



California Lawyers Association

presents

Protecting or Piercing the Corporate Veil

1.25 Hours MCLE

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Speakers:

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Conference Reference Materials

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PROTECTING OR PIERCING THE CORPORATE VEIL

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September 23, 2023

CALIFORNIA LAWYERS ASSOCIATION

SAN DIEGO / SEPTEMBER 21- 23

ANNUAL MEETING

BREAKING BARRIERS

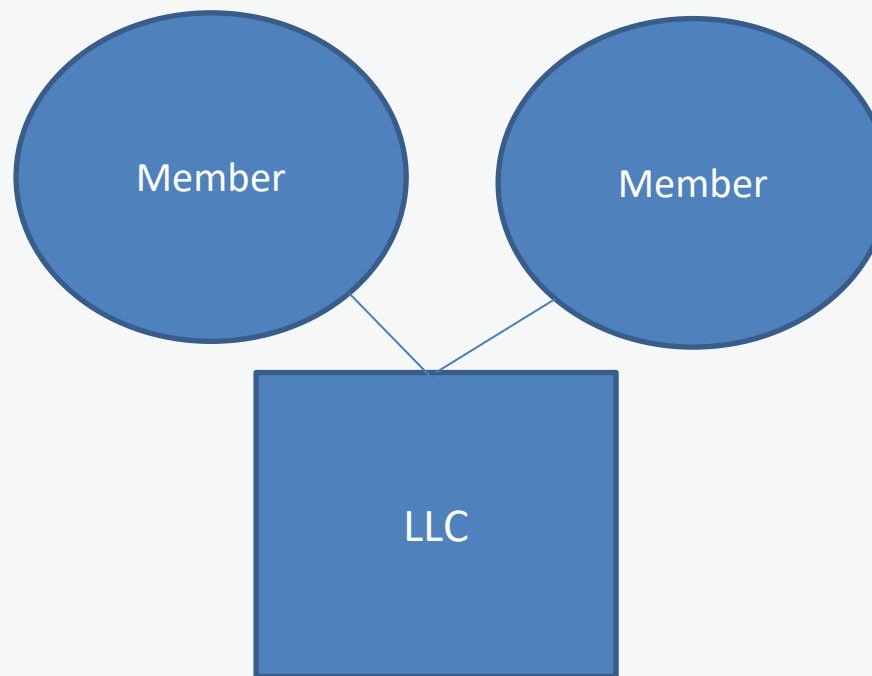
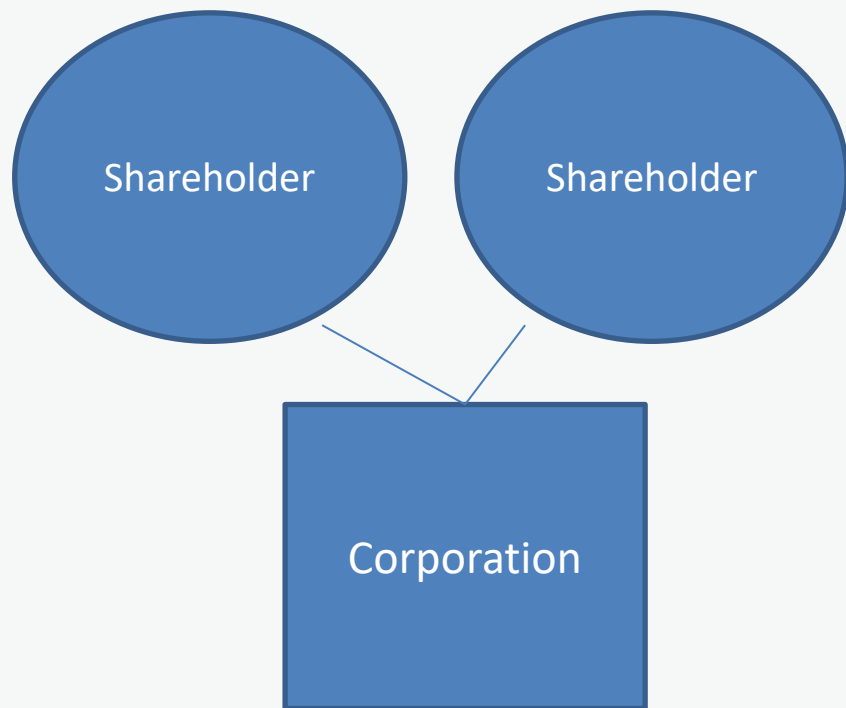
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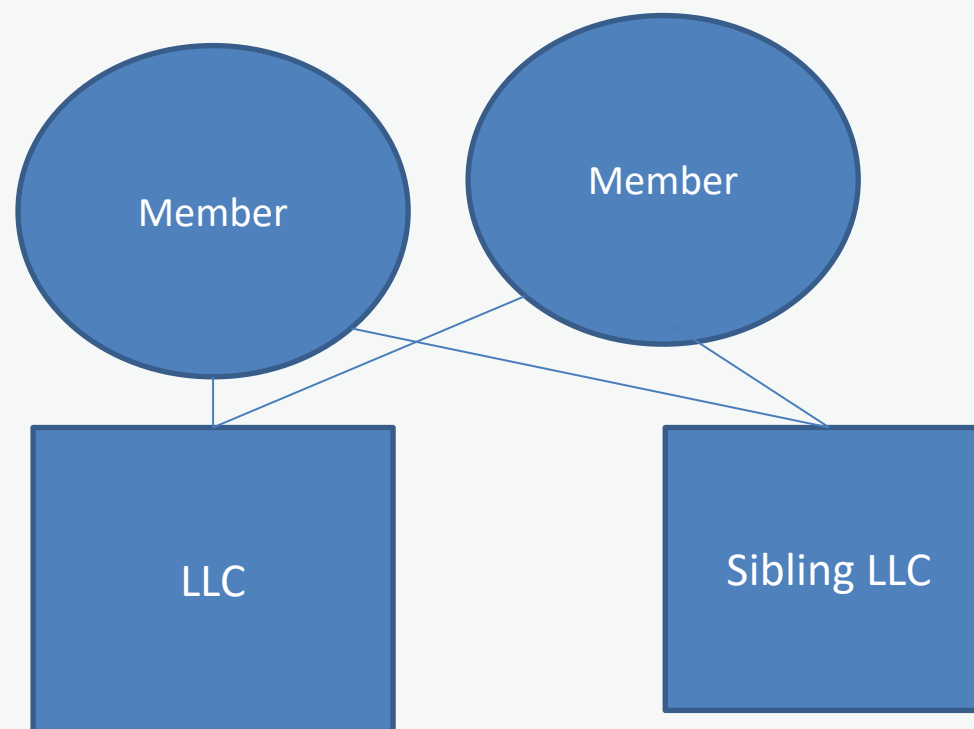
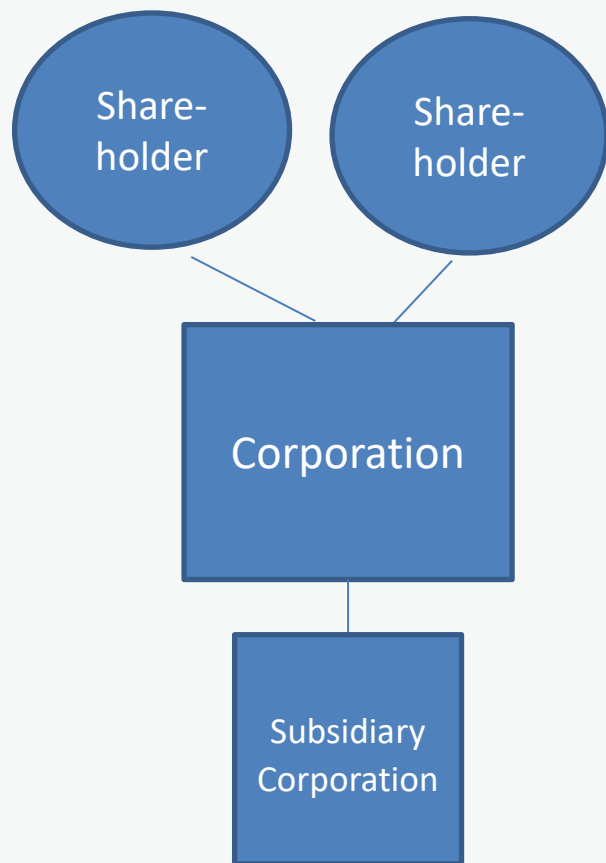
Objectives

1. Understanding Entity Protection and the Corporate Veil
2. Litigation Perspective: Bringing and Defending Alter Ego Claims
3. Transactional Perspective: Setting Up and Maintaining Entities and Documenting Dealings between Affiliated Entities

Owners and Entities Examples



Owners and Entities Examples (Continued)



Choice of Law in Alter Ego Cases

Internal affairs doctrine. See Cal. Corp. Code Section 17708.01(a).

Limited Exception for claims that implicate broader public interest of vital interest to California.
Lidow v. Sup. Ct., (2012) 206 Cal. App. 4th 351.

Entity Protection (Corporate Veil) in California

CA Constitution Art. IV, Sec. 31 (1849) authorized the formation of corporations under general laws.

CA Constitution Art. IV, Sec. 36 (1849) (“Each stockholder of a corporation...shall be individually and personally liable for his proportion of all its debts and liabilities”)

-Current Shareholder/Member Liability Clauses

No corporation statute that shareholder/member not liable for entity’s debts/obligations; subject to common law. But See Cal. Corp. Code Section 17703.04 (LLC’s liabilities do not become liabilities of an LLC manager or member solely because acting as manager or member)

Alter Ego Doctrine

Equitable doctrine to impose liability on another person for liability of the entity. Could be brought against individual or corporate shareholders and against a sibling entity.

Two Elements (must have both):

- There is such a unity of interest and ownership that the separate personalities of the entity and the owners no longer exists and; individuality of the one corporation and the owner or owners of its stock has ceased
- If the acts are treated as those of the corporation alone, an inequitable result will follow.

Hennessey's Tavern, Inc. v. American Air Filter Co. (1988) 204 Cal. App. 3d 1351 (citing to *Marr v. Postal Union Life Ins. Co.* (1940), 40 Cal App.2d 673, 681); *Wells Fargo Bank, N.A. v. Weinberg* (2014) 227 Cal. App. 4th 1 (citing to *Jack Ferenbaugh & Son v. Belmont Construction Inc.* (1987) 197 Cal. App. 3d 1023, 1032).

First Element Factors

Associated Vendors, Inc. v. Oakland Meat Co, 210 Cal App 2d 825 (1962)- sets out a bunch of factors that go to determine whether there is such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist:

- commingling funds
- treatment by individual of corporate assets as individual's own
- failure to issue stock
- holding out by individual that individual is personally responsible for debts of corporation
- failure to maintain minutes or adequate records
- confusion of records of separate entities
- identical equitable ownership and control in two entities
- contracting using corporate entity to shield personal liability and avoid performance
- use of same office/business location
- Undercapitalization
- use of corporation as a mere shell, concealment or misrepresentation of the identity of the ownership management and financial interest or concealment of personal business activities
- failure to maintain arms length among entities
- using one entity to get services for the other, diversion of assets to the detriment of creditors to put assets in one entity and liabilities in the other.
- Formation and use of corporation to transfer to it the existing liabilities of another person or entity

First Element Satisfied

-*Wells Fargo Bank, N.A. v. Weinberg* (2014) 227 Cal. App. 4th 1: Lawyer practiced law through law corporation that took out line of credit (no personal guaranty), court held that lawyer had alter ego liability because:

- (i) Lawyer dissolved corporation but afterwards continued doing business as a sole proprietor under the same name, using the same offices, employees, equipment, Web site, and phone number.
- (ii) Lawyer distributed all the corporate assets to family members and himself.
- (iii) Corporate formalities not followed.

First Element Satisfied

-*Kao v. Joy Holiday*, (2020) 58 Cal. App. 5th 199:

Trial court found the two owners of Joy Holiday (Lin and Chen) liable for its unpaid wages to employee under alter ego liability.

Lin and Chen owned all the stock and made all the decisions of the company and commingled assets and made unauthorized use of corporate assets (using corporate funds to pay rent and using personal funds to pay the employee's salary).

Trial court has discretion in choosing which factors to apply in first prong.

First Element Satisfied

-*Cam-Carson, LLC v. Carson Reclamation Authority*, (2022) 82 Cal. App. 5th 535: City of Carson set up a subsidiary entity (CRA), CAM-Carson, LLC (Plaintiff) entered into contracts to develop land that CRA remediated. Plaintiff sought to hold City liable or CRA's breach of contract. The court denied City's demurrer because the following allegations, if proved could result in alter ego liability:

- (i) corporate formalities not respected and City makes decisions for and retains direct control over CRA;
- (ii) City has same individuals, officers, and employees manage and control activities
- (iii) CRA is undercapitalized and finances are not separate from the City

Second Element

“Under the alter ego doctrine, then, when the **corporate** form is used to perpetrate a fraud, circumvent a statute, or accomplish some other wrongful or inequitable purpose, the courts will ignore the **corporate** entity and deem the corporation's acts to be those of the persons or organizations actually controlling the corporation, in most instances the equitable owners.”

Sonoma Diamond Corp. v. Superior Court, (2000) 83 Cal. App. 4th 523, 538.

See *Eleanor Licensing LLC v. Classic Recreations LLC*, (2018) 21 Cal. App. 5th 599 (reversed alter ego finding because no evidence of second element); *Constellation-F, LLC v. World Trading 23, Inc.*, (2020) 45 Cal App 4th 22

Reverse Veil Piercing

-Holding an entity liable for the obligations of its owner.

Curci Investments, LLC v. Baldwin, (2017), 14 Cal. App. 5th 214.

Reliant Life Shares, LLC v. Cooper, (2023) 90 Cal. App. 5th 14

When to Bring Alter Ego Claim

- When filing complaint or answer
- Post-Judgment
- In settlement

Amending Judgment to Add Additional Judgment Debtor

To add an alter ego nonparty to the judgment, the plaintiff may:

- file a noticed motion to amend the judgment, or
- apply for an order to show cause why the nonparty alter ego should not be joined as a defendant.

There is no time limit for these procedures, although the plaintiff must act with due diligence.

Standard is preponderance of the evidence

Settlements/Judgments and Alter Ego

When a plaintiff in a tort action sues one party as the alter ego of another, the plaintiff is not barred from proceeding against the former after settlement with its alter ego. [Mesler v. Bragg Management Co., 39 Cal. 3d 290, 216 Cal. Rptr. 443, 702 P.2d 601 \(1985\)](#)

See also in bankruptcy context – *In re RS Air, LLC*, (9th Cir. BAP 2023), 651 B.R. 538)

Defending Alter Ego Claims

- Can be raised in a complaint or answer
- Post-judgment
- Estoppel
- Unjust result/Prejudice/Delay
- Application would obligate minority owners or innocent corporation

Formalities When Forming Entity

Corporation:

- File Articles of Incorporation
- Incorporator Resigns and Appoints Director (or Director named in Articles)
- Minutes of Board and Shareholder
- Adopt Bylaws
- Issuance of Share Certificates/Payment for Shares

LLC:

- File Articles of Organization
- Incorporator Appoints Managing Member/Manager
- Operating Agreement (if none, default provisions of statute)
- Documentation of issuance of membership interest/payment for membership interest
- Meetings not Required (see Cal. Corp. Code Sec. 17703.04(b))

Operational Formalities After Entity is Formed

Management

- Corporation Decision-making:
 - Shareholders
 - Board
 - Officers
- LLC Decision-making:
 - Managers or Managing Members
 - Members

Finances

- Bank Accounts
- Payments to Shareholders/Members
 - Distributions
 - Salary
 - Loans
- Adequate Capitalization

Dealing with Affiliated Entities

- Inter-company agreements for sharing resources, licensing, development, back-end services
- Financial Separation
- Consider impact on creditors before transferring liabilities
- Be clear on ownership/management of each entity and for whom acting, different managers/officers. Separate communication means for each business (emails/phone numbers)
- Keep records separate
- Limit day-to-day control among subsidiaries/parents
Associated Vendors, Inc. v. Oakland Meat Co., (1962) 210 Cal App 2d 825;

QUESTIONS

SPEAKER BIOS

Rachelle Cohen is a principal at Valensi Rose, PLC in Los Angeles. Her practice focuses on assisting clients with their business transactions and advising on legal ethics issues. She is a member of the California Lawyers Association (CLA) Business Law Section Corporation's Committee, a former Vice Chair of the Executive Committee of the CLA Business Law Section, and is a former Chair of the CLA's Partnerships and Limited Liability Companies Committee. She also is a member of the CLA Ethics Committee and the former Chair of the Los Angeles County Bar Association Professional Responsibility and Ethics Committee. Rachelle speaks frequently and has written about legal ethics issues and corporate and transactional issues, and has been a lecturer at the USC Gould School of Law.

Reza I. Gharakhani is a partner at Rostow & Auster LLP and a trial lawyer who maintains a complex litigation practice focusing on matters involving corporate governance, fiduciary duties and unfair business practice claims. He has won cases both at the pleading stage and through jury verdicts in both state and federal courts in California and Hawaii. He has successfully represented clients in partnership disputes and dissolutions, shareholder representative litigation, derivative litigation, and shareholder class actions. Reza is currently a member of California Lawyer's Association's Business Law Section's Standing Committee and was a former Chair of the Partnership and LLC Standing Committee.