Using the Single-Enterprise Doctrine to hold sister corporations liable

Look to the old "alter ego" factors to prove unity of interest between companies

By Daniel B. Pleasant

You know who injured your client, so you sue the tortfeasor. But during discovery, you learn that the "company" is actually two or more interrelated corporations. The corporations were formed at the same time and are owned and controlled by the same people. One corporation – the one that injured your client – is the actual negligent party, but another corporation holds the assets of the enterprise. How can you ensure your client can recover the full amount of his or her damages?

One approach is to argue that the aligned corporations are jointly liable under the single-enterprise doctrine. Similar to the alter-ego doctrine, single-enterprise liability requires two elements: "(1) such a unity of interest and ownership that the separate corporate personalities are merged, so that one corporation is a mere adjunct of another or the two companies form a single enterprise; and (2) an inequitable result if the acts in question are treated as those of one corporation alone." (*Tran v. Farmers Group, Inc.* (2002) 104 Cal.App.4th 1202, 1219, citing *Las Palmas Associates v. Las Palmas Center Associates* (1991) 235 Cal.App.3d 1220, 1249-1250.) While the alter-ego doctrine applies to a parent-subsidiary relationship, "under the single-enterprise rule, liability can be found between sister companies." (*Las Palmas Associates*, *supra*, 235 Cal.App.3d at 1249.)

Use "alter ego" factors

Whether there is sufficient unity of interest and a resulting inequitable result are questions of fact. (*Tran*, *supra*, 104 Cal.App.4th at p. 1219.) Since the single-enterprise doctrine is a variant of alter-ego liability, we can look to the factors identified by the courts that tend to show the unity of interest necessary to pierce the corporate veil.

The seminal case discussing these factors is *Associated Vendors, Inc. v. Oakland Meat Co.* (1962) 210 Cal.App.2d 825. As a preliminary matter, the *Associated Vendors* court noted that because the question as to whether there is a unity of interest between the defendants justifying imposition of joint liability is fact intensive, only general guidance… could be provided. Further, the determination is an issue of fact for the trial court, not a question of law. (*Id*. at p. 837.)

Associated Vendors' "general guidance" was supplied by a list of more than 20 factors the trier of fact could consider:

• 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
• 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
• 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
• 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
• 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 transactions

• the formation and use of a corporation to transfer to it the existing liability of another person or entity

(*Id*. at p. 838.)

Obviously, no situation will present all of these factors. But *some* of these factors must be shown to overcome the presumption that the subject corporations are separate and distinct. Accordingly, it is imperative to craft and execute a discovery plan that takes into account as many of the *Associated Vendors* factors as possible, given your actual facts on the ground.

Single-enterprise liability's first prong – Unity of interest

Here are a few illustrations of situations where the Court of Appeal applied these factors and found the single-enterprise doctrine applicable, justifying the imposition of liability on horizontally related corporations:

Real estate developer:

In *Pan Pacific Sash & Door Co. v. Greendale Park, Inc.* (1958) 166 Cal.App.2d 652, defendants formed Greendale Park, Inc., and the Ralmor Corporation to build homes on undeveloped lots. Defendants transferred the real property to Greendale Park and later had that corporation contract with Ralmor for the construction. Plaintiff sold sash doors, frames and jambs to Ralmor. When Ralmor did not pay for the goods, plaintiff sued each corporation asserting they were both one and the same. The trial court entered judgment against both corporations under an alter-ego theory.

The Court of Appeal in *Pan Pacific* affirmed the judgment, stating: "Upon the basis of the ... evidence the trial court was warranted in concluding, as it did, that each corporation was but an instrumentality or conduit of the other in the prosecution of a single venture namely, the construction and sale of houses upon the tract in question. ... There was such unity of interest and ownership that the separateness of the two corporations had in effect ceased and an adherence to the fiction of a separate existence of the two corporations would, under the circumstances here present, promote injustice and make it inequitable for Greendale to escape liability for an obligation incurred as much for its benefit as for Ralmor." (166 Cal.App.2d at pp. 658-659.)

Shopping center developer:

Relying on the reasoning of *Pan Pacific*, the court in *Las Palmas Associates*, *supra*, also found a real estate developer, this time a shopping center, liable under a single-enterprise theory. Buyers claimed they were defrauded when the sellers – an interlocking group of three corporations – refused to honor rent guarantees that buyers had relied on in making the purchase. After the sale, the guarantor corporation transferred the obligations to its sister corporation, who in turn disavowed them.

The court explained the underlying legal theory:

> In effect what happens is that the court, for sufficient reason, has determined that though there are two or more personalities, there is but one enterprise; and that this enterprise has been so handled that it should respond, as a whole, for the debts of certain component elements of it. The court thus has constructed for purposes of imposing liability an entity unknown to any secretary of state comprising assets and liabilities of two or more legal personalities; endowed that entity with the assets of both, and charged it with the liabilities of one or both.

(235 Cal.App.3d at pp. 1249-50, citations omitted.)

Accordingly, the court upheld a jury verdict finding all three seller corporations joint and severally liable.

Interinsurance exchange:

In *Tran*, *supra*, the Court of Appeal found that an interinsurance exchange could be considered a unitary enterprise subject to the single-enterprise doctrine. An interinsurance exchange is an unincorporated business organization made up of subscribers and managed by an attorney-in-fact. The exchange is the insurer and the subscribers are the insureds. The subscribers execute powers of attorney appointing the attorney-in-fact to act on their behalf. The attorney-in-fact executes the exchange's insurance contracts.

When a subscriber sued a group of insurers and their agents, claiming fraud, and adduced evidence that the insurance company defendants shared the same general management, accounting system, trademarks, and advertising, the court found (and the defendants did not dispute) that the element of unitary interest was met.

The second prong – Injustice

> Because society recognizes the benefits of allowing persons and organizations to limit their business risks ... sound public policy dictates that imposition of [single-enterprise] liability be approached with caution. [Citation.] Nevertheless, it would be unjust to permit those who control companies to treat them as a single or a unitary enterprise and then assert their ... separateness in order to commit frauds and other misdeeds with impunity.

(*Las Palmas Associates*, *supra*, 235 Cal.App.3d at p. 1249, quoted with approval in *Tran*, *supra*, 104 Cal.App.4th at p. 1219.)

Inadequate capitalization is sufficient to satisfy the requirement of inequity if the sister corporations are considered to be a unitary enterprise. As the California Supreme Court has held, "If the capital is illusory or trifling compared with the business to be done and the risks of loss, this is a ground for denying the separate-entity privilege." (*Automotriz del Golfo de Calif. S.A. de C.V. v. Resnick* (1957) 47 Cal.2d 792, 797.)

And an inequity or injustice is also more likely to be found in tort cases. Unlike contractual creditors, who voluntarily choose to deal with corporations and can protect themselves through the negotiation process, tort victims do not volunteer to enter into the tortfeasor-victim relationship:

> The obvious difference between consensual and nonconsensual transactions is that the claimants in consensual transactions generally have chosen the parties with whom they have dealt and have some ability, through personal guarantees, security agreements, or similar mechanisms, to protect themselves from loss. For example, the fact that a company is undercapitalized can be overcome in many contractual settings, because the parties can allocate the risk of financial failure as they see fit. But in nonconsensual cases, there is “no element of voluntary dealing, and the question is whether it is reasonable for businessmen to transfer a risk of loss or injury to members of the general public through the device of conducting business in the name of a corporation that may be marginally financed.

(*Cascade Energy & Metals Corp. v. Banks* (10th Cir. 1990) 896 F.2d 1557, 1577, citation omitted.)

Conclusion

Alleging a single-enterprise theory can lead to some complex discovery and evidentiary challenges. In the right case, however, it can make the difference between your client’s full recovery and an inadequate one.


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