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Piercing the Corporate Veil:

When is Too Much Fiction a Bad Thing?

By Will Hill Tankersley and Kelly Brennan

General Rule: Uphold the Corporate Identity

The corporate identity is a useful fiction. Indeed, some would argue that it is a vital fiction in the sense that individuals might balk at launching new ventures if it meant their personal assets were readily at risk. In general, the common law has enforced the corporate identity unless it is a sham or *alter ego* of another. This presumption against piercing the corporate veil can be overcome by showing fraud or other exceptional circumstances. Given the nature of piercing the corporate veil, such “piercing” is generally a fact intensive exercise of a court’s equitable powers. The court’s power to reach a determination on “piercing” or alter ego issues has particular application not only in reaching assets behind a sham corporation but also can be important in patent infringement venue questions. This article sets forth the general principles for piercing the corporate veil and its application under both Alabama law as well as its application to venue questions under patent law.

Presumption of validity

Alabama law upholds the “the corporate identity . . . unless the individual sought to be charged with the corporation’s liability has used the corporate identity as his alter ego.” *Chenault v. Jamison*, 578 So. 2d 1059, 1061 (Ala. 1991) (citing *Forester & Jerue, Inc. v. Daniels*, 409 So. 2d 830 (Ala. 1982)). Indeed, in Alabama, “the corporate form is **not lightly disregarded**, since limited liability is one of the principal purposes for which the

law has created the corporation.” *Id.* (quotation marks omitted); see also *M & M Wholesale Florist, Inc. v. Emmons*, 600 So. 2d 998, 999 (Ala. 1992). In virtually every situation where a court is asked to pierce the corporate veil, the court typically observes that such an exercise of judicial power is extraordinary, or is not to be done lightly. See *Gilbert v. James Russell Motors, Inc.*, 812 So. 2d 1269, 1273 (Ala. Civ. App. 2001) (“extraordinary”); *Transamerican Properties v. Watkins*, 673 So. 2d 422, 425 (Ala. Civ. App. 1993) (“not . . . lightly exercised”); *M & M Wholesale Florist, Inc. v. Emmons*, 600 So. 2d 998, 999 (Ala. 1992) (“corporate form [] not lightly disregarded”); *First Health, Inc. v. Blanton*, 585 So. 2d 1331, 1334 (Ala. 1991) (“not . . . lightly exercised”); cf. *Ex parte Thorn*, 788 So. 2d 140, 143 (Ala. 2000) (“The doctrine of ‘piercing the corporate veil’ is equitable in nature.”). Thus, a presumption is in favor of upholding the corporate veil.

General standards for piercing the veil

The presumption against piercing notwithstanding, courts may disregard the corporate form when (1) the corporation is inadequately capitalized; (2) the corporation is conceived or operated for a fraudulent purpose; (3) the corporation is operated as an instrumentality or alter ego of an individual or entity with corporate control; or (4) the interests of justice and equity so require. See *Southern Sash Sales & Supply Co. v. Wiley*, 631 So. 2d 968, 970 (Ala. 1994) (“[S]eparate corporate existence will not be recognized where a corporation is so organized and controlled and its business conducted in such a manner as to make it merely an instrumentality

of another”); *Culp v. Economy Mobile Homes, Inc.*, 895 So. 2d 857, 859-60 (Ala. 2004)(same); *Gilbert*, 812 So. 2d at 1273 (“The Alabama Supreme Court has set out the following extraordinary circumstances in which it would be appropriate to pierce the corporate veil: where the corporation is inadequately capitalized; where the corporation is conceived or operated for a fraudulent purpose; or where the corporation is operated as an instrumentality or alter ego of an individual or entity with corporate control.”); *M & M Wholesale Florist*, 600 So. 2d at 999 (same); *First Health*, 585 So. 2d at 1334 (same); *Deupree v. Ruffino*, 505 So. 2d 1218 (Ala. 1987) (“A separate corporate existence will not be recognized when a corporation is so organized and controlled and its business so conducted as to make it a mere instrumentality of another or the alter ego of the person owning and controlling it. A corporation and the individual or individuals owning all its stock and assets can be treated as identical, even in the absence of fraud, to prevent injustice or inequitable consequences.”).

For example, Alabama law has recognized that a corporate form should be disregarded in certain cases:

A separate corporate existence will not be recognized when a corporation is so organized and controlled and its business so conducted as to make it a mere instrumentality of another or the alter ego of the person owning and controlling it. A corporation and the individual or individuals owning all its stock and assets can be treated as identical, even in the absence of fraud, to prevent injustice or inequitable consequences.

Deupree v. Anderson, 505 So. 2d 1218, 1222 (Ala. 1987).¹ Depletion of corporate funds also can be used as a basis to disregard the corporate form and pierce the corporate veil:

The corporate veil may be pierced where a corporation is set up as a subterfuge, where shareholders do not observe the corporate form, where the legal requirements of corporate law are not complied with, where the corporation maintains no corporate records, where the corporation maintains no bank account, where the corporation has no employees, where corporate and personal funds are intermingled and corporate funds are used for personal purposes, *or where an individual drains funds from the corporation.*

Econ Marketing, Inc. v. Leisure American Resorts, Inc., 664 So. 2d 869, 870 (Ala. 1995) (emphasis added).

1. “*Fraud*” or “*Injustice*” To pierce the corporate veil under Alabama law, a plaintiff must show either fraud in asserting the corporate existence or must show that recognition of the corporate existence will result in injustice or inequitable consequences. (Additionally, mere domination cannot be enough to pierce the corporate veil; there must be the added elements of misuse of control and harm or loss resulting from it.) *Id. Econ Marketing, Inc. v. Leisure American Resorts, Inc.*, 664 So. 2d 869, 870 (Ala. 1994). To establish a fraudulent purpose or to prove that a business is being operated as an alter ego, plaintiff must show more than just a shareholder’s desire to avoid personal liability for the business’ debts. “To pierce the corporate veil, a plaintiff must show fraud in asserting the corporate existence or must show that recognition of the corporate existence will result in injustice or inequitable consequences.” *Simmons v. Clark Equip. Credit Corp.*, 554 So. 2d 398, 400 (Ala. 1989).

The Alabama Supreme Court has explained:


[A] parent corporation which owns all the stock of a subsidiary corporation is not liable for acts of its subsidiary corporation, unless the parent corporation so controls the operation of the subsidiary corporation as to make it a mere adjunct, instrumentality, or alter ego of the parent corporation. *Baker v. Hospital Corporation of America*, 432 So.2d 1281 (Ala. 1983). Furthermore, where one corporation controls and dominates another corporation to the extent that the second corporation becomes the mere instrumentality of the first, the dominant corporation becomes liable for those debts or torts of the subservient corporation attributable to an abuse of that control.

Duff v. Southern Ry. Co., 496 So. 2d 760, 762 (Ala. 1986). The court has applied a number of factors to determine whether this control exists:

- (a) The parent corporation owns all or most of the capital stock of the subsidiary.
- (b) The parent and subsidiary corporations have common directors or officers.
- (c) The parent corporation finances the subsidiary.
- (d) The parent corporation subscribes to all the capital stock of the subsidiary or otherwise causes its incorporation.


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- (e) The subsidiary has grossly inadequate capital.
- (f) The parent corporation pays the salaries and other expenses or losses of the subsidiary.
- (g) The subsidiary has substantially no business except with the parent corporation or no assets except those conveyed to it by the parent corporation.
- (h) In the papers of the parent corporation or in the statements of its officers, the subsidiary is described as a department or division of the parent corporation, or its business or financial responsibility is referred to as the parent corporation's own.
- (i) The parent corporation uses the property of the subsidiary as its own.
- (j) The directors or executives of the subsidiary do not act independently in the interest of the subsidiary but take their orders from the parent corporation in the latter's interest.
- (k) The formal legal requirements of the subsidiary are not observed.

Id. (The test above was used to determine whether the corporate form should be disregarded as between a parent and its subsidiary. Although not precise to the facts of this case, the factors used are relevant and should be persuasive.)

In *Duff*, for example, the court held that the following four factors (plus some other "relevant factors" concerning control) were enough for the plaintiff's claims to survive summary judgment and to be sent to the jury on a veil piercing theory: (1) company A owned all the stock in Company B; (2) an individual named Garner was an officer of one company and a director of the other; (3) Company A paid the salaries of Company B's workers; (4) that over 99 percent of Company B's business was with Company A; and (5) Garner, a director of Company B, may not have acted independently from Company A. *Id.* at 763.

These factors are important for a court to consider, but no single factor will determine the outcome, and a court may consider other factors as well. Furthermore, in part because piercing the corporate veil is "an equitable doctrine," *Ex parte Thorn*, 788 So. 2d 140, 145 (Ala. 2000), there is significant flexibility in the way it is applied. Therefore, outcomes are difficult to predict, and a court has significant discretion in applying the factors.

Additionally, as the cases below demonstrate, a critical finding in most decisions to pierce the corporate veil is some finding of misuse, in the form of fraud, corporate form abuse or other malfeasance. A combination of elements—such as control, under-capitalization and equities favoring piercing—may well justify piercing, but in the absence of wrongdoing, a court will be less inclined to pierce the corporate veil, even if a party proves control or the equities favor piercing.

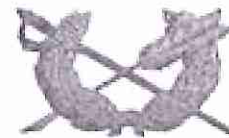
2. Sample Alabama Cases

Shelton v. Clements, 2002 WL 161328 (Ala. Civ. App. Feb. 1, 2002)—In *Shelton*, the court of civil appeals upheld the trial court's decision to pierce the corporate veil because the evidence supported an alter-ego/instrumentality theory. In reaching its conclusion, the court focused on evidence that the individual to whom the court attached

liability was the president of the corporation, the corporation was undercapitalized, the individual commingled his funds with those of the corporation and the individual intended to file a petition in bankruptcy for the corporation if it did not earn a profit on the project that was the subject of the lawsuit. The court concluded this despite the fact that the record contained no information regarding the identities of the other officers of the corporation, the number of corporate stockholders or their ownership interests, or the corporation's financial information.

Ex parte AmSouth Bank, 669 So. 2d 154 (Ala. 1995)—In *Ex parte AmSouth Bank*, the Alabama Supreme Court reversed the court of civil appeals' decision to affirm entry of summary judgment. The court found that the existence of a material fact precluded entry of judgment on whether the corporate veil should be pierced and held that AmSouth's interaction with a certain individual as the corporation's representative did not foreclose piercing, but only militated against it. Moreover, pertinent facts justifying the denial of summary judgment included the fact that the individual was the sole shareholder, sole director and sole officer of the corporation; that the corporation had no financial records, business licenses or bank accounts; that the corporation assumed responsibility for the individual's debts for no consideration; and that the individual may have misused the corporate form.

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Southern Sash Sales & Supply Co. v. Wiley, 631 So. 2d 968, 970 (Ala. 1994)—In *Southern Sash*, the Alabama Supreme Court upheld a jury’s determination that sufficient evidence existed to pierce the corporate veil. The lawsuit related to certain indebtedness incurred by the “second corporation” that remained unpaid and essentially uncollectible because the second corporation did not have any assets. The court found the corporation that purchased the second corporation was liable for the second corporation’s debt in light of evidence that the first corporation took over responsibility of the second corporation’s bank account, purchased its assets prior to plaintiffs’ effort to collect judgment and then operated the second corporation in a manner virtually identical to how it had been operated before the sale.

Econ Marketing, Inc. v. Leisure Am. Resorts, Inc., 664 So. 2d 869 (Ala 1994)—In *Econ*, the Alabama Supreme Court reversed the trial court’s decision not to pierce the corporate veil because there was evidence in the record to support the conclusion that the subsidiary sought to be pierced failed to keep complete and correct records of all transactions of the corporation and minutes of meetings (including a record of a transaction between it and the parent by which the subsidiary was to provide goods and services to other subsidiaries of the parent), and failed to produce financial records regarding several relationships and financial transactions between the subsidiary, the parent and the sole shareholder.

Deupree v. Ruffino, 505 So. 2d 1218 (Ala. 1987)—The Alabama Supreme Court affirmed the trial court decision to pierce the corporate veil because evidence showed that the corporation in whose name the business had been transacted never issued stock, never adopted by-laws, failed to keep financial records, had no employees, and the dominant shareholder commingled personal and corporate funds.


Kwick Set Components, Inc. v. Davidson Indus., 411 So. 2d 134 (Ala. 1982)—The Alabama Supreme Court affirmed the trial court’s decision to pierce the corporate veil where

not only did the dominant and subservient corporations share the same president and same board of directors, the dominant corporation purchased goods through the name of the defunct corporation to perform contracts, and the dominant corporation also apparently sought to avoid payment of the subservient corporation’s debts while benefiting from the use of the goods causing the debts.

Transamerican Properties v. Watkins, 673 So. 2d 422, 425 (Ala. Civ. App. 1993)—The Alabama Court of Civil Appeals upheld the trial court’s finding that sufficient evidence existed to justify piercing the corporate veil. The court found it was proper to attach individual liability because one individual dominated the two corporate defendants named in the action; the corporations were grossly undercapitalized, the plaintiff did not have workers’ compensation insurance to cover employees and neither corporation owned any assets to compensate the plaintiff for his injury. In upholding the verdict, the appeals court stated: “While it is true that mere undercapitalization or dominance by one person alone would not be enough to pierce the corporate veil, those two factors, when combined with the fact that the corporate form in this case was misused and created an injustice or inequitable consequences, are enough to support the trial court’s finding that Pate is personally liable to Watkins for workmen’s compensation benefits.”


Reverse Piercing

In some instances, parties may seek to “reverse pierce.” “Reverse pierce” treats the assets of the LLC as owned by the member in order to avoid fraud on creditors. The authors are not aware of any Alabama cases that have accepted or rejected an attempt to “reverse pierce.” In cases outside of Alabama, courts have permitted judgment creditors to pierce the corporate veil or “reverse pierce” the corporate veil of limited liability companies or partnerships where it was clear the judgment debtor was using the corporate form to evade judgment creditors. Sample cases include:



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C.F. Trust, Inc. v. First Flight LTD Partnership, 140 F. Supp. 2d 628 (E.D. Va. 2001)—The Virginia court permitted reverse piercing of the corporate veil where a judgment debtor used his limited partnership interest to evade creditors. The court was persuaded by the fact that the debtor maintained control over the partnership and its distributions despite official transfer of control and ownership to another person, and the debtor siphoned business assets for his own personal use and without a business purpose.

In re Phillips, 139 P.3d 639 (Colo. 2006)—The court stated that Colorado law allows reverse piercing of the corporate veil when justice requires.

Mallard Automotive Group, Ltd. v. LeClair Management Corp., 153 F. Supp. 2d 1211 (D. Nev. 2001)—The Nevada court held that a party seeking to hold a corporation responsible for an individual's debt under reverse piercing does not have to prove that the corporation was a sham, but instead only that the corporate form would perpetuate fraud or injustice.

BLD Products, LTC v. Technical Plastics of Oregon, LLC, 2006 WL 3628062 (D. Or. 2006)—The Oregon court allowed the corporate veil to be pierced where assets were commingled and the corporate form was disregarded.

Litchfield Asset Management Corp. v. Howell, 799 A. 2d 298 (Conn. App. 2002)—The Connecticut court found the evidence was sufficient to disregard the corporate form and hold limited liability company responsible for the debtor's personal debt where the debtor used company funds to pay for the debtor's personal expenses and used corporate funds as her own; the corporation did not pay her a salary but paid her expenses directly; the debtor owned 97 percent of the stock and all of the stock of the second corporation; and both companies operated outside of the same office space over the debtor's garage.

State Bank of Eden Valley v. Euerle Farms, Inc., 441 N.W.2d 121 (Minn. Ct. App. 1989)—The Minnesota court held the family farm was the alter ego of its occupants and the corporate veil was properly reverse pierced to reach property.

LFC Marketing Group, Inc. v. Loomis, 8 P.3d 841 (Nev. 2000)—The Nevada court listed reverse piercing cases and found use of the doctrine was appropriate where a corporation is being used to hide assets or secretly conduct business to avoid pre-existing liability of controlling debtor.

Piercing and Venue in Intellectual Property Cases

Piercing the corporate veil is often relevant in intellectual property ("IP") cases, especially patent cases, for the determination of venue. Specifically, 28 U.S.C. § 1400(b) provides: "Any civil action for patent infringement may be brought in the judicial district where the defendant resides, or where the defendant has committed acts of infringement and has a regular and established place of business." Accordingly, it is sometimes important to consider the "alter ego" of the company relative to its shareholders.

For example, in *Minnesota Mining & Mfg. Co. v. Eco Chem., Inc.*, 757 F.2d 1256 (CAFC 1985), venue was established under an alter ego theory based on the following facts:

- One shareholder owned 80 percent of the company stock;
- Majority shareholder's spouse possessed all of the company's know-how;
- There was no meaningful board of directors' oversight;
- Minority shareholders were not apprised of company operations;
- Corporate formalities were ignored; and
- The majority shareholder and her spouse manipulated the company assets in an effort to thwart recovery.

In any event, with the high cost of patent litigation, being able to achieve a venue advantage can be useful to a patent plaintiff.

Conclusion

Those who seek to pierce the corporate veil have an uphill, but not impossible, struggle ahead of them. Indeed, not piercing the veil could result in a worthless judgment (or a difficult patent venue). In any event, Alabama practitioners who follow the above guidelines may be able to show a court when too much corporate fiction is a bad thing. ▲▲▲

Endnote

1. That is not to suggest that ownership of a controlling amount, or even all, of the shares of a corporation is dispositive on a veil-piercing or alter ego analysis. On the contrary, courts have explained that the "fact that a party owns all or a majority of the stock in a corporation does not alone destroy the corporate entity, nor does the fact that the corporation is not sufficiently capitalized alone work to defeat the corporate existence." *Shelton v. Clements*, No. 2000851, 2002 WL 161328 at *5 (Ala. Civ. App. Feb. 1, 2002); see also *Transamerican Properties*, 673 So. 2d at 424 (citations omitted (same)); *First Health*, 585 So. 2d at 1334 ("The mere fact that an individual or another corporation owns all or a majority of the stock of a corporation does not, of itself, destroy the separate corporate entity.")



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