

2.2.7: Cases

Limiting a Corporation's First Amendment Rights

First National Bank of Boston v. Bellotti

435 U.S. 765 (1978)

MR. JUSTICE POWELL delivered the opinion of the Court.

In sustaining a state criminal statute that forbids certain expenditures by banks and business corporations for the purpose of influencing the vote on referendum proposals, the Massachusetts Supreme Judicial Court held that the First Amendment rights of a corporation are limited to issues that materially affect its business, property, or assets. The court rejected appellants' claim that the statute abridges freedom of speech in violation of the First and Fourteenth Amendments. The issue presented in this context is one of first impression in this Court. We postponed the question of jurisdiction to our consideration of the merits. We now reverse.

The statute at issue, Mass. Gen. Laws Ann., Ch. 55, § 8 (West Supp. 1977), prohibits appellants, two national banking associations and three business corporations, from making contributions or expenditures "for the purpose of...influencing or affecting the vote on any question submitted to the voters, other than one materially affecting any of the property, business or assets of the corporation." The statute further specifies that "[no] question submitted to the voters solely concerning the taxation of the income, property or transactions of individuals shall be deemed materially to affect the property, business or assets of the corporation." A corporation that violates § 8 may receive a maximum fine of \$50,000; a corporate officer, director, or agent who violates the section may receive a maximum fine of \$10,000 or imprisonment for up to one year, or both. Appellants wanted to spend money to publicize their views on a proposed constitutional amendment that was to be submitted to the voters as a ballot question at a general election on November 2, 1976. The amendment would have permitted the legislature to impose a graduated tax on the income of individuals. After appellee, the Attorney General of Massachusetts, informed appellants that he intended to enforce § 8 against them, they brought this action seeking to have the statute declared unconstitutional.

The court below framed the principal question in this case as whether and to what extent corporations have First Amendment rights. We believe that the court posed the wrong question. The Constitution often protects interests broader than those of the party seeking their vindication. The First Amendment, in particular, serves significant societal interests. The proper question therefore is not whether corporations "have" First Amendment rights and, if so, whether they are coextensive with those of natural persons. Instead, the question must be whether § 8 abridges expression that the First Amendment was meant to protect. We hold that it does. The speech proposed by appellants is at the heart of the First Amendment's protection.

The freedom of speech and of the press guaranteed by the Constitution embraces at the least the liberty to discuss publicly and truthfully all matters of public concern without previous restraint or fear of subsequent punishment. Freedom of discussion, if it would fulfill its historic function in this nation, must embrace all issues about which information is needed or appropriate to enable the members of society to cope with the exigencies of their period. *Thornhill v. Alabama*, 310 U.S. 88, 101-102 (1940).

The referendum issue that appellants wish to address falls squarely within this description. In appellants' view, the enactment of a graduated personal income tax, as proposed to be authorized by constitutional amendment, would have a seriously adverse effect on the economy of the State. The importance of the referendum issue to the people and government of Massachusetts is not disputed. Its merits, however, are the subject of sharp disagreement.

We thus find no support in the First or Fourteenth Amendment, or in the decisions of this Court, for the proposition that speech that otherwise would be within the protection of the First Amendment loses that protection simply because its source is a corporation that cannot prove, to the satisfaction of a court, a material effect on its business or property. The "materially affecting" requirement is not an identification of the boundaries of corporate speech etched by the Constitution itself. Rather, it amounts to an impermissible legislative prohibition of speech based on the identity of the interests that spokesmen may represent in public debate over controversial issues and a requirement that the speaker have a sufficiently great interest in the subject to justify communication.

Section 8 permits a corporation to communicate to the public its views on certain referendum subjects—those materially affecting its business—but not others. It also singles out one kind of ballot question—individual taxation as a subject about which corporations may never make their ideas public. The legislature has drawn the line between permissible and impermissible speech according to whether there is a sufficient nexus, as defined by the legislature, between the issue presented to the voters and the business interests of the speaker.

In the realm of protected speech, the legislature is constitutionally disqualified from dictating the subjects about which persons may speak and the speakers who may address a public issue. If a legislature may direct business corporations to “stick to business,” it also may limit other corporations—religious, charitable, or civic—to their respective “business” when addressing the public. Such power in government to channel the expression of views is unacceptable under the First Amendment. Especially where, as here, the legislature’s suppression of speech suggests an attempt to give one side of a debatable public question an advantage in expressing its views to the people, the First Amendment is plainly offended.

Because that portion of § 8 challenged by appellants prohibits protected speech in a manner unjustified by a compelling state interest, it must be invalidated. The judgment of the Supreme Judicial Court is reversed.

Case Questions

1. According to the court, does § 8 abridge a freedom that the First Amendment is intended to protect? If so, which freedom(s)?
2. Must a corporation prove a material effect on its business or property to maintain protection under the First Amendment?
3. Can a state legislature dictate the subjects on which a corporation may “speak”?

Piercing the Corporate Veil

United States v. Bestfoods

113 F.3d 572 (1998)

SOUTER, JUSTICE

The United States brought this action under §107(a)(2) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) against, among others, respondent CPC International, Inc., the parent corporation of the defunct Ott Chemical Co. (Ott II), for the costs of cleaning up industrial waste generated by Ott II’s chemical plant. Section 107(a)(2) authorizes suits against, among others, “any person who at the time of disposal of any hazardous substance owned or operated any facility.” The trial focused on whether CPC, as a parent corporation, had “owned or operated” Ott II’s plant within the meaning of §107(a)(2). The District Court said that operator liability may attach to a parent corporation both indirectly, when the corporate veil can be pierced under state law, and directly, when the parent has exerted power or influence over its subsidiary by actively participating in, and exercising control over, the subsidiary’s business during a period of hazardous waste disposal. Applying that test, the court held CPC liable because CPC had selected Ott II’s board of directors and populated its executive ranks with CPC officials, and another CPC official had played a significant role in shaping Ott II’s environmental compliance policy.

The Sixth Circuit reversed. Although recognizing that a parent company might be held directly liable under §107(a)(2) if it actually operated its subsidiary’s facility in the stead of the subsidiary, or alongside of it as a joint venturer, that court refused to go further. Rejecting the District Court’s analysis, the Sixth Circuit explained that a parent corporation’s liability for operating a facility ostensibly operated by its subsidiary depends on whether the degree to which the parent controls the subsidiary and the extent and manner of its involvement with the facility amount to the abuse of the corporate form that will warrant piercing the corporate veil and disregarding the separate corporate entities of the parent and subsidiary. Applying Michigan veil-piercing law, the court decided that CPC was not liable for controlling Ott II’s actions, since the two corporations maintained separate personalities and CPC did not utilize the subsidiary form to perpetrate fraud or subvert justice.

Held:

1. When (but only when) the corporate veil may be pierced, a parent corporation may be charged with derivative CERCLA liability for its subsidiary’s actions in operating a polluting facility. It is a general principle of corporate law that a parent corporation (so-called because of control through ownership of another corporation’s stock) is not liable for the acts of its subsidiaries. CERCLA does not purport to reject this bedrock principle, and the Government has indeed made no claim that a corporate parent is liable as an owner or an operator under §107(a)(2) simply because its subsidiary owns or operates a polluting facility. But there is an equally fundamental principle of corporate law, applicable to the parent-subsidiary relationship as well as generally, that the corporate veil may be pierced and the shareholder held liable for the corporation’s conduct when, *inter alia*, the corporate form would otherwise be misused to accomplish certain wrongful purposes, most notably fraud, on the shareholder’s behalf. CERCLA does not purport to rewrite this well-settled rule, either, and against this venerable common-law backdrop, the congressional silence is audible. Cf. *Edmonds v. Compagnie Generale Transatlantique*, 443 U.S. 256, 266-267. CERCLA’s failure to speak to a matter as fundamental as the liability implications of corporate ownership demands application of the rule that, to abrogate a common-law principle, a statute must speak directly to the question addressed by the common law. *United States v. Texas*, 507 U.S. 529, 534.

2. A corporate parent that actively participated in, and exercised control over, the operations of its subsidiary's facility may be held directly liable in its own right under §107(a)(2) as an operator of the facility.

(a) Derivative liability aside, CERCLA does not bar a parent corporation from direct liability for its own actions. Under the plain language of §107(a)(2), any person who operates a polluting facility is directly liable for the costs of cleaning up the pollution, and this is so even if that person is the parent corporation of the facility's owner. Because the statute does not define the term "operate," however, it is difficult to define actions sufficient to constitute direct parental "operation." In the organizational sense obviously intended by CERCLA, to "operate" a facility ordinarily means to direct the workings of, manage, or conduct the affairs of the facility. To sharpen the definition for purposes of CERCLA's concern with environmental contamination, an operator must manage, direct, or conduct operations specifically related to the leakage or disposal of hazardous waste, or decisions about compliance with environmental regulations.

(b) The Sixth Circuit correctly rejected the direct liability analysis of the District Court, which mistakenly focused on the relationship between parent and subsidiary, and premised liability on little more than CPC's ownership of Ott II and its majority control over Ott II's board of directors. Because direct liability for the parent's operation of the facility must be kept distinct from derivative liability for the subsidiary's operation of the facility, the analysis should instead have focused on the relationship between CPC and the facility itself, *i.e.*, on whether CPC "operated" the facility, as evidenced by its direct participation in the facility's activities. That error was compounded by the District Court's erroneous assumption that actions of the joint officers and directors were necessarily attributable to CPC, rather than Ott II, contrary to time-honored common-law principles. The District Court's focus on the relationship between parent and subsidiary (rather than parent and facility), combined with its automatic attribution of the actions of dual officers and directors to CPC, erroneously, even if unintentionally, treated CERCLA as though it displaced or fundamentally altered common-law standards of limited liability. The District Court's analysis created what is in essence a relaxed, CERCLA-specific rule of derivative liability that would banish traditional standards and expectations from the law of CERCLA liability. Such a rule does not arise from congressional silence, and CERCLA's silence is dispositive.

(c) Nonetheless, the Sixth Circuit erred in limiting direct liability under CERCLA to a parent's sole or joint venture operation, so as to eliminate any possible finding that CPC is liable as an operator on the facts of this case. The ordinary meaning of the word "operate" in the organizational sense is not limited to those two parental actions, but extends also to situations in which, *e.g.*, joint officers or directors conduct the affairs of the facility on behalf of the parent, or agents of the parent with no position in the subsidiary manage or direct activities at the subsidiary's facility. Norms of corporate behavior (undisturbed by any CERCLA provision) are crucial reference points, both for determining whether a dual officer or director has served the parent in conducting operations at the facility, and for distinguishing a parental officer's oversight of a subsidiary from his control over the operation of the subsidiary's facility. There is, in fact, some evidence that an agent of CPC alone engaged in activities at Ott II's plant that were eccentric under accepted norms of parental oversight of a subsidiary's facility: The District Court's opinion speaks of such an agent who played a conspicuous part in dealing with the toxic risks emanating from the plant's operation. The findings in this regard are enough to raise an issue of CPC's operation of the facility, though this Court draws no ultimate conclusion, leaving the issue for the lower courts to reevaluate and resolve in the first instance.

113 F.3d 572, vacated and remanded.

Case Questions

1. In what ways can operator liability attach to a parent corporation? How did the Sixth Circuit Court disagree with the district court's analysis?
2. Is direct liability for a parent company's operation of the facility distinct from derivative liability for the subsidiary's operation of the facility? Should the focus be on parent and subsidiary or on parent and facility?
3. What norms of corporate behavior does the court look to in determining whether an officer or a director is involved in the operation of a facility?

Corporate Promoter

RKO-Stanley Warner Theatres, Inc. v. Graziano

355 A.2d. 830 (1976)

EAGEN, JUSTICE.

On April 30, 1970, RKO-Stanley Warner Theatres, Inc. [RKO], as seller, entered into an agreement of sale with Jack Jenofsky and Ralph Graziano, as purchasers. This agreement contemplated the sale of the Kent Theatre, a parcel of improved commercial real

estate located at Cumberland and Kensington Avenues in Philadelphia, for a total purchase price of \$70,000. Settlement was originally scheduled for September 30, 1970, and, at the request of Jenofsky and Graziano, continued twice, first to October 16, 1970, and then to October 21, 1970. However, Jenofsky and Graziano failed to complete settlement on the last scheduled date.

Subsequently, on November 13, 1970, RKO filed a complaint in equity seeking judicial enforcement of the agreement of sale. Although Jenofsky, in his answer to the complaint, denied personal liability for the performance of the agreement, the chancellor, after a hearing, entered a decree nisi granting the requested relief sought by RKO.... This appeal ensued.

At the time of the execution of this agreement, Jenofsky and Graziano were engaged in promoting the formation of a corporation to be known as Kent Enterprises, Inc. Reflecting these efforts, Paragraph 19 of the agreement, added by counsel for Jenofsky and Graziano, recited:

It is understood by the parties hereto that it is the intention of the Purchaser to incorporate. Upon condition that such incorporation be completed by closing, all agreements, covenants, and warranties contained herein shall be construed to have been made between Seller and the resultant corporation and all documents shall reflect same.

In fact, Jenofsky and Graziano did file Articles of Incorporation for Kent Enterprises, Inc., with the State Corporation Bureau on October 9, 1971, twelve days prior to the scheduled settlement date. Jenofsky now contends the inclusion of Paragraph 19 in the agreement and the subsequent filing of incorporation papers, released him from any personal liability resulting from the non-performance of the agreement.

The legal relationship of Jenofsky to Kent Enterprises, Inc., at the date of the execution of the agreement of sale was that of promoter. As such, he is subject to the general rule that a promoter, although he may assume to act on behalf of a projected corporation and not for himself, will be held personally liable on contracts made by him for the benefit of a corporation he intends to organize. This personal liability will continue even after the contemplated corporation is formed and has received the benefits of the contract, unless there is a novation or other agreement to release liability.

The imposition of personal liability upon a promoter where that promoter has contracted on behalf of a corporation is based upon the principle that one who assumes to act for a nonexistent principal is himself liable on the contract in the absence of an agreement to the contrary.

[T]here [are] three possible understandings that parties may have when an agreement is executed by a promoter on behalf of a proposed corporation:

When a party is acting for a proposed corporation, he cannot, of course, bind it by anything he does, at the time, but he may (1) take on its behalf an offer from the other which, being accepted after the formation of the company, becomes a contract; (2) make a contract at the time binding himself, with the stipulation or understanding, that if a company is formed it will take his place and that then he shall be relieved of responsibility; or (3) bind himself personally without more and look to the proposed company, when formed, for indemnity.

Both RKO and Jenofsky concede the applicability of alternative No. 2 to the instant case. That is, they both recognize that Jenofsky (and Graziano) was to be initially personally responsible with this personal responsibility subsequently being released. Jenofsky contends the parties, by their inclusion of Paragraph 19 in the agreement, manifested an intention to release him from personal responsibility upon the mere formation of the proposed corporation, provided the incorporation was consummated prior to the scheduled closing date. However, while Paragraph 19 does make provision for recognition of the resultant corporation as to the closing documents, it makes no mention of any release of personal liability. Indeed, the entire agreement is silent as to the effect the formation of the projected corporation would have upon the personal liability of Jenofsky and Graziano. Because the agreement fails to provide expressly for the release of personal liability, it is, therefore, subject to more than one possible construction.

In *Consolidated Tile and Slate Co. v. Fox*, 410 Pa. 336, 339, 189 A.2d 228, 229 (1963), we stated that where an agreement is ambiguous and reasonably susceptible of two interpretations, "it must be construed most strongly against those who drew it."... Instantly, the chancellor determined that the intent of the parties to the agreement was to hold Jenofsky personally responsible until such time as a corporate entity was formed and until such time as that corporate entity adopted the agreement. We believe this construction represents the only rational and prudent interpretation of the parties' intent.

As found by the court below, this agreement was entered into on the financial strength of Jenofsky and Graziano, alone as individuals. Therefore, it would have been illogical for RKO to have consented to the release of their personal liability upon the mere formation of a resultant corporation prior to closing. For it is a well-settled rule that a contract made by a promoter, even though made for and in the name of a proposed corporation, in the absence of a subsequent adoption (either expressly or impliedly)

by the corporation, will not be binding upon the corporation. If, as Jenofsky contends, the intent was to release personal responsibility upon the mere incorporation prior to closing, the effect of the agreement would have been to create the possibility that RKO, in the event of non-performance, would be able to hold no party accountable: there being no guarantee that the resultant corporation would ratify the agreement. Without express language in the agreement indicating that such was the intention of the parties, we may not attribute this intention to them.

Therefore, we hold that the intent of the parties in entering into this agreement was to have Jenofsky and Graziano personally liable until such time as the intended corporation was formed and ratified the agreement. [And there is no evidence that Kent Enterprises ratified the agreement. The decree is affirmed.]

Case Questions

1. Does a promoter's personal liability continue even after the corporation is formed? Can he or she look to the corporation for indemnity after the corporation is formed?
2. In what instance(s) is a contract made by a promoter not binding on a corporation?
3. In whose favor does a court construe an ambiguous agreement?

De Jure and De Facto Corporations

Cranson v. International Business Machines Corp.

234 Md. 477, 200 A.2d 33 (1964)

HORNEY, JUDGE

On the theory that the Real Estate Service Bureau was neither a *de jure* nor a *de facto* corporation and that Albion C. Cranson, Jr., was a partner in the business conducted by the Bureau and as such was personally liable for its debts, the International Business Machines Corporation brought this action against Cranson for the balance due on electric typewriters purchased by the Bureau. At the same time it moved for summary judgment and supported the motion by affidavit. In due course, Cranson filed a general issue plea and an affidavit in opposition to summary judgment in which he asserted in effect that the Bureau was a *de facto* corporation and that he was not personally liable for its debts.

The agreed statement of facts shows that in April 1961, Cranson was asked to invest in a new business corporation which was about to be created. Towards this purpose he met with other interested individuals and an attorney and agreed to purchase stock and become an officer and director. Thereafter, upon being advised by the attorney that the corporation had been formed under the laws of Maryland, he paid for and received a stock certificate evidencing ownership of shares in the corporation, and was shown the corporate seal and minute book. The business of the new venture was conducted as if it were a corporation, through corporate bank accounts, with auditors maintaining corporate books and records, and under a lease entered into by the corporation for the office from which it operated its business. Cranson was elected president and all transactions conducted by him for the corporation, including the dealings with I.B.M., were made as an officer of the corporation. At no time did he assume any personal obligation or pledge his individual credit to I.B.M. Due to an oversight on the part of the attorney, of which Cranson was not aware, the certificate of incorporation, which had been signed and acknowledged prior to May 1, 1961, was not filed until November 24, 1961. Between May 17 and November 8, the Bureau purchased eight typewriters from I.B.M., on account of which partial payments were made, leaving a balance due of \$4,333.40, for which this suit was brought.

Although a question is raised as to the propriety of making use of a motion for summary judgment as the means of determining the issues presented by the pleadings, we think the motion was appropriate. Since there was no genuine dispute as to the material facts, the only question was whether I.B.M. was entitled to judgment as a matter of law. The trial court found that it was, but we disagree.

The fundamental question presented by the appeal is whether an officer of a defectively incorporated association may be subjected to personal liability under the circumstances of this case. We think not.

Traditionally, two doctrines have been used by the courts to clothe an officer of a defectively incorporated association with the corporate attribute of limited liability. The first, often referred to as the doctrine of *de facto* corporations, has been applied in those cases where there are elements showing: (1) the existence of law authorizing incorporation; (2) an effort in good faith to incorporate under the existing law; and (3) actual use or exercise of corporate powers. The second, the doctrine of estoppel to deny the corporate existence, is generally employed where the person seeking to hold the officer personally liable has contracted or otherwise dealt with the association in such a manner as to recognize and in effect admit its existence as a corporate body.

* * *

There is, as we see it, a wide difference between creating a corporation by means of the *de facto* doctrine and estopping a party, due to his conduct in a particular case, from setting up the claim of no incorporation. Although some cases tend to assimilate the doctrines of incorporation *de facto* and by estoppel, each is a distinct theory and they are not dependent on one another in their application. Where there is a concurrence of the three elements necessary for the application of the *de facto* corporation doctrine, there exists an entity which is a corporation *de jure* against all persons but the state.

On the other hand, the estoppel theory is applied only to the facts of each particular case and may be invoked even where there is no corporation *de facto*. Accordingly, even though one or more of the requisites of a *de facto* corporation are absent, we think that this factor does not preclude the application of the estoppel doctrine in a proper case, such as the one at bar.

I.B.M. contends that the failure of the Bureau to file its certificate of incorporation debarred *all* corporate existence. But, in spite of the fact that the omission might have prevented the Bureau from being either a corporation *de jure* or *de facto*, *Jones v. Linden Building Ass'n*, we think that I.B.M. having dealt with the Bureau as if it were a corporation and relied on its credit rather than that of Cranson, is estopped to assert that the Bureau was not incorporated at the time the typewriters were purchased. In *1 Clark and Marshall, Private Corporations*, § 89, it is stated:

The doctrine in relation to estoppel is based upon the ground that it would generally be inequitable to permit the corporate existence of an association to be denied by persons who have represented it to be a corporation, or held it out as a corporation, or by any persons who have recognized it as a corporation by dealing with it as such; and by the overwhelming weight of authority, therefore, a person may be estopped to deny the legal incorporation of an association which is not even a corporation *de facto*.

In cases similar to the one at bar, involving a failure to file articles of incorporation, the courts of other jurisdictions have held that where one has recognized the corporate existence of an association, he is estopped to assert the contrary with respect to a claim arising out of such dealings.

Since I.B.M. is estopped to deny the corporate existence of the Bureau, we hold that Cranson was not liable for the balance due on account of the typewriters.

Judgment reversed; the appellee to pay the costs.

Case Questions

1. What is the fundamental question presented by the case?
2. What are the differences between creating a corporation *de facto* and by estoppel?

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