Maurer School of Law: Indiana University
Digital Repository @ Maurer Law

Indiana Law Journal

Volume 13 | Issue 6 Article 12

8-1938

Parent and Subsidiary Corporations-Set-Off and Counterclaim

Follow this and additional works at: http://www.repository.law.indiana.edu/ilj

Part of the Business Organizations Law Commons

Recommended Citation
(1938) "Parent and Subsidiary Corporations-Set-Off and Counterclaim," *Indiana Law Journal*: Vol. 13 : Iss. 6 , Article 12.
Available at: http://www.repository.law.indiana.edu/ilj/vol13/iss6/12

This Note is brought to you for free and open access by the Law School Journals at Digital Repository @ Maurer Law. It has been accepted for inclusion in Indiana Law Journal by an authorized editor of Digital Repository @ Maurer Law. For more information, please contact wattn@indiana.edu.

JEROME HALL LAW LIBRARY
INDIANA UNIVERSITY
Maurer School of Law
Bloomington

PARENT AND SUBSIDIARY CORPORATIONS—SET-OFF AND COUNTERCLAIM.—Action by the successor of a reorganized bank upon a note executed by defendant corporation. Defendant claims the right to set off against its obligation a deposit credit maintained in the defunct bank by a subsidiary corporation. The subsidiary had established the account by resolution of its own board of directors, and withdrawal powers were confined to five officers of the subsidiary. However, the same five individuals were the controlling officers of the parent corporation. Moreover, the bank was frequently given reports of financial condition by the parent corporation, and in these reports the subsidiary was regarded as a mere division. Practically the management was the same, but the formalities of separate management were observed. *Held*, defendant is not entitled to set off the deposit credit of its subsidiary against its own indebtedness.[1]

The relationship between parent and subsidiary corporations causes considerable difficulty in the law.[2] Although for most purposes the two corpora-

---

[21] Aetna Life Ins. Co. v. Burton (Ind. App., 1938), 12 N. E. (2nd) 360—decided subsequently to the instant case allowed recovery for mental anguish alone, resulting from the defendant's wilfully making an unauthorized autopsy of the body of plaintiff's husband. The language used by the court is sufficiently broad to be in conflict with the decision in the principal case—"Mental suffering need not be accompanied by physical injury where the act . . . resulted in the invasion of the legal rights of another." However, this is mere dictum because recovery was granted on the grounds pointed out above—Note 8.

[1] Feucht v. Real Silk Hosiery Mills (Ind. App. 1938), 12 N. E. (2d) 1019.

[2] For discussion of the general problem, see: Powell, Parent and Subsidiary Corporations (1931); Douglas and Shanks, Insulation from Liability

tions will be regarded as separate entities with no relation other than that of stockholder and corporation, there are occasions when the courts will recognize a closer relationship. This may be done by treating them as principal and agent, or by "disregarding the corporate fiction"[3] and treating the two corporations as substantially identical. Mere stock ownership will not produce this result; numerous factors including extent of ownership, observation of formalities of separate management, separate financial units, holding out to the public as unified, and solvency of the subsidiary will be considered.[4] The sum and substance of the inquiry is whether the dual organization is used to gain legitimate advantages of the separate entity privilege conferred upon incorporators, or whether the subsidiary entity is being used as a subversive device to gain unfair advantages over those with whom they deal.

A situation that has arisen in several recent cases is the right to use claims of one corporation as equitable setoffs against liabilities of the others, especially in connection with insolvent banks. It is held by the overwhelming weight of authority that a deposit credit may be set off against a liability of the depositor to a bank; and such a setoff does not constitute an unlawful preference of creditors where the bank is insolvent.[5] With the flood of bank failures in the period from 1929-1933 came frantic attempts by depositors to realize on the value of their deposits by setoffs against indebtedness. The efforts have not been confined to personal indebtedness, but attempts have extended to partnership indebtedness, representative indebtedness, corporate indebtedness, and the like. And conversely, partnership deposits, representative deposits, and corporate deposits have been claimed as setoffs against individual indebtedness.

It is often stated as a general rule that setoffs will be allowed only where there is a mutuality of claims. That is, a person can set off against his own obligations only claims which he has against the same person asserting the claim against him. The parties to the two obligations must be identical. However, many courts, including Indiana, will recognize an equitable right to a setoff without mutuality if recognition of the right is necessary to effect a clear equity.[6] The application of this principle to the parent and subsidiary muddle is the problem raised in the present case.

Where a subsidiary is so dominated by the parent that the bank could hold the assets of one liable for the obligations of the other, the rule of

---

Through Subsidiary Corporations, 39 Yale L. J. 193 (1929); Ballantine, Separate Entity of Parent and Subsidiary Corporations, 14 Calif. L. Rev. 12 (1925); Wormser, Piercing the Veil of Corporate Entity, 12 Col. L. Rev. 496 (1912).

[3] This mystic phrase is found in a multitude of cases. In many instances, it is used to cover loose reasoning in order to reach a justifiable result. In most cases, the same result could be reached by the application of more conventional legal doctrines, especially that of agency.

[4] The analysis of Douglas and Shanks, cited supra note 2, is outstanding. For a somewhat different approach, see Powell, also cited supra, note 2. The cases are collected in 39 A. L. R. 1071, 50 A. L. R. 611, and 102 A. L. R. 1054, as well as in the discussions cited.

[5] Miles v. Bossert (1930), 92 Ind. App. 10, 173 N. E. 656; Scott v. Armstrong (1892), 146 U. S. 499; McCagg v. Woodman (1862), 28 Ill. 84; Re Thacher (1933), 311 Pa. 278, 166 A. 873; Smith v. Felton (1871), 43 N. Y. 419.

[6] Lamb v. Morris (1888), 188 Ind. 179, 20 N. E. 746; Porter v. Rosenman (1905), 165 Ind. 255, 74 N. E. 1105.

mutuality should entitle the corporations to set off assets of one against obligations of the other.[7] Where, as in the case at bar, the relationship was not so close as to render one liable for the debts of the other, there must be a very strong equity before a setoff will be allowed. Since the subsidiary was established for gaining the advantages of the separate entity form of organization, doubts should be resolved against the corporation when it seeks to disregard the separate entity concept to gain a benefit peculiar to unified organization. This is especially true since the benefit of the setoff, if allowed, would be at the expense of the other depositors and the stockholders of the bank. The instant case in so holding appears sound, and is in accord with the prevailing authorities.[8]

D. M. C.

INSURANCE—PRESUMPTION OF SURVIVORSHIP.—The decedent, some time before his death, took out three insurance policies on his life, in each of which, after naming his wife as beneficiary, he reserved the power of changing the beneficiary. Each of the policies provided for distribution of the proceeds in case the beneficiary predeceased the insured. The language whereby this was accomplished varied. One policy stipulated that the proceeds were "payable to the beneficiary if surviving the insured, otherwise to the insured's estate." The other two policies provided, in substance, that if the beneficiary should have died before the insured, the proceeds should be paid to the estate of the insured. The insured and the beneficiary were killed in a common disaster, and no evidence was available to show which survived. The suit here is between the heirs of the husband and the heirs of the wife to determine who is entitled to the proceeds of the policies. The court held in favor of the husband's heirs.[1]

The court declared that its decision followed the weight of authority on the three propositions which it enunciated, although this was the first time the questions had arisen in this jurisdiction.

The first and second propositions may well be treated together: the court held that where two people die in a common disaster there is no presumption in favor of either as to survivorship, and that proof of the same must be furnished by him whose claim is based upon the right of one of the deceased to inherit from the other, or who would recover in the right of the beneficiary of the policy. There can be no doubt that the majority of the courts are in accord with the principal case as to the ability of one of the victims to inherit from the other,[2] but that is of meagre importance here, for this is not an

---

[7] Lucey Mfg. Corp. v. Oil City Iron Works (1930), 15 La. App. 12, 131 So. 57; Piedmont Print Works v. Receivers of Peoples State Bank (1934), 68 F. (2d) 110.

[8] General Discount Corp. v. First Nat'l. Bank (1933), 5 F. Supp. 709; Jewett v. Martinsville Milling Co. (1935), 76 F. (2d), 153; Gallagher v. Germania Brewing Co. (1893), 53 Minn. 214, 54 N. W. 1115 (dominant individual stockholder); Erie Bronze Co. v. Haughney (1936), 17 F. Supp. 1022; Taub v. Coker (1931), 162 S. C. 391, 161 S. E. 117; State ex rel. Sorenson v. Weston Bank (1933), 125 Neb. 612, 251 N. W. 164; Frigidaire Sales Corp. v. Alexandria Bank and Trust Co. (La. App., 1933), 145 So. 703.

[1] McKinney v. Depoy (Ind., 1938), 12 N. E. (2d) 250.

[2] Young Women's Christian Home v. French (1903), 187 U. S. 401, 23 S. Ct. 184; Russel v. Hallet (1880), 23 Kan. 276; Southwell v. Gray (1901), 72 N. Y. S. 342.