

# Understanding the Alter Ego Doctrine

## Holding Principals Responsible for Corporate Debts

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By: Nazgole Hashemi



# Nazgole Hashemi

Co-Founder | LegalAxxis, Inc.

Nazgole Hashemi co-founded her law practice, LegalAxxis, Inc., in 2013 and has also served as an adjunct professor at Southwestern Law School since 2018. She has a broad range of experience in civil litigation, with an emphasis on employment and business cases. She is a skilled negotiator and litigator, and is committed to providing her clients with the best possible representation.

[nhashemi@legalaxxis.com](mailto:nhashemi@legalaxxis.com)

[www.legalaxxis.com](http://www.legalaxxis.com)

T: (424) 249-3685

# Agenda

- **Application of the Alter Ego Doctrine**
  - Definition, origin, types of cases, who decides it
- **Procedural Aspects of the Alter Ego Doctrine**
  - When to assert the doctrine in litigation
- **Substantive Aspects of the Alter Ego Doctrine**
  - Unity of interest and ownership + promote injustice
- **Litigation Practice Tips**

# Introduction to the Alter Ego Doctrine

- **What is it?**
  - Legal principle that allows a court to:
    - Disregard the corporate veil and impose personal liability for corporate debts on principals, i.e., shareholders, officers, or directors,
    - Where there is unity of interest and ownership and
    - Failure to do so would promote an injustice

# Introduction to the Alter Ego Doctrine

- Where does it come from?
  - *Relley v. Campbell* (1901) 134 Cal. 175
    - Facts
    - Evidence
    - Legal Principal
      - “[A]uthority for the statement that where one individual owns all the stock of a corporation, the same is but the corporate double of the owner of the stock, and such proof destroys the separate entity of the corporation . . .” (*Rutz v. Obear* (1911) 15 Cal. App. 436, 438.)
      - The shareholder or director is “virtually the corporation itself, or, as the cases put it, the corporation [is] his ‘corporate double.’” (*Deming v. Maas* (1912) 18 Cal.App. 330, 337, citing to *Relley v. Campel.*)
  - See also *United States v. Bestfoods* (1998) 524 U.S. 51

# Introduction to the Alter Ego Doctrine

- **What kinds of cases does it apply to?**
  - All kinds of cases where the corporation is responsible for a debt and the corporate veil can be pierced
    - Litigation generally
    - Torts
    - Contracts
    - Employment
    - False advertising
    - Bankruptcy
    - Taxes

# Introduction to the Alter Ego Doctrine

- **When is it used?**

- “Extreme remedy, sparingly used.” (*Sonora Diamond Corp. v. Superior Court* (2000) 99 Cal.Rptr.2d 824, 836.)
- “. . . to be exercised reluctantly and cautiously.” (*Mesler v. Bragg Management Co.* (1985) 216 Cal.Rptr. 443.)

- **Who decides it?**

- Question of fact. (*Mid–Century Ins. Co. v. Gardner* (1992) 9 Cal.App.4th 1205.)
- Preponderance of evidence standard

# When to Assert the Doctrine

- During Various Phases of Litigation

- Complaint

- Outset of case
- Motion to amend complaint
  - Middle of trial
  - Post judgment
  - *BUT note:* Same standards apply for a motion to amend complaint, including whether amendment will unduly prejudice opposing party

- Post judgment

- Separate complaint
  - SOL issue? No! SOL on substantive cause of action does not apply to proceedings to declare alter ego.
- Motion to amend judgment



# When to Assert the Doctrine

- **Complaint**

- Pleading standard

- *First Western Bank & Trust Co. v. Bookasta* (1968) 73 Cal.Rptr. 657

- **Post judgment**

- Motion to amend judgment

- Equitable procedure based on the theory that the court is not amending the judgment to add a new defendant but is merely inserting the correct name of the real defendant. (*Highland Springs Conference & Training Center v. City of Banning* (2016) 199 Cal.Rptr.3d.)
    - Due process requires a finding that the additional judgment debtor controlled the litigation in its capacity as an alter ego, and was thus “virtually represented” in the lawsuit. (*Baize v. Eastridge Companies, LLC* (2006) 47 Cal.Rptr.3d 763.)

# Elements of the Doctrine

- **Element 1: Unity of Interest and Ownership**
  - No individuality or separateness between principal and corporation
  - Various factors to consider
    - No single factor determinative
    - No “litmus test” – result depends on all circumstances of each particular case. (*Mesler v. Bragg Management Co.* (1985) 216 Cal.Rptr. 443.)
- **Element 2: Promote Injustice**
  - Not holding principal responsible for corporate debt would promote an injustice
  - A showing of an inequitable, unfair, unjust, or fraudulent result

# Factors to Consider

- Factors (*Associated Vendors, Inc. v. Oakland Meat Co.* (1962) 26 Cal.Rptr. 806)
  - “Commingling of funds and other assets, failure to segregate funds of the separate entities, and the unauthorized diversion of corporate funds or assets to other than corporate uses”
  - “the treatment by an individual of the assets of the corporation as his own”
  - “the failure to obtain authority to issue stock or to subscribe to or issue the same”
  - “the holding out by an individual that he is personally liable for the debts of the corporation”
  - “the failure to maintain minutes or adequate corporate records, and the confusion of the records of the separate entities”

# Factors to Consider

- **Factors**

- “the identical equitable ownership in the two entities; the identification of the equitable owners thereof with the domination and control of the two entities; identification of the directors and officers of the two entities in the responsible supervision and management; sole ownership of all of the stock in a corporation by one individual or the members of a family”
  - BUT one person owning all shares or controlling entity does not automatically destroy separate existence if other factors not present. (*Waters v. Superior Court of Los Angeles County* (1962) 58 Cal.2d 885.)
- “the use of the same office or business location; the employment of the same employees and/or attorney”
- “the failure to adequately capitalize a corporation; the total absence of corporate assets, and undercapitalization”

# Factors to Consider

- **Factors**

- “the use of a corporation as a mere shell, instrumentality or conduit for a single venture or the business of an individual or another corporation”
- “the concealment and misrepresentation of the identity of the responsible ownership, management and financial interest, or concealment of personal business activities”
- “the disregard of legal formalities and the failure to maintain arm's length relationships among related entities”
- “the use of the corporate entity to procure labor, services or merchandise for another person or entity”

# Factors to Consider

- **Factors**

- “the diversion of assets from a corporation by or to a stockholder or other person or entity, to the detriment of creditors, or the manipulation of assets and liabilities between entities so as to concentrate the assets in one and the liabilities in another”
- “the contracting with another with intent to avoid performance by use of a corporate entity as a shield against personal liability, or the use of a corporation as a subterfuge of illegal transaction”
- “the formation and use of a corporation to transfer to it the existing liability of another person or entity”

# Promote Injustice

- **Standard**
  - Actual fraud not required
  - Designed to avoid or prevent a fraud
  - Unjust or inequitable result if corporate veil not pierced

# Litigation Practice Tips

- **Gather evidence**
  - Interview Client
    - Ask factual questions that relate to the doctrine
    - If you have specific and sufficient allegations of commingling, no individuality, no separateness, etc., then should include alter ego allegations in complaint
    - Examples of questions to ask client



# Litigation Practice Tips

- **Gather evidence**

- **Conduct Discovery**

- Case Law

- A plaintiff seeking to assert claims against an entity is entitled to discovery in order to pursue alter ego theories of liability. (*Warburton/Buttner v. Superior Court* (2002) 103 Cal.App.4th 1170.)
      - Contrary to popular belief, “fishing expeditions *are* permissible in some cases.” (*Gonzalez v. Superior Court* (1995) 33 Cal.App.4th 1539.)

- Interrogatories

- Formality questions; when and where incorporated; bates of BOD meetings; how meetings recorded; how business records kept; whether have bank accounts; how paid employees; signatory and name on contracts; etc.

- Requests for Production

- Articles; bylaws; minutes; bank and credit card statements; expense records; profit and loss statements; etc.

# Litigation Practice Tips

- **Discovery Considerations**

- **Privacy Issues?**

- Individuals have reasonable expectation of privacy in finances against serious invasions. (*Hill v. National Collegiate Athletic Assn.* (1994) 7 Cal.4th 1.)
  - BUT, “[t]he constitutional provision simply does not apply to corporations. The provision protects the privacy rights of people.” (*Roberts v. Gulf Oil Corp.* (1983) 147 Cal.App.3d 770.)
  - Two critical factors are the strength of the nexus between the artificial entity and human beings and the context in which the controversy arises. (*Ameri-Medical Corp. v. Workers' Comp. Appeals Bd.* (1996) 42 Cal.App.4th 1260.)

- **Protective Order?**

- Defense can seek stipulation for PO for confidential or sensitive corporate records

# Conclusion

- Advise corporate clients that entity protection is not absolute
- Consider the doctrine when bringing a lawsuit
- Make sure discovery is reasonable based on the particular case
- Research other state and federal cases on the doctrine

# History

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