corporation and enjoy the benefit of tax exemption, a small business may *not*:

- Have more than 100 shareholders;
- Have as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual;

- Have a nonresident alien as a shareholder; and
- Have more than one class of stock (however, voting and nonvoting classifications within a class of stock are permitted).

Financial institutions and insurance companies are generally ineligible for S corporation status. S corporations are permitted to have **wholly owned subsidiaries** as long as the corporation owns 100% of the subsidiary S corporation's stock.

Undistributed corporate income must be treated as taxable income to the shareholders. (Such income is not treated as taxable income in a regular C corporation until it is actually **distributed** to shareholders, such as by cash dividends.) Shareholders are allowed to deduct net operating losses from their gross income, whereas shareholders in a standard corporation may not take such deductions.

The purpose of Chapter S incorporation is to allow relatively small, closely held businesses that would otherwise be organized as partnerships or limited partnerships to take advantage of the corporate form of business organization without being subjected to double taxation or to the formalities of corporate governance, such as annual meetings and **boards of directors**. Since S corporations were first recognized in 1958, the trend has been to expand the eligibility requirements, at least as related to the maximum number of allowed shareholders, which has been incrementally increased during the past two decades from 15 to 100.

Some states require corporations to file for Chapter S treatment with the state as well as with the federal government. After all, federal tax-exempt status does not automatically guarantee that a given state or city may not tax the corporation or apply different standards for income tax exemption under state and local law.

Chapter C Corporations

Corporations subject to taxation that do not elect S corporation status are referred to as **Chapter C corporations** under IRC § 1361(a)(2). A Chapter C corporation (or C corporation) is, broadly speaking, a large, publicly traded corporation that may have an unlimited number of shareholders, both domestic and foreign.

30.3 Corporate Formation

Corporations are formed in accordance with their state's business corporation act. Therefore, corporations can be formed only by complying with the relevant state statute that makes the corporate form of business organization possible. To begin a corporation, someone must first have an idea for a service or product. The people who form the initial group who aim to create a new corporation are called the **incorporators** (or sometimes the **promoters**) because they are usually the founders of the company and put up or help raise the money to begin the venture.

Preincorporation Activities

One way in which promoters raise money is through **stock subscriptions**. These are promises from third parties to purchase stock when the corporation comes into existence and, as such, are contracts (see [Unit III \(http://content.thurzelearning.com/books/AUBUS670.12.2/sections/unit03#unit03\)](http://content.thurzelearning.com/books/AUBUS670.12.2/sections/unit03#unit03), Contracts). Because promoters are acting on behalf of a nonexistent entity when they sell subscriptions, they are not held to be *agents* of the corporation; a corporation that is not yet in existence cannot be a *principal* and, thus, cannot consent to the agency (see [Chapter 27 \(http://content.thurzelearning.com/books/AUBUS670.12.2/sections/ch27#ch27\)](http://content.thurzelearning.com/books/AUBUS670.12.2/sections/ch27#ch27) for concepts of principal–agency law). What this means is that promoters are *personally liable* for any contracts they enter into on the future corporation's behalf *before* the corporation comes into existence. In most instances, this does not present a problem for promoters because the new corporation will *ratify* the contracts, thereby taking the promoters off the hook with regard to liability.

Nevertheless, there is an element of risk for promoters when they carry out their preincorporation duties because there is no guarantee that the board of directors of the company will ratify the promoters' contracts on the corporation's behalf. In fact, the corporation may never even be formed. In such cases, promoters can find themselves in the very uncomfortable position of retaining personal liability for contracts entered into on the corporation's behalf and monies extended on behalf of the corporation. They put themselves at risk as they fronted money for such necessary preincorporation activities as hiring lawyers, accountants, and other professionals to assist in getting the corporation off the ground; paying filing fees; and arranging commercial leases or employment contracts.

Once the promoters' initial groundwork for the corporation is completed, the promoters must select one or more persons to act as incorporators (alternatively, the promoters can act as incorporators themselves).

Articles of Incorporation

The incorporators are responsible for writing the Articles of Incorporation. This document forms the skeleton of the corporation by clearly outlining the following:

- The name for the corporation. Incorporators must meet two requirements in selecting a corporate name:
 1. With few exceptions, the name may not currently be in use by another corporation in the same state.
 2. The corporate name must include one of the following words in its title: *corporation*, *incorporated*, *company*, *limited*, or one of the following abbreviations for such words: *Corp.*, *Inc.*, *Co.*, or *Ltd.* (The abbreviation *Ltd.* is more commonly used in Great Britain and Canada; in those U.S. states that allow such an abbreviation, it means Inc.)
- The number of shares of stock that the corporation is authorized to issue;
- The address of the corporation's initial registered office and its initial registered agent at that office; and
- The name and address of each incorporator.

In addition to the above mandatory minimum information, Articles of Incorporation may contain some or all of the following types of information:

- The names and addresses of the individuals who are to serve as the initial directors;
- Provisions regarding the purpose of the corporation, its management, and its regulation;
- Limits on powers of the corporation or its board of directors and its shareholders;
- The par value of its authorized shares or **classes of shares**; and
- The imposition of personal liability on shareholders for the debts of the corporation.

Classes of shares refers to the types of shares of stocks that a corporation issues. For example, most corporations issue both common and preferred stock. **Preferred stock** gives its owners priority with regard to the distribution of dividends and a more elevated status if the corporation goes through bankruptcy. As you can see, the Articles of Incorporation have similar requirements to the certificate of limited liability. <https://content.ashford.edu/print/AUBUS670.12.2?sections=ch30,sec30.1,sec30.2,sec30.3,sec30.4,sec30.5,sec30.6,sec30.7,sec30.8,sec30.9,sec30.10,sec30.11,sec30.12,sec30.13,sec30.14,sec30.15,sec30.16,sec30.17,sec30.18,sec30.19,sec30.20,sec30.21,sec30.22,sec30.23,sec30.24,sec30.25,sec30.26,sec30.27,sec30.28,sec30.29,sec30.30,sec30.31,sec30.32,sec30.33,sec30.34,sec30.35,sec30.36,sec30.37,sec30.38,sec30.39,sec30.40,sec30.41,sec30.42,sec30.43,sec30.44,sec30.45,sec30.46,sec30.47,sec30.48,sec30.49,sec30.50,sec30.51,sec30.52,sec30.53,sec30.54,sec30.55,sec30.56,sec30.57,sec30.58,sec30.59,sec30.60,sec30.61,sec30.62,sec30.63,sec30.64,sec30.65,sec30.66,sec30.67,sec30.68,sec30.69,sec30.70,sec30.71,sec30.72,sec30.73,sec30.74,sec30.75,sec30.76,sec30.77,sec30.78,sec30.79,sec30.80,sec30.81,sec30.82,sec30.83,sec30.84,sec30.85,sec30.86,sec30.87,sec30.88,sec30.89,sec30.90,sec30.91,sec30.92,sec30.93,sec30.94,sec30.95,sec30.96,sec30.97,sec30.98,sec30.99,sec30.100>

partnership (see **Chapter 29**, <http://content.thuzelearning.com/books/AUBUS670.12.2/sections/ch29#ch29>). The required information serves a similar purpose: to give notice to the public at large of the existence of the corporation and to provide an agent on whom process can be served by anyone seeking to initiate legal action against the corporation.

The incorporators next send the Articles of Incorporation to the secretary of state's office in the state in which they wish to form their corporation. This is the state where the corporation is domesticated, or initially formed. The secretary of state examines the Articles and, if all is in order and accompanied by the appropriate filing fee, stamps and files them. At that moment, the corporation "comes into existence." A stamped copy of the Articles of Incorporation is then returned to the corporate office, along with a stamped receipt for the paid filing fee. The exact time of the corporation coming into existence is significant because it is only after it is in existence that it can have liability for corporate acts.

If the corporation's directors are named in the Articles of Incorporation, an organizational meeting is called by a majority of the directors. The primary purpose of this meeting is the appointment of corporate officers and adoption of the corporate **bylaws**—the internal rules governing the operation of the corporation. During this first meeting, the directors also typically ratify any contracts entered into on the corporation's behalf by the promoters, thereby relieving them of personal liability. In the event that the directors are not listed in the articles of incorporation, the majority of the incorporators call the organizational meeting. At this meeting, the first order of business is the appointment of directors by the incorporators. Once appointed, the directors appoint the corporate officers, adopt the corporate bylaws, and ratify the incorporators' preincorporation contracts on the corporation's behalf.

Defective Incorporation

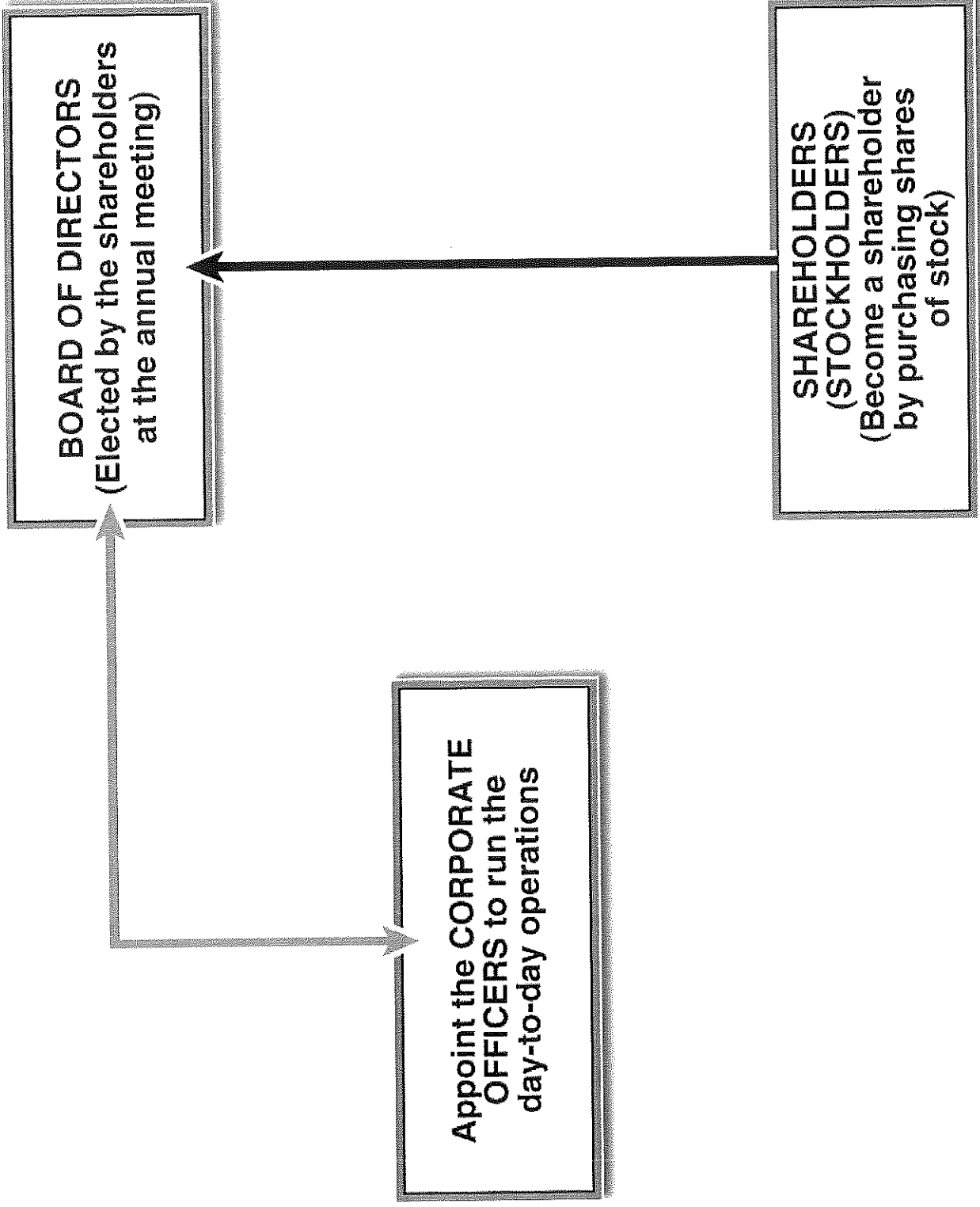
Given all the rules and paperwork surrounding the formation of a corporation, it is not unusual that mistakes are made. Sometimes, there is a defect in the Articles of Incorporation submitted for filing, for example. The problem could be something as simple as a typographical error or something as serious as fraud. If the corporation is correctly formed with no mistakes in the paperwork, then we say it is a **de jure corporation**, or a corporation by virtue of law. Sometimes a good-faith effort is made to comply with the law, but necessary information is negligently omitted from the Articles of Incorporation, such as an incorporator's address. The business enterprise will be considered a **de facto corporation**, or a corporation in fact, and treated as a valid corporation until such errors or omissions are legally corrected.

30.4 Management of the Corporation

The day-to-day operation of a corporation is carried out by **corporate officers**. The officers are elected by the board of directors, which is elected by the shareholders. Thus, one may argue that the shareholders hold the power, since ultimately they decide who is elected to the board. Figure 30.1 illustrates the management structure of the corporation.

Figure 30.1: Corporate management structure

The management structure of a corporation involves three groups, the shareholders, the corporate officers, and the board of directors. Shareholders are those who have purchased shares of stock. This group elects the board of directors, who oversee the corporation and set policy. The board of directors appoint corporate officers, who are responsible for running the day-to-day operations of the business.



Corporate Directors

Corporate officers carry out the day-to-day decisions of the corporation, but corporate directors are in charge of policy decisions. Should the corporation expand? Who should be the next president? Does the current plant in Indiana need to be refitted, or should a new one be built? Additionally, the board appoints the corporate officers, who run the business and who determine the fate of the business. Depending

on how they tackle these questions, the corporation will be profitable or not. If it is profitable, the shareholders will most likely be pleased and retain the members by voting them on to successive terms; if not, they will be voted out.

By law, corporate directors have a highly refined legal duty called a *fiduciary responsibility* (see **Chapters 9** (<http://content.thuzelearning.com/books/AUBUS670.12.2/sections/ch09#ch091>) and **27** (<http://content.thuzelearning.com/books/AUBUS670.12.2/sections/ch27#ch271>) for more on this topic) to the corporation they serve. As such, they must exercise their responsibilities in good faith and use reasonable care in their efforts to further the best interest of the corporation. Directors are personally liable to the corporation if they breach these duties.

In addition to having the right to vote for directors at the annual shareholders' meetings, shareholders can remove directors by calling a special meeting for that purpose at any time and then voting them out of office. The Articles of Incorporation can stipulate that removal be only for cause; however, if the Articles of Incorporation are silent as to removal of directors, then they can be removed with or without cause (e.g., with or without a valid reason).

The term of the first board of directors named in the Articles of Incorporation or by the incorporators expires at the first shareholders' meeting. After this initial term, the Articles of Incorporation can provide for staggered terms for board of directors members, such as two or three staggered groups that are as nearly equal in size as possible. If such a scheme is selected, the board members in the first group serve for one year, the members in the second serve for two years, and the third group serves for three years.

The board of directors of a corporation meets a few times a year to consider and vote on important policy decisions. The meetings may involve experts and corporate officers who meet with the directors and provide information on a specific topic. In this way, members of the board can be informed on matters. The board then votes, and an affirmative vote becomes an official action recorded in the corporate minutes. One question that arises is how informed board members have to be before they vote. The law holds them to a standard known as the "**business judgment rule**," which states that boards must make their decisions on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company. Failure to come up to this standard may result in individual liability for the directors.

Corporate Officers

Corporate officers are appointed by the board of directors and serve at the pleasure of the board. The specific duties of corporate officers can be set out in the corporate bylaws or prescribed by the board of directors. The board of directors, acting in a manner consistent with the corporate bylaws, can also appoint an officer to prescribe the duties of other officers. Like directors, officers serve in a fiduciary capacity: They must exercise their responsibilities in good faith, using reasonable care, and make a good-faith effort to further the best interests of the corporation.

The precise number and titles of corporate officers can be spelled out in the corporate bylaws, but every corporation must have a **secretary** or the equivalent: an officer whose duty it is to keep records of directors' and shareholders' meetings and to authenticate records of the corporation. A single person can act in various capacities as an officer, so it is possible to have one officer who acts as both president and secretary of the corporation. Some states, though, require there to be at least two corporate officers in every corporation (e.g., a president and a secretary) even if a single shareholder owns all the corporation's stock, as in some closely held corporations.

Shareholders

The owners of a corporation are its shareholders. Each shareholder owns a part of the corporation equal to the number of shares owned divided by the total number of shares issued and outstanding. As an example, if a corporation has 1,000 shares issued and outstanding and a shareholder owns 100 of those shares, he or she would own a one-tenth interest in the corporation.

Even though they are the corporation's owners, shareholders do not have the right to directly participate in the management of the company. Instead, they participate indirectly by voting for the board of directors at the annual shareholders' meetings. The responsibility for managing the corporation falls to the directors, who in turn hire corporate officers to implement their policies and manage the day-to-day operations of the corporate enterprise.

30.5 Special Types of Corporate Lawsuits

This section will discuss two unique situations involving corporate lawsuits, **derivative actions** and **piercing the corporate veil**.

Derivative Actions

Directors and officers of a corporation have the responsibility to manage and further the interests of the corporations they serve. When shareholders believe that corporate actions have damaged the corporation, or when management refuses to enforce the rights of the corporation in civil proceedings against third parties, one or more shareholders can seek to bring a *derivative action* on behalf of the corporation to recover civil damages.

Before a shareholder can begin a derivative action on behalf of the corporation, the corporation must be given notice and the opportunity to entertain the shareholder's demand. Under corporation law, 90 days are required to pass from the date that notice is given by the shareholder, or rejection of the demand by the corporation, before the derivative action can commence. If a corporation begins an inquiry into the allegations of the complaint, a court can stay the action for a time period it deems appropriate to allow the corporation to investigate and possibly address the substance of the complaint. If the derivative action continues and is successful, any proceeds obtained in the proceedings go to the corporation on whose behalf the suit was brought by the shareholder(s). For an example of how complex a derivative lawsuit involving a large multinational conglomerate is, see *In re the Dow Chemical Company Derivative Litigation* (<http://courts.delaware.gov/opinions/download.aspx?ID=132000>) (January 11, 2010).

After a derivative action finishes, a court can order the corporation to reimburse the reasonable costs of the suit, including attorney's fees, to the shareholder(s) who brought the derivative action if the proceedings result in a substantial benefit to the corporation.

Corporate Organization & Operation

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Piercing the Corporate Veil

If shareholders are to enjoy the limited liability offered by the corporate form of business organization, it is crucial that the separate entity status of the corporation be maintained. This means, for example, that shareholders are protected if there is a lawsuit against the corporation. There is, in effect, a shield protecting their personal assets; shareholders are liable up to the amount of their investment only.

Failure to comply with the formalities required of a corporation, however, can result in a court ignoring the corporate entity and holding its owners subject to unlimited personal liability for all corporate debt. A court will *pierce the corporate veil* in instances where it finds that a corporation has been created to defraud creditors, where corporate funds or property are not kept separate from those of its shareholders, or when required formalities (such as keeping minutes of directors' and shareholders' meetings) have been ignored.

The following are excerpts from one of the most famous cases involving a request to pierce the corporate veil.

Cases to Consider: *Walkovszky v. Carlton*

Walkovszky v. Carlton, 18 N.Y.2d. 414 (N.Y. Ct. App. 1966)

This case involves what appears to be a rather common practice in the taxicab industry of vesting the ownership of a taxi fleet in many corporations, each owning only one or two cabs.

The complaint alleges that the plaintiff was severely injured four years ago in New York City when he was run down by a taxicab owned by the defendant Seon Cab Corporation and negligently operated at the time by the defendant Marchese. The individual defendant, Carlton, is claimed to be a stockholder of 10 corporations, including Seon, each of which has but two cabs registered in its name, and it is implied that only the minimum automobile liability insurance required by law (in the amount of \$10,000) is carried on any one cab. Although seemingly independent of one another, these corporations are alleged to be "operated as a single entity, unit and enterprise" with regard to financing, supplies, repairs, employees and garaging, and all are named as defendants. The plaintiff asserts that he is also entitled to hold their stockholders personally liable for the damages sought because the multiple corporate structure constitutes an unlawful attempt "to defraud members of the general public" who might be injured by the cabs.

The law permits the incorporation of a business for the very purpose of enabling its proprietors to escape personal liability but, manifestly, the privilege is not without its limits. Broadly speaking, the courts will disregard the corporate form, or, to use accepted terminology, "pierce the corporate veil," whenever necessary "to prevent fraud or to achieve equity." In determining whether liability should be extended to reach assets beyond those belonging to the corporation, we are guided, as Judge Cardozo noted, by "general rules of agency." In other words, whenever anyone uses control of the corporation to further his own rather than the corporation's business, he will be liable for the corporation's acts "upon the principle of *respondent superior* applicable even where the agent is a natural person." Such liability, moreover, extends not only to the corporation's commercial dealings but to its negligent acts as well.

In the *Mangan* case (247 App. Div. 853, *mot. for lv. to app. den.* 272 N.Y. 676, *supra*), the plaintiff was injured as a result of the negligent operation of a cab owned and operated by one of four corporations affiliated with the defendant Terminal. Although the defendant was not a stockholder of any of the operating companies, both the defendant and the operating companies were owned, for the most part, by the same parties. The defendant's name (Terminal) was conspicuously displayed on the sides of all of the taxis used in the enterprise and, in point of fact, the defendant actually serviced, inspected, repaired and dispatched them. These facts were deemed to provide sufficient cause for piercing the corporate veil of the operating company—the nominal owner of the cab which injured the plaintiff—and holding the defendant liable. The operating companies were simply instrumentalities for carrying on the business of the defendant without imposing upon it financial and other liabilities incident to the actual ownership and operation of the cabs.

In the case before us, the plaintiff has explicitly alleged that none of the corporations "had a separate existence of their own" and, as indicated above, all are named as defendants. However, it is one thing to assert that a corporation is a fragment of a larger corporate combine which actually conducts the business. It is quite another to claim that the corporation is a "dummy" for its individual stockholders who are in reality carrying on the business in their personal capacities for purely personal rather than corporate ends. Either circumstance would justify treating the corporation as an agent and piercing the corporate veil to reach the principal but a different result would follow in each case. In the first, only a larger corporate entity would be held financially responsible while, in the other, the stockholder would be personally liable. Either the stockholder is conducting the business in his individual capacity or he is not. If he is, he will be liable; if he is not, then, it does not matter—insofar as his personal liability is concerned—that the enterprise is actually being carried on by a larger "enterprise entity."

The individual defendant is charged with having "organized, managed, dominated and controlled" a fragmented corporate entity but there are no allegations that he was conducting business in his individual capacity. Had the taxicab fleet been owned by a single corporation, it would be readily apparent that the plaintiff would face formidable barriers in attempting to establish personal liability on the part of the corporation's stockholders. The fact that the fleet ownership has been deliberately split up among many corporations does not ease the plaintiff's burden in that respect. The corporate form may not be disregarded merely because the assets of the corporation, together with the mandatory insurance coverage of the vehicle

which struck the plaintiff, are insufficient to assure him the recovery sought. If Carlton were to be held individually liable on those facts alone, the decision would apply equally to the thousands of cabs which are owned by their individual drivers who conduct their businesses through corporations organized pursuant to section 401 of the Business Corporation Law and carry the minimum insurance required by subdivision 1 (par. [a]) of section 370 of the Vehicle and Traffic Law. These taxi owner-operators are entitled to form such corporations and we agree with the court at Special Term that, if the insurance coverage required by statute "is inadequate for the protection of the public, the remedy lies not with the courts but with the Legislature." It may very well be sound policy to require that certain corporations must take out liability insurance which will afford adequate compensation to their potential tort victims. However, the responsibility for imposing conditions on the privilege of incorporation has been committed by the Constitution to the Legislature (N.Y. Const., art. X, § 1) and it may not be fairly implied, from any statute, that the Legislature intended, without the slightest discussion or debate, to require of taxi corporations that they carry automobile liability insurance over and above that mandated by the Vehicle and Traffic Law.

While the complaint alleges that the separate corporations were undercapitalized and that their assets have been intermingled, it is barren of any "sufficiently particularized" statements that the defendant Carlton and his associates are actually doing business in their individual capacities, shutting their personal funds in and out of the corporations "without regard to formality and to suit their immediate convenience." Such a "perversion of the privilege to do business in a corporate form" would justify imposing personal liability on the individual stockholders. Nothing of the sort has in fact been charged, and it cannot reasonably or logically be inferred from the happenstance that the business of Seon Cab Corporation may actually be carried on by a larger corporate entity composed of many corporations which, under general principles of agency, would be liable to each other's creditors in contract and in tort.

In point of fact, the principle relied upon in the complaint to sustain the imposition of personal liability is not agency but fraud. Such a cause of action cannot withstand analysis. If it is not fraudulent for the owner-operator of a single cab corporation to take out only the minimum required liability insurance, the enterprise does not become either illicit or fraudulent merely because it consists of many such corporations. The plaintiff's injuries are the same regardless of whether the cab which strikes him is owned by a single corporation or part of a fleet with ownership fragmented among many corporations. Whatever rights he may be able to assert against parties other than the registered owner of the vehicle come into being not because he has been defrauded but because, under the principle of *respondent superior*, he is entitled to hold the whole enterprise responsible for the acts of its agents.

In sum, then, the complaint fails short of adequately stating a cause of action against the defendant Carlton in his individual capacity.

The order of the Appellate Division should be reversed, with costs in this court and in the Appellate Division, the certified question answered in the negative and the order of the Supreme Court, Richmond County, reinstated, with leave to serve an amended complaint.

Read the full text of the case [here \(http://www.courts.state.ny.us/reporter/archives/walkovszky_carlton.html\)](http://www.courts.state.ny.us/reporter/archives/walkovszky_carlton.html).

Questions to Consider

1. Did the court decide to pierce the corporate veil?
2. What factors did the court say were necessary before the corporation lost its shield against personal liability?