

1977

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Recommended Citation

(1977) "Corporations—Piercing the Corporate Veil—Manufacturers Building, Inc. v. Heller, _____ Minn. _____, 235 N.W.2d 825 (1975)," *William Mitchell Law Review*: Vol. 3: Iss. 1, Article 13.

Available at: <http://open.mitchellhamline.edu/wmlr/vol3/iss1/13>

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Corporations—PIERCING THE CORPORATE VEIL—*Manufacturers Building, Inc. v. Heller*, ___ Minn. ___, 235 N.W.2d 825 (1975).

In the recent case of *Manufacturers Building, Inc. v. Heller*,¹ the Minnesota Supreme Court pierced a corporate veil, but failed to elucidate clearly the theory that justified its decision, thereby creating possible confusion in the Minnesota law on disregard of corporateness. After disregarding the corporate entity, the court held that the corporation would be treated as a partnership; that the partners owned the partnership property, a building, as tenants in common; and that the defendant did not breach his fiduciary duty owed to the partnership and his fellow partners. This comment will explore the basis the court used to disregard the corporate entity of *Manufacturers Building, Inc.*, and thereafter will examine the partnership law the court applied upon that disregard.

In *Heller*, four purchasers of a building created a de jure corporation to manage the building. Defendant, Heller, who owned fifty percent of the building corporation, controlled another corporation that was a tenant in the building. When his own business suffered severe financial difficulties, defendant failed to pay rent to the plaintiff building corporation. After unlawful detainer proceedings were commenced to remove defendant, he filed a petition under the Federal Bankruptcy Act² and thereby suspended the unlawful detainer action. Plaintiff-lessor corporation therefore faced the prospect of no rent for a year because of an act of its own shareholder. Another shareholder in plaintiff corporation commenced a shareholder derivative action against Heller, seeking to hold him personally liable for the loss of rent. The trial court found that the plaintiff corporation was acting merely as “an agent or conduit” for the handling of accounts for the building, and the supreme court agreed,³ allowing the disregard of *Manufacturers’* corporate entity because it was “simply a convenient depository and conduit for rentals.”⁴

While the Minnesota corporate disregard law is not entirely clear or well-established,⁵ the court generally has pierced only in cases involving

1. ___ Minn. ___, 235 N.W.2d 825 (1975).

2. BANKRUPTCY ACT § 11, 11 U.S.C. § 29 (1970).

3. The court also affirmed the trial court’s order for an accounting and award of damages on Heller’s counterclaim against the other shareholders for half of the net profits of the partnership business generated during the period the unlawful detainer action was stayed.

4. ___ Minn. at ___, 235 N.W.2d at 827.

5. Minnesota cases which discuss disregard of corporateness include: *United States v. Martin*, 337 F.2d 171, 175 (8th Cir. 1964) (disregard allowable upon showing of no legitimate business purpose; disregard not granted); *Hudson Minneapolis, Inc. v. Hudson Motor Car Co.*, 124 F. Supp. 720, 723 (D. Minn. 1954) (court will ignore corporate fiction when circumstances require, such as when it is used to justify wrong or perpetrate fraud; disregard not granted); *In re Burntside Lodge, Inc.*, 7 F. Supp. 785, 787 (D. Minn. 1934)

fraud.⁶ In *Heller*, however, no fraud or other inequitable conduct affecting third parties was established.⁷ The court's decision to pierce was based primarily on evidence that no corporate dividend had ever been declared and that the corporation had filed at least one partnership income tax return. However, Minnesota corporations generally are not required to pay dividends⁸ and the only partnership income tax return admitted into evidence was filed after the commencement of the litigation.⁹ While this reliance on evidence of lack of some corporate formalities, without a showing of fraud, suggests a departure from existing Minnesota corporate disregard law,¹⁰ *Heller* actually can be interpreted

(courts of equity will ignore corporate fiction when it is used as instrumentality to defeat rights of creditors, justify wrong, or perpetrate fraud); *Ahlm v. Rooney*, 274 Minn. 259, 264, 143 N.W.2d 65, 69 (1966) (single shareholder corporations are allowable and cannot be disregarded on that basis); *General Underwriters, Inc. v. Kline*, 233 Minn. 345, 349-50, 46 N.W.2d 794, 797 (1951) (courts will not allow corporate entity prevent judgment otherwise required); *Whitney v. Leighton*, 225 Minn. 1, 8, 30 N.W.2d 329, 333 (1947) (in absence of fraud corporation must be treated as separate legal entity from its shareholders); *Central Motors & Supply Co. v. Brown*, 219 Minn. 467, 469, 18 N.W.2d 236, 237 (1945) (court may disregard corporate entity when it is dominated and controlled by individual who made use of corporate entity to conceal his property from his creditors); *Erickson-Hellekson-Vye Co. v. A. Wells Co.*, 217 Minn. 361, 381-82, 15 N.W.2d 162, 173 (1944) (dictum) (where individual owns all, or practically all, stock in corporation, corporation and individual will be regarded as one and the same if the equities so require); *State v. McBride*, 215 Minn. 123, 130-31, 9 N.W.2d 416, 420 (1943) (corporation cannot be used as shield from personal responsibility for unlawful criminal activity); *In re Will of Clarke*, 204 Minn. 574, 578, 284 N.W. 876, 878 (1939) (courts will not let interposition of corporate entity prevent judgment otherwise required); *Matchan v. Phoenix Land Inv. Co.*, 159 Minn. 132, 138, 198 N.W. 417, 420 (1924) (where individual has incorporated himself to hinder, and if possible, defraud creditors, courts may disregard corporateness if necessary to accomplish justice).

6. *E.g.*, *Whitney v. Leighton*, 225 Minn. 1, 8, 30 N.W.2d 329, 333 (1947); *Central Motors & Supply Co. v. Brown*, 219 Minn. 467, 469, 18 N.W.2d 236, 237 (1945); *Matchan v. Phoenix Land Inv. Co.*, 159 Minn. 132, 138, 198 N.W. 417, 420 (1924). *But see In re Will of Clarke*, 204 Minn. 574, 578-79, 284 N.W. 876, 878 (1939) (courts technically never disregard corporateness, but only consider presence of corporation as one factor in deciding whether individual should be held personally liable). The concept of fraud in disregard law embodies both actual common-law fraud and other improper shareholder conduct technically not meeting all the requirements of a fraud cause of action. *See* 1 W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 44 (rev. perm. ed. 1974) [hereinafter cited as W. FLETCHER] (actual or constructive fraud); Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 HARV. L. REV. 505, 544 (1977) ("soft-core" fraud).

7. The court did discuss whether fraud was present, but only in conjunction with the issue of whether *Heller* breached his fiduciary duty to the corporation. *See* ____ Minn. at ____, 235 N.W.2d at 827.

8. *See, e.g.*, *Keough v. St. Paul Milk Co.*, 205 Minn. 96, 117-18, 285 N.W. 809, 821 (1939).

9. Copies of income tax returns prior to 1966 (when litigation commenced) were not available. *See* Brief for Appellants at 29-30. In 1967, a United States Partnership Return of Income (Form 1065) was filed. *See* Brief for Respondent at 17.

10. *See Whitney v. Leighton*, 225 Minn. 1, 4-9, 30 N.W.2d 329, 331-33 (1947).

as adding a new dimension to the doctrine because of the absence of third party involvement. In *Heller*, the defendant was not a third party creditor, but rather was an insider of the plaintiff corporation. Although not expressed by the *Heller* court, this distinction provides the justification for its withdrawal from the fraud or improper conduct bases of earlier decisions. A little-used disregard theory, which has been termed the "internal dealings" rule,¹¹ has been applied by some courts in cases where the dispute is between individual shareholders of a close corporation where the interests of third parties are not involved.¹² In such cases, the courts have ignored the existence of the corporate entity and have treated the shareholders as partners.¹³ The rationale of the internal dealings rule apparently is that, as against third parties, shareholders of a close corporation are allowed limited liability unless the corporate form is used as an instrument for fraud, but when the litigation is between corporate insiders, who have failed to observe the formalities incident to that form, it is not unreasonable for the courts to treat them as they have treated themselves.¹⁴

At least one court in another jurisdiction has applied the internal dealings rule to facts similar to those in *Heller*, holding that where tenants in common of real estate create a corporation to manage the common property with equal division of stock, the corporate form may be disregarded in a controversy between them.¹⁵ That same court, however, also required a clear demonstration that the rules of corporate conduct had been violated.¹⁶ Under this holding, *Heller* can be justified because some evidence was presented indicating that the corporate formalities were not strictly followed.

If *Heller* is viewed as an internal dealings case, the ease with which the court pierced Manufacturers' corporate form then should not be taken as precedent in cases involving third parties attempting to hold shareholders liable for corporate debts. In such cases, the fraud basis

11. See 1 W. FLETCHER, *supra* note 6, § 46.

12. See, e.g., *Urnest v. Forged Tooth Gear Co.*, 102 Ill. App. 2d 178, 186, 243 N.E.2d 596, 601 (1968) (where interests of third parties are not involved, corporate entity may be disregarded to adjudicate what is in reality only dispute between individual members); *Siegel v. Ribak*, 43 Misc. 2d 7, 13, 249 N.Y.S.2d 903, 908-09 (Sup. Ct. 1964). An earlier Minnesota case, *Walsh v. Mankato Oil Co.*, 201 Minn. 58, 275 N.W. 377 (1937), can be viewed as having applied a type of internal dealings rule. In *Walsh*, the dispute was between the sole shareholder and an employee who was promised corporate stock. The court held that the agreement was between the two individuals and the corporate entity could not be used to protect the defendant from personal liability.

13. See, e.g., *In re Oswald's Estate*, 20 Misc. 2d 1001, 1007, 189 N.Y.S.2d 472, 479 (Sur. Ct. 1959); *Gamer Paper Co. v. Tuscany*, 264 S.W. 132, 135 (Tex. Ct. App. 1924).

14. See generally 1 W. FLETCHER, *supra* note 6, § 46.

15. *Cleveland-Cliffs Iron Co. v. Arctic Iron Co.*, 261 F. 15 (6th Cir. 1919), *cert. denied*, 251 U.S. 558 (1920).

16. *Id.* at 18.

expressed in prior Minnesota cases is probably still applicable. The internal dealings rule, however, is a liberal expansion of the disregard doctrine¹⁷ and therefore its use should be limited to cases where the facts demonstrate clearly that corporate formalities have not been observed and the rights of third parties are not at issue.

The balance of the court's opinion in *Heller* dealt with partnership asset ownership and the fiduciary duties of partners. When the corporate entity was dissolved, the court stated that "[t]he practical effect of their relationship was to make them partners and tenants in common of the building."¹⁸ While the general rule is that a partnership relationship is created upon the successful disregard of a corporate entity,¹⁹ the court's statement cannot be read to suggest that partners hold partnership realty as tenants in common. Under the Uniform Partnership Act, when a partnership owns property, the partners own the property as tenants in partnership,²⁰ not as tenants in common,²¹ and their rights in the property are defined by the Act. However, in *Heller*, although not stated in the court's opinion, Manufacturers did not own the realty but was formed only to manage it, and therefore it was not partnership property. Prior to the organization of Manufacturers, the shareholders had purchased the property personally and owned it as tenants in common.²² Consequently, *Heller* is not in conflict with the Uniform Partnership Act rule concerning tenancy in partnership.

The court also found that Heller had a right to petition for bankruptcy, despite his fiduciary duties to his fellow partners.²³ A fiduciary

17. See 1 W. FLETCHER, *supra* note 6, § 46 (under this rule, entity can be disregarded more readily than under other disregard theories).

18. ___ Minn. at ___, 235 N.W.2d at 827.

19. See, e.g., *Metropolitan Holding Co. v. Snyder*, 79 F.2d 263, 266 (8th Cir. 1935). See generally H. HENN, *HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES* § 147 (2d ed. 1970). Similarly, it is uniformly held that if the corporation fails to achieve de facto status, the associates are treated as partners. E.g., *Finnegan v. Noerenberg*, 52 Minn. 239, 243-44, 53 N.W. 1150, 1151 (1893). See generally *Carpenter, Are the Members of a Defectively Organized Corporation Liable as Partners?*, 8 MINN. L. REV. 409 (1924).

20. See MINN. STAT. § 323.24 (1976).

21. E.g., *Kraus v. Kraus*, 250 N.Y. 63, 67, 164 N.E. 743, 744 (1928) (Cardozo, C.J.) ("plaintiff was not tenant in common, but 'tenant in partnership'"). See generally Comment, *Partnership Realty and Its Treatment Under the Uniform Partnership Act*, 19 MD. L. REV. 141 (1959).

22. See Brief for Respondent at 3; Brief for Appellants at 4. *But see* ___ Minn. at ___, 235 N.W.2d at 826 ("four purchasers formed a corporation . . . to take title to the Ressler Building").

23. ___ Minn. at ___, 235 N.W.2d at 827. This finding makes the court's decision to pierce the corporate veil troublesome. Because the fiduciary duties owed by corporate officers are similar, and in most cases identical, to those owed by partners, compare *Minnesota Loan & Trust Co. v. Peteler Car Co.*, 132 Minn. 277, 282-83, 156 N.W. 255, 257 (1916) (corporate fiduciary duties) with *Lipinski v. Lipinski*, 227 Minn. 511, 518, 35

obligation which imposes a duty of care, loyalty, good faith, and full disclosure clearly attaches to the partnership relationship.²⁴ The latter duty requires full and frank disclosure of all matters affecting the partnership entity,²⁵ and it presumably was satisfied in this case because Heller discovered financial difficulties in April and notified his copartners of that fact in May.²⁶ In addition, Heller was entitled to do business with the firm and the trial court found no evidence indicating a breach of trust, fraud, or misconduct.²⁷ Consequently, Heller apparently did act in good faith and at arm's length and therefore could properly bring the bankruptcy action without breaching his duties to the partnership or his fellow shareholder-partners.

Domestic Relations—ALIENATION OF AFFECTIONS—*Gorder v. Sims*, ___ Minn. ___, 237 N.W.2d 67 (1975).

Some call it legalized "blackmail";¹ others find it to be an anachronism in contemporary society;² still others believe it prevents intrusion into the "special relationship which exists between a husband and wife."³ This last view describes the recent posture of the Minnesota Supreme Court in affirming a \$20,000 jury award for the tort of alienation of affections in *Gorder v. Sims*.⁴ The court, by its dual acts of affirming a substantial jury award of damages and possibly lessening the proof required to establish the tort, has ripened this cause of action for renewed legislative attack.

In *Gorder*, a husband sued for the loss of his wife's affections which

N.W.2d 708, 712 (1949) (partnership fiduciary duties), the *Heller* court could have reached the conclusion that the defendant did not breach his fiduciary duty without piercing the corporate veil.

24. See *Lipinski v. Lipinski*, 227 Minn. 511, 518, 35 N.W.2d 708, 712 (1949); *Bloom v. Lofgren*, 64 Minn. 1, 2, 65 N.W. 960, 961 (1896). See generally Note, *Fiduciary Duties of Partners*, 48 IOWA L. REV. 902 (1963).

25. See, e.g., *Crawford v. Lugoff*, 175 Minn. 226, 228, 220 N.W. 822, 823 (1928). MINN. STAT. § 323.19 (1976) requires full disclosure "on demand." However, because the law of agency supplements the U.P.A., MINN. STAT. § 323.04 (1976), the disclosure requirement is not restricted to demand. *Accord*, *Alexander v. Sims*, 220 Ark. 643, 651, 249 S.W.2d 832, 836 (1952) (each partner has right to know all that others know and each is required to make full disclosure of all material facts within his knowledge).

26. ___ Minn. at ___, 235 N.W.2d at 826.

27. *Id.*

1. See, e.g., ILL. STAT. ANN. ch. 68, § 34 (Smith-Hurd 1959) ("action for alienation of affections has been subjected to grave abuses and has been used as an instrument for blackmail by unscrupulous persons for their unjust enrichment").

2. See, e.g., *Moulin v. Monteleone*, 165 La. 169, 176-78, 115 So. 447, 450 (1928) (court refused to recognize alienation of affections as a cause of action); *Wyman v. Wallace*, 15 Wash. App. 395, 549 P.2d 71 (1976) (per curiam) (judicial abolition of the tort).

3. See *Gorder v. Sims*, ___ Minn. ___, ___, 237 N.W.2d 67, 71 (1975).

4. ___ Minn. ___, 237 N.W.2d 67 (1975).