

## INCORPORATION IN ONE STATE FOR BUSINESS: TO BE DONE IN ANOTHER.

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It is no new thing to form a corporation in one State to do business in another. But attention is now called to the practice by the frequent incorporation of existing industrial enterprises with the purpose of permitting the public to share therein. For it seems to be the rule rather than the exception, in such cases, to incorporate under the laws of a State other than that in which the business is to be carried on. A business already in successful operation has an established home ; so that, if the public advertisement by which subscriptions are invited to the stock of a corporation which has taken the business over, states under what laws the company is incorporated, as it usually does, it is made at once apparent whether incorporation has been obtained at the natural home of the business or not.

The common practice seems to be, after the plan has been determined, to look about for a State whose corporation laws fit the purposes of the plan. The preference is, perhaps, given to the State where the business is located. But if the laws of that State do not allow a large enough capitalization, do not provide for preferred stock, (if that is desired,) put too much liability upon stockholders, are burdensome as to taxation, or are otherwise unsatisfactory, a suitable source of corporate life is found elsewhere, without much regard to the location of the property and business. And undoubtedly many an enterprise has acquired corporate character from a State in which no business is expected to be done, in which none of the persons interested reside, which has and is expected to have no relation to the enterprise except that the corporation is created by and exists under its laws.

It has been suggested that such incorporation is "a fraud upon the law." Mr. Ernst, in an article published in the *American Law Review* for May-June, 1891, seems to find such a suggestion in the case of *Montgomery v. Forbes* (148 Mass. 249), or rather

in the tendency of the court as shown in that case. Chancellor Williamson, in 1858, suggested the same thing in *Hill v. Beach*, 12 N. J. Eq. 352. It has been several times, but unsuccessfully, urged before the Supreme Court of Ohio (see *Hanna v. Petroleum Co.*, 23 Ohio St. 352; *Newburg Petroleum Co. v. Weare*, 27 Ohio St. 352; *Bank v. Hall*, 35 Ohio St. 158). And the idea has quite lately found favor with the Supreme Court of Texas (*Empire Mills v. Alston Grocery Co.*, 12 Lawyers Rep. Ann. 366).

“A fraud upon the law”—this is a high-sounding, even an awe-inspiring phrase. But much of its power lies in the uncertainty of its meaning. There can be no fraud unless there be somebody defrauded. “A fraud upon the law” must mean a fraud upon the State,—as applied to the case in hand, either the incorporating State or the State where the business of the corporation is to be done. And if there is any fraud upon either it is important to understand which State is affected by it in order to decide as to the remedies applicable.

As to the incorporating State—the first thought which arises is, that it is difficult to see any damage resulting. Fraud without damage presents no question either for courts or legislatures. The incorporating State gains by whatever taxes it receives from the corporation. What possible injury can it receive from the corporate existence? But there is no fraud, no wrongful use of the statutory privilege of incorporation, if the statutes, properly construed, permit such incorporation. If the meaning of the statutes is that persons may obtain incorporation, without regard to the residence of the real associates or the place where the business is to be done, there certainly can be no question of fraud with respect to the incorporating State. And such is the meaning, as a rule, of the general laws for the creation of manufacturing and business corporations in the United States. Sometimes a limited number of residents is required among the incorporators or the directors, and these requirements must be complied with. But these requirements are not evidence of a general intent to limit the benefit of the acts to citizens of the State—rather the contrary. And it is doubted whether there be any such law which is intended to apply only when the business is to be done in the State.

Even in the rare cases in which incorporation has been obtained contrary to the intention of the statutes by false statements in the certificates, the effect of the fraud is limited. The Massachusetts case above referred to was decided upon the ground that the law had not been complied with and that incorporation had not been obtained. But whether the reasoning of that case is correct or

not—such an instance must be very rare. If incorporation has been obtained, it can be annulled only at the instance of the incorporating State. Fraud does not of itself avoid; it only gives the right to avoid, and such right it gives only to the party defrauded and privies. It would seem, therefore, that if such incorporation is in any case a fraud upon the law of the incorporating State, the incorporation stands and is open to no attack save at the instance of that State and in its courts.

Is there, then, in such case any "fraud upon the law" of the State where the business is to be done? It is submitted that, in the nature of things there cannot be, because incorporation in one State gives no rights in any other. The legislation of a State reaches only within its boundaries. A corporation created in one State has no *right* to do business in another. It is generally allowed to do so by comity. But the rules of comity may be altered at pleasure. One State by incorporating a company to do business in another does no more than to permit the company, as a corporation of its creation, to *seek* admission into that other State. It lies with the other State to say whether admission shall be granted or not. If one tells his boy he may ask a neighbor to let him go on his premises, he does not affect the rights of that neighbor. It is no fraud upon the law (to use the language of the Supreme Court of Kansas in *Land Grant Ry. Co. v. Com'rs*, 6 Kan. 245) for "one State to spawn corporations and send them forth into other States to be nurtured and do business there," because the other States have a perfect and undoubted right to say whether they shall be nurtured or do business therein or not.

And so, it is submitted, that the suggestion that such corporation is "a fraud upon the law," is substantially barren.

At the same time, it is evident, in a general way, what is the remedy for the evil, if it be such, in this practice. The State in which the business is done may say whether it shall be done there or not, no matter what the provisions of the charter, obtained in another State may be. The inquiry is open in the courts of the former State, whether it is in accordance with the State policy as shown generally by its laws, to admit such foreign corporation by comity to do business within its borders. And that is really the inquiry upon which several of the cases suggesting "fraud upon the law" have turned. It seems to be the vital question in the Texas case, in the Kansas case, and in the New Jersey case, above referred to. With the validity of the incorporation, in each of those cases, the courts had really nothing to do. Whatever the rights of the corporation at home might be, the question was whether under

the rules of comity as then established, it had the right to do business in the other State. The law and policy of the latter State must determine this. And, if it be found that the rules of comity in any State admit corporations organized only to do business away from home, it is a proper question for the legislature of that State, whether the rules of comity should be changed. What should be emphasized, it seems, is that whether the question be, as it arises in the courts, what the status of such corporations outside of their domicile *is*, or, as it may come before the legislatures, what their status there *should be*, the rules of comity are the only principal subject for consideration. If this is generally recognized, there will be less confusion in the decisions and less probability of error in legislation.

Two lines of thought lead out from what has been said, both interesting and important, but which can only be briefly suggested within the limits of this article. The first brings up questions of policy, whether the rules of comity should be so modified as to prevent or restrict or regulate the practice referred to; what principles should determine the attitude of the State to foreign corporations, especially to those created in other States of the Union. The benefits of the admission of foreign corporations are forcibly commented upon in the opinion of the Court of Appeals of New York in the case of *Merrick v. Van Santvoord*, 34 N. Y. 208. It may not be inconsistent with the views there expressed for the State of New York, for example, to deny admission to corporations formed outside of that State but by its citizens and to do business within its borders. But it is quite obvious that before legislating to thus limit the broad rule of comity to which New York owes so much of its prosperity, the reasons for so doing should be carefully canvassed, and that if there is an evil, which requires a remedy, the utmost care and wisdom will be needed to so frame the remedy that it shall be confined in its operation to cases really within its purpose. It would be very easy to injure the tree in trying to cut off what may seem to be an excrescence.

The other line of thought is upon the question of law, what is the legal effect when corporate business is done in a State into which, by the rule of comity there prevailing, the corporation is not admitted. The Texas case before referred to seems to hold that in such case the business is in effect done by a partnership, the stockholders incurring liability as partners. This conclusion seems to be taken in the opinion as settled by authority. Expressions to this effect are found in the text-books and perhaps in some of the cases cited, but none of these cases distinctly so holds.

These questions are live ones ; they are worthy of careful consideration. It is easy to suggest a method by which their importance in this country might, with great advantage, be reduced to a minimum ; that is, by the adoption of a uniform law for the creation and regulation of business corporations throughout the United States. But this is not likely to come soon. The tendency of thought to-day seems to be somewhat in the opposite direction — towards a rivalry among the States as to which can offer incorporation in most attractive form. From such rivalry so much of evil and confusion may result, that in time a uniform law may be recognized as a necessity. But there will be time enough for plenty of thinking upon the questions herein suggested, before they are in this way removed or reduced to little importance.