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Use of Corporate Entity to Evade Contractual Obligations. Scott v. McReynolds[1] afforded the Court of Appeals an opportunity to pierce the corporate veil. Plaintiff and defendant McReynolds were partners in the business of selling butane-propane gas and appliances. In a contract dissolving the partnership, McReynolds agreed not to sell gas or appliances within a specified area. Shortly thereafter, the other defendant, a corporation, was formed, and it sold gas within the exempted area in competition with plaintiff. McReynolds was president of the defendant corporation, was actively engaged in the business and was a "prime mover in the organization of the corporation." He owned 49 of the 100 shares of its capital stock and together with his wife owned one-half of the entire stock. In a suit to enjoin McReynolds and the corporation, one defense was that the corporation was not bound by the contract in which McReynolds agreed not to compete. The Court of Appeals affirmed an injunction running against both McReynolds and the corporation.

While a corporation has a personality separate and distinct from that of its shareholders, the corporate entity privilege may not be used for the purpose of evading contractual obligations.[2] Thus, if *A* agrees not to compete with *B* in order to protect *B* in the purchase of the good will of *A*'s business and *A* then organizes a corporation for the purpose of conducting the same business under a corporate name, the separate entity concept of the corporation will not insulate it from liability for breach of *A*'s contract.[3] In the Massachusetts case of *Berry v. Old South Engraving Co.*,[4] a corporation, to escape a closed shop agreement, was dissolved, and another corporation with the same shareholders and directors was formed. The court held that the new corporation was not bound by the closed shop agreement of its predecessor. That decision brought forth some very caustic criticism from the leading authority in the field of corporation law, Professor Ballentine. He commented: "In most jurisdictions such a bare-faced evasion of a contractual obli-

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1. 255 S.W.2d 401 (Tenn. App. M.S. 1952).
2. See BALLENTINE, CORPORATIONS § 130 (Rev. ed. 1946).
3. Blank v. Olcovich Shoe Corp., 20 Cal. App.2d 456, 67 P.2d 376 (1937); Arctic Dairy v. Winans, 267 Mich. 80, 255 N.W. 290 (1934); Kramer v. Old, 119 N.C. 1, 25 S.E. 813 (1896); Dairy Co-operative Ass'n v. Brandes Creamery, 147 Ore. 488, 30 P.2d 338 (1934); *cf.* National Labor Relations Board v. Hopwood Retinning Co., 104 F.2d 302 (2d Cir. 1939).
4. 283 Mass. 441, 186 N.E. 601 (1933). *But cf.* Packard Clothes, Inc. v. Director of the Division of Employment Security, 318 Mass. 329, 61 N.E.2d 528 (1945), where employment law benefits which had accrued to an individual also accrued to a subsequently formed corporation.

gation by the formation of a corporation to carry on the same business would be regarded as a mere subterfuge and the abuse of the separate corporate entity would be prevented."[5] Professor Ballentine's observation seems entirely applicable to the conduct of the defendants in the case at hand, and the overwhelming weight of authority supports the Court in its decision.[6]

Ultra Vires Contracts. In *Buice v. Scruggs Equipment Co.*,[7] the Tennessee Supreme Court had something to say about the law of *ultra vires* contracts made by a corporation. Keen and Scruggs, the two owners of all the outstanding stock in Scruggs Equipment Co., had a disagreement, and it was decided that one should buy the other out. Keen and the plaintiff, an employee of Scruggs Equipment Co., entered into an oral agreement whereby Keen, speaking for himself and the Scruggs Equipment Co., promised plaintiff a certain contract if plaintiff would assist Keen in purchasing the stock of the Scruggs Equipment Co. and in conducting the business of the Company in the event Keen bought out Scruggs. The contract which Keen promised plaintiff included, among other things, a promise to let plaintiff have a certain number of shares of Scruggs Equipment Co. stock. Plaintiff remained with the Company, helped Keen buy the shares of the Company, helped retain certain accounts and assisted in reorganizing the business. Plaintiff thus carried out his part of the bargain, and Keen got the shares of the Company, except a certain number of shares which the Company kept. Then the Company and Keen refused to deliver the promised shares to plaintiff, who sued both for breach of contract. A demurrer to the plaintiff's bill of complaint interposed several defenses, which included the defense that the contract was *ultra vires* and void. The trial court sustained the demurrer and dismissed the bill.

In reversing the lower court, the Supreme Court held that, since the corporation accepted the benefits of the performance of the contract by plaintiff, the contract was not void. The Court thought that perhaps the contract was not *ultra vires* at all because of Keen's relationship to the corporation, but that, even if it were *ultra vires* in its inception, it had become enforceable by reason of plaintiff's performance.

In view of the very broad statutory grant of power given to ordinary domestic corporations in Tennessee, the contract under which plaintiff assisted in managing and reorganizing the defendant corporation in exchange for the promise to sell him stock appears not to be a transaction beyond the actual authority of the directors and representatives of the corporation under the charter contract so as to warrant the con-

5. BALLENTINE, CORPORATIONS § 130 (Rev. ed. 1946).
6. See authorities cited in notes 2 and 3 *supra*.
7. 250 S.W.2d 44 (Tenn. 1952). See the discussion of another aspect of this case in the section on the Statute of Frauds in the Personal Property and Sales article.

demnation of *ultra vires*.[8] After setting forth a wide compass of powers granted to corporations, the Tennessee statute concludes with this sweeping grant:

> "To do all and everything necessary and proper for the accomplishment of the objects enumerated in its certificate of incorporation or any amendment thereof, or necessary or incidental to the protection and benefit of the corporation, and in general to carry on any lawful business necessary or incidental to the attainment of the objects of the corporation, whether or not such business is similar in nature to the objects set forth in the certificate of incorporation of such corporation or any amendment thereof. . . ."[9]

Instead of a strictly *ultra vires* transaction, the *Buice* Court may have been thinking of a contract which is apparently within the authorized scope of the corporation's business but is actually unauthorized by reason of extrinsic facts, such as the lack of authority of Keen to represent the corporation. Such acts are not necessarily *ultra vires;* they may be within the power of the corporation but not within the power of the officers.[10] While the courts often refer to such contracts as *ultra vires,* all that is meant is that the particular officer had no power to make the contract.[11] In this class of cases, the question is merely one of agency, and the decisions are governed by rules relating to agency. Consequently, an estoppel to plead the officer's lack of authority may arise where the other party to the contract is ignorant of the extrinsic facts rendering the contract unauthorized.[12] Moreover, in the present case, any question of lack of authority of Keen to make the contract as an agent of the corporation seems to be completely eliminated by reason of the fact that the corporation could be said to have ratified the contract, even if it were outside of Keen's authority. Keen was the sole shareholder, and he could be said to have ratified, assented to, or acquiesced in the contract by receiving the performance of plaintiff.[13]

Perhaps a word should be said concerning the observations of the Court relative to the consequences which flow from an *ultra vires* contract. Where an *ultra vires* contract is executory on one side only,

8. For authority for this meaning of *ultra vires,* as well as for a discussion of the varied meanings of that term, see State v. Holston Trust Co., 168 Tenn. 546, 557, 79 S.W.2d 1012, 1016 (1934); BALLENTINE, CORPORATIONS §§ 83, 89 (Rev. ed. 1946); 7 FLETCHER, CORPORATIONS § 3399 (Perm. ed., Jones, 1931).

9. TENN. CODE ANN. § 3722 (Williams 1934). As illustrative of the broad scope of powers granted, see Nashville Breeko Block Co. v. Hopton, 29 Tenn. App. 394, 196 S.W.2d 1010 (M.S. 1946), where a corporation organized to manufacture blocks had power to build houses to demonstrate the blocks.

10. See Charles A. Hill & Co. v. Belmont Heights Baptist Church, 17 Tenn. App. 603, 611, 69 S.W.2d 612, 617 (M.S. 1933); 7 FLETCHER, CORPORATIONS § 340 (Perm. ed., Jones, 1931); *cf.* State v. Holston Trust Co., 168 Tenn. 546, 557, 79 S.W.2d 1012, 1016 (1934).

11. 7 FLETCHER, CORPORATIONS § 3401 (Perm. ed., Jones, 1931).

12. BALLENTINE, CORPORATIONS § 97 (Rev. ed. 1946); 7 FLETCHER, CORPORATIONS, §§ 3548-3553 (Perm. ed., Jones, 1931).

13. Martin v. Niagara Falls Mfg. Co., 122 N.Y. 165, 25 N.E. 303 (1890); BALLENTINE, CORPORATIONS § 101 (Rev. ed. 1946).

having been fully performed on the other, Tennessee has been classified with that minority view which will not permit an action *on the contract* against the corporation and which holds that the obligation, if any, is quasi-contractual for the value of what has been received under the contract.[14] The majority view, on the other hand, holds that, when a contract with a corporation which is merely *ultra vires* has been fully executed by one of the parties so that the other party has received benefits under it in either money, property or services, the party who has performed may maintain an action upon the contract and the other party cannot defeat the action by pleading that the contract is *ultra vires*.[15] Under this majority view, the one who has received benefits by the other party's full performance is said to be estopped to raise the defense of *ultra vires* to an action on the contract. It is noteworthy that in the *Buice* opinion the Tennessee Court spoke of the contract itself becoming "enforceable." Perhaps Tennessee is lining up with the majority of courts to permit an action on the contract itself where one side has fully performed rather than limiting the remedy to a quasi-contractual recovery for the money paid or loaned or the value of the property delivered or services rendered under the contract.[16]

14. Dillard & Coffin Co. v. Oil Co., 140 Tenn. 290, 301, 204 S.W. 758, 761 (1918); Lewis Leonhardt & Co. v. Small & Co., 117 Tenn. 153, 164, 96 S.W. 1051, 1053 (1906); BALLENTINE, CORPORATIONS § 95 (Rev. ed. 1946); 7 FLETCHER, CORPORATIONS §§ 3467-3471 (Perm. ed., Jones, 1931).

15. BALLENTINE, CORPORATIONS § 95 (Rev. ed. 1946); 7 FLETCHER, CORPORATIONS § 3473 (Perm. ed., Jones, 1931).

16. For an earlier expression of the view by the Tennessee Court which would support the majority view, see Tennessee Ice Co. v. Raine, 107 Tenn. 151, 159, 64 S.W. 29, 31 (1901).