Navigating the Mists of Metaphor: An Examination of the Doctrine of Piercing the Corporate Veil

Boyce L. Graham

Follow this and additional works at: https://scholar.smu.edu/jalc

Recommended Citation
https://scholar.smu.edu/jalc/vol56/iss4/6

This Comment is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in Journal of Air Law and Commerce by an authorized administrator of SMU Scholar. For more information, please visit http://digitalrepository.smu.edu.
A FUNDAMENTAL CONCEPT of corporation law is that a corporation is a separate legal entity. As such, the corporation alone, not its stockholders, is liable for the debts and torts of the corporation, with certain qualifications. Because of the risks of massive liability extant in the aviation business, the popularity of the corporate form of enterprise is not surprising among air carriers, aircraft manufacturers, and related businesses. Other considerations such as sources of capitalization and tax advantages also influence the decision to incorporate a business, but the limitation of liability to the assets of the corporation itself is one of the extraordinary characteristics of the corporate entity. "Limited liability is the rule, not the exception; and on that assumption large undertakings are rested, vast enterprises are launched, and huge sums of capital attracted."

The limitation of liability is not absolute, however. A dark cloud looms over the corporate form: the doctrine

---


2 1 W. Fletcher, supra note 1, § 5.

known metaphorically as "piercing the corporate veil." Formally stated as "disregard of the corporate entity," the doctrine is an equitable remedy which courts may apply when continued recognition of the separate corporate entity would promote or protect fraud or injustice, or contravene public policy or convenience. The effect of the remedy is to pierce the veil of limited liability that normally shields shareholders of a corporation from personal liability for corporate acts. Courts tend to be reluctant and cautious about piercing the corporate veil, however, because limited liability is a legitimate purpose and a major incentive to form a corporation.

Courts may consider a number of factors in deciding whether to disregard the corporate entity in any given case, but there is "no precise formula" for the determination. This comment analyzes the doctrine of piercing the corporate veil primarily as it affects the field of aviation. The analysis begins with a discussion of the various incarnations of the doctrine. Next, the comment focuses on the applicability of the doctrine in cases involving tort liability, contractual liability, and labor

---

* 1 W. Fletcher, supra note 1, § 41.
* Id. § 41.25.
* Id. § 41.25.
* Id. § 41; see 18 C.J.S. Corporations § 9 (1990).
* 1 W. Fletcher, supra note 1, § 41.30, at 662, 664.
* Id.; see Steven v. Roscoe Turner Aeronautical Corp., 324 F.2d 157, 161 (7th Cir. 1963).
* For a general discussion of the doctrine, see infra notes 16-44 and accompanying text.
* For applications of the doctrine in tort cases, see infra notes 45-122 and accompanying text.
* For a discussion of veil-piercing in contract actions, see infra notes 131-209 and accompanying text.
relations. Finally, the comment examines a recent statutory development limiting the use of the veil-piercing remedy.

I. DISREGARD OF THE CORPORATE ENTITY: A RULE BY ANY OTHER NAME WOULD CUT AS DEEP

As with other legal theories and doctrines, the courts and commentators have created several labels for the doctrine of disregard of the corporate entity. The metaphor "piercing the corporate veil" is frequently used both in treatises and court opinions to describe the doctrine. Either of the foregoing terms is suitable in the broader context, whether the matter involves a parent corporation and its subsidiary, two or more corporations related by common shareholders, directors or management, or a close corporation and its sole shareholder.

In narrower contexts, courts often use such labels as "instrumentality rule" and "alter ego theory." The "instrumentality" label usually refers to the parent-subsidiary context in which the subsidiary is found to be the mere instrumentality of the parent corporation. The "alter ego" label describes the case where one or more individual shareholders use the corporation as a shell to conduct personal transactions. According to one au-

---

14 For a discussion of corporate disregard in the context of labor relations, see infra notes 219-238 and accompanying text.
15 For a discussion of recent amendments to the Texas Business Corporation Act, see infra notes 250-261 and accompanying text.
16 See generally 1 W. FLETCHER, supra note 1, §§ 41-48; H. BALLANTINE, BALLANTINE ON CORPORATIONS § 122 (1946).
17 See, e.g., De Letelier v. Republic of Chile, 748 F.2d 790 (2d Cir. 1984) (using both the "piercing the corporate veil" metaphor and "disregard of corporate entity"); Boggs v. Blue Diamond Coal Co., 590 F.2d 655 (6th Cir. 1979) (both "piercing" and "disregard" used in opinion); Transportes Aereos de Angola v. Ronair, Inc., 693 F. Supp. 102 (D. Del. 1988) (court uses "piercing" and "disregard the corporate form"); Wilcox v. Precision Parachute Co., 685 F. Supp. 821 (D. Kan. 1988) ("piercing" and "disregard" language; "alter ego" and "instrumentality" also used interchangeably); Castleberry v. Branscum, 721 S.W.2d 270 (Tex. 1986) (compare majority's consistent phrase, "disregard the corporate fiction," with dissent's use of "piercing the corporate veil").
18 1 W. FLETCHER, supra note 1, § 43.10.
19 Id. § 41.10.
authority, "instrumentality" is not an apt word to use in the context of disregarding the corporate entity, because every corporation is, in a sense, the instrumentality of its stockholders. Practically speaking, however, "instrumentality" is interchangeable with "alter ego." Justice Cardozo long ago warned against the danger of casually using and interchanging such terminology. In Berkey v. Third Avenue Railway Co., Cardozo wrote:

The whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor. Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it. We say at times that the corporate entity will be ignored when the parent corporation operates a business through a subsidiary which is characterized as an "alias" or a "dummy." All this is well enough if the picturesqueness of the epithets does not lead us to forget that the essential term to be defined is the act of operation.

By "operation," Cardozo referred to the parent's dominion and control over its subsidiary, an issue which to this day remains critical in deciding whether to pierce the corporate veil.

A. The Instrumentality Rule

In the parent-subsidiary context, the three elements of the instrumentality rule are: (1) such substantial control by the parent corporation as to render the subsidiary its

---

20 Id. § 43.10, at 759; see also Krivo Indus. Supply Co. v. Nat'l Distillers & Chem. Corp., 483 F.2d 1098 (5th Cir. 1973).
21 See infra notes 38-43 and accompanying text.
22 244 N.Y. 84, 155 N.E. 58 (1926).
23 Id. at 94, 155 N.E. at 61. Berkey was injured when alighting from a streetcar as a result of the motorman's negligence. She sued the parent corporation which owned several subsidiary streetcar companies with interconnecting lines in New York City, including the company that actually operated the streetcar she had ridden. The court of appeals affirmed the trial court's dismissal of the action because plaintiff failed to prove that the parent exercised dominion over the subsidiary. Id., 155 N.E. at 61-62.
24 Id.
mere instrumentality; (2) the parent's commission of fraud or other wrong, acting through the subsidiary; and (3) injury or unjust loss to the plaintiff. A plaintiff must prove all three elements in order to pierce the subsidiary's corporate veil. The linchpin of the instrumentality rule is control. In applying the rule, the threshold question is whether the parent corporation exercised dominion and control over the subsidiary.

Control is the most ambiguous element of the rule because at least eleven individual factors may be considered by a court in determining the degree of control exercised by the parent. These factors are as follows:

(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.
(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

---

25 Steven v. Roscoe Turner Aeronautical Corp., 324 F.2d 157, 160 (7th Cir. 1963); see 1 W. Fletcher, supra note 1, § 43.10.
26 1 W. Fletcher, supra note 1, § 43.10. "Control, not mere majority or complete stock control, but complete domination, not only of finances but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own . . . ." Id.
27 The courts most frequently derive or quote these factors from a treatise by Professor Frederick Powell. See F. Powell, Parent and Subsidiary Corporations 8-9 (1931).
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.\(^{28}\)

If certain of these factors are not present in the proper combination, the first element of the instrumentality rule (and thus the whole test) fails. Powell offers some guidance as to the relative importance of his factors in the discussions following his basic list. The first factor is "essential" to the rule, and the second and third are "important."\(^{29}\) But these three factors, without more, are insufficient grounds to pierce the corporate veil because they are consistent with "conventional business practice."\(^{30}\) Powell continues:

[W]e approach the danger line when we introduce additional elements showing a further exercise of control by the parent corporation. . . . [A] hard and fast rule cannot be laid down but, as a rough guide, it may be stated, generally, that proof of the following additional [factors] (sometimes one and often two) will be sufficient to hold the parent corporation [liable]. Some, of course, are more important than others.\(^{31}\)

Powell proceeds to analyze each remaining factor, characterizing most as "some evidence," but only two as conclusive. The parent's use of the subsidiary's property as its own is "almost always fatal proof."\(^{32}\) The lack of independent action by the subsidiary's officers and direc-

\(^{28}\) *Id.* at 9.

\(^{29}\) *Id.* at 10-11.

\(^{30}\) *Id.* at 12.

\(^{31}\) *Id.*

\(^{32}\) *Id.* at 17 (factor (i)).
tors, if directly proven, is "conclusive." Unfortunately, such direct proof is rarely available, so in practice this factor is not often dispositive.

As this comment will reveal, most courts have chosen to ignore Powell's guidelines, preferring to cite or merely pirate the basic list of factors and to determine their relative importance based on the facts of each case. This ad hoc approach by the courts makes it difficult for either party in a particular case to predict which and how many of the control factors the plaintiff must prove in order to satisfy the first element of the instrumentality rule. If a court finds that the subsidiary was in fact under the domination of the parent at the time of the injury or loss, the court then reaches the comparatively straightforward second and third elements of the rule.

The second element of the instrumentality rule requires a claimant to show that the parent, acting through its subsidiary, committed a fraud, breach of duty, or other wrong. The term "other wrong" is necessarily broad in the context of the rule; it is defined by the substance of the underlying cause of action. Significantly, disregard of the corporate entity is not an end in itself, but a means to an end. That one corporation controls another does not of itself give rise to a cause of action. Rather, the courts will disregard the corporate entity only when justice requires such a step in order to remedy an actionable wrong.

The third element of the rule requires the claimant to show that the parent's fraud, breach, or other wrong, per-

---

53 Id. at 18 (factor (j)).
54 See id.
55 Steven, 324 F.2d at 160; 1 W. Fletcher, supra note 1, § 43.10. "Such control must have been used by the defendant to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or dishonest and unjust act in contravention of plaintiff's legal rights . . . ." Id.
56 United States v. Milwaukee Refrig. Transit Co., 142 F. 247 (C.C.E.D. Wis. 1905) "[W]hen the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons." Id. at 255; 1 W. Fletcher, supra note 1, § 41, at 603.
petrated through its subsidiary, proximately caused the claimant's injury or loss. Reversing the order of the elements yields a succinct restatement of the instrumentality rule: the claimant must show actual injury or loss that was proximately caused by the parent corporation acting through pervasive control and domination of its subsidiary. When a plaintiff proves all three elements, the court will disregard the corporate entity of the subsidiary if necessary to prevent the protection of fraud, contravention of public policy, or other inequitable result.

B. The Alter Ego Theory: Another Misty Metaphor?

The alter ego theory and the instrumentality rule are functionally interchangeable in that a plaintiff generally must establish the same three elements in order for a court to disregard the corporate entity. The principal distinction is that "alter ego" connotes a natural person or persons controlling the corporation in question rather than another corporation. In recognition of the fact that the sole or a few stockholders of a close corporation may legitimately exercise substantial control over it, courts sometimes use an alternative approach to the control element in alter ego cases. The plaintiff satisfies the control test in these cases when he can show such substantial identity of interest that the corporation no longer has a personality separate from its owners. Powell mentions this approach as a corollary of his control test for parent-subsidiary relationships, noting that the difference is merely one of degree.

The leading treatise on corporation law illustrates the interchangeability of the "alter ego" and "instrumentality" labels. In discussing the alter ego theory, Fletcher first speaks of fastening liability on a person who uses a

---

37 1 W. Fletcher, supra note 1, § 43.10; see Steven, 324 F.2d at 160.
38 See 1 W. Fletcher, supra note 1, § 41.10.
39 Id. § 41.10, at 615.
40 F. Powell, supra note 27, at 7-8 (citing United States v. Lehigh Valley R.R. Co., 220 U.S. 257, 272 (1911)).
corporation as a mere instrumentality for his personal affa
drs.41 The same section of the treatise then states that 
"[a] corporation may be the alter ego of another corpo
ration . . . ."42 Such indiscriminate use of labels and meta
phors is precisely the object of Justice Cardozo's warning 
and other commentators' criticisms.43

Whatever the label used by a particular court, the case 
law clearly demonstrates that courts may apply the doc
trine of disregard of the corporate entity in many substan
tive areas of law.44 The scope of this comment is limited 
to tort, contract, and labor relations cases, most of which 
involve the aviation industry.

___________________________
41 1 W. Fletcher, supra note 1, § 41.10, at 615.
42 Id. § 41.10, at 616.
43 See Note, supra note 10, at 678. The Fifth Circuit recently drew attention to 
the confusion in terms related to veil-piercing theories. Lubrizol Corp. v. Cardi

There are many different terms ascribed to a cause of action seeking 
to hold one corporation liable for the actions of another corpo
ration. Common theories use terms and phrases such as "alter ego", 
"agency", "mere instrumentality", "sham corporation", and "iden
tity". Not only are these terms unhelpful, but they cloud the think-
ing of lawyers and judges.

Id. at 769.

44 Plaintiffs have invoked corporate disregard theory as a procedural device in 
conjunction with long-arm statutes to assert in personam and subject matter juris-
diction over foreign corporations. See, e.g., Grimandi v. Beech Aircraft Corp., 512 
F. Supp. 764 (D. Kan. 1981) (applying alter ego theory to questions of both per-
sonal and subject matter jurisdiction, where plaintiffs were French citizens, parent 
was Connecticut corporation, and subsidiary was Canadian corporation); Taca 
N.Y.S.2d 129 (1965) (service of process on officer of United States sub-subsidiary 
of British corporation was sufficient to establish personal jurisdiction where sub-
subsidiary was mere department of foreign parent).

In tax cases, courts generally will not disregard corporate entities when doing 
so would allow one corporation to avoid tax liability. See Bonnar-Vawter, Inc. v. 
Johnson, 157 Me. 380, 173 A.2d 141 (1961) (printing company liable for use tax 
on plates bought in ordinary course of business from wholly-owned subsidiary). 
But see Maine Aviation Corp. v. Johnson, 160 Me. 1, 196 A.2d 748 (1964) (general 
rule held inapplicable to casual sale of used aircraft by parent to subsidiary, even 
though both corporations were aircraft dealers).
II. PIERCING THE CORPORATE VEIL IN TORT ACTIONS

A. To Fasten Liability on Shareholders

The act of incorporating brings several benefits to an enterprise. One of the major advantages of the corporate entity is the limited liability that its shareholders generally enjoy. Assuming that his or her stock is fully paid in, an individual stockholder (even a sole shareholder) is not personally liable for the torts of the corporation. There are two exceptions to this general rule. One concerns certain cases involving tortious conduct by the officers and directors of the corporation; the other is the case where the court will pierce the corporate veil and fasten liability on individual or corporate stockholders.

As a practical matter, a plaintiff injured by a corporation will attempt to pierce the corporate veil when the assets of the corporation are insufficient to compensate his or her injuries. Plaintiffs often employ such a "deep pockets" strategy in aircraft crash cases. Despite the frequency with which plaintiffs advance the theory, courts are expressly reluctant to pierce the corporate veil in any business context, including aviation.

A good example of this judicial reluctance is found in Steven v. Roscoe Turner Aeronautical Corp. In this wrongful death action, the plaintiff sought to recover damages for the death of her husband in the crash of a single-engine aircraft.

---

45 19 C.J.S. Corporations § 544 (1990). A director, officer, or agent is liable for his or her own torts, regardless of whether the corporation also is liable. These persons may also be liable for torts committed by the corporation if they authorized, participated or acquiesced in the torts. Id.; see id. § 699; see also 3A W. Fletcher, supra note 1, §§ 1135, 1137 (rev. perm. ed. 1986 & Supp. 1990).


47 324 F.2d 157 (7th Cir. 1963).
airplane in which he was a paying passenger.\textsuperscript{48} The facts of the case are as follows: Turner Aviation Corporation (TAC) operated charter flights under authority of an air taxi certificate issued by the Civil Aeronautics Authority.\textsuperscript{49} Based in Terre Haute, Indiana, TAC was incorporated in 1953 by Roscoe Turner, French Elrod, and Cecil Taylor. Madonna Turner was secretary-treasurer of TAC. The Turners and Elrod were also directors or officers of Roscoe Turner Aeronautical Corporation (RTAC), an Indianapolis-based business incorporated in 1931. RTAC also held an air taxi operating certificate. Both TAC and RTAC engaged in sales and service of aircraft in addition to carrying passengers for hire.\textsuperscript{50}

Richard Meserve, general manager and vice president of TAC, had standing instructions from Roscoe Turner to use only aircraft owned by RTAC or TAC for charter operations. TAC owned only one single-engine airplane and employed only one pilot. Consequently, at Meserve’s request, RTAC would occasionally send additional aircraft and pilots to TAC in Terre Haute. Meserve was also an officer and shareholder of Wremco Enterprises, Inc. (Wremco), together with one Vernon Hux.\textsuperscript{51}

On the night of the crash, plaintiff’s decedent (Steven) and others were stranded at Terre Haute by the cancellation of a scheduled airline flight. Steven and five others contacted TAC to charter a flight to Chicago.\textsuperscript{52} Unwilling to pay for one twin-engine airplane owned by RTAC, plus the cost of flying that aircraft into Terre Haute from Indianapolis to perform the charter, Steven and the other passengers agreed to charter two single-engine airplanes from TAC, each of which carried three passengers. The airplane which crashed, killing Steven, was rented by TAC

\textsuperscript{48} Id. at 158.
\textsuperscript{49} Id. TAC’s certificate authorized daytime flights only. Id.
\textsuperscript{50} Id.
\textsuperscript{51} Id.
\textsuperscript{52} Id. Steven and the others first requested one airplane capable of carrying all six of them. Id.
from Wremco, contrary to Roscoe Turner's instructions. Plaintiff, Steven's widow and administratrix, sued RTAC as well as TAC, Wremco, Hux, and Meserve. Plaintiff alleged that TAC was the agent or alternatively the mere instrumentality of RTAC. The district court granted RTAC's motion for summary judgment and plaintiff appealed.

The question presented to the Seventh Circuit was whether a genuine issue of material fact existed as to the evidence of agency or instrumentality offered by plaintiff. The court quickly resolved the agency issue and turned to the instrumentality rule. Addressing the control element of the rule, the court first quoted the eleven factors enumerated by Powell. Plaintiff's evidence established (1) that the Turners owned seventy per cent of the stock of TAC and (2) the "substantial identity of officers and directors" of TAC and RTAC. The court found that these two factors alone were not sufficient to invoke the instrumentality rule.

Plaintiff also introduced into evidence business records of RTAC and TAC for the five years preceding the crash. The court said that these records clearly showed the absence of many of the other requisite control factors, and noted further that RTAC itself did not own stock in TAC. The Seventh Circuit found that other evidence

---

53 Id. at 158-59. The rented airplane was the sole asset of Wremco. Hux, pilot of the airplane that crashed, was not licensed to carry passengers. Meserve piloted the TAC airplane, which landed safely in Chicago. Id. at 158.
54 Id. at 159.
55 Id. at 158.
56 Id. at 160. RTAC had convinced the district court that there was no question about its separate corporate identity. Id.
57 Id. The court disposed of the agency question on the ground that only where an express agency relationship was shown as between a parent and subsidiary would the parent's liability become an issue. The court found no evidence of such a relationship between RTAC and TAC. Id. at 161, 163.
58 Id. at 161. For a list of the factors, see supra notes 27-28 and accompanying text.
59 Id. at 161. For a list of the factors, see supra notes 27-28 and accompanying text.
60 Steven, 324 F.2d at 161.
61 Id. at 162.
which the trial court refused to admit would not have helped plaintiff's case.\textsuperscript{62} Having found no issue concerning the applicability of the instrumentality rule, the court affirmed the summary judgment below.\textsuperscript{63}

The \textit{Steven} case is still good law in the Seventh Circuit, and is cited as persuasive authority in seven other circuits. The citing cases rely on \textit{Steven} for the list of control factors, the requirement of showing them in proper combination, or for the other elements of the instrumentality rule.\textsuperscript{64} In 1976, a different panel of the Seventh Circuit followed the \textit{Steven} decision in \textit{Allegheny Airlines, Inc. v. United States},\textsuperscript{65} a case involving the mid-air collision of an airliner and a small airplane flown by a student pilot.\textsuperscript{66}

\begin{itemize}
\item \textsuperscript{62} \textit{Id.} The district court struck an uncertified copy of Roscoe Turner's testimony before the CAB, but later read and considered it. \textit{Id.} at 161. The testimony did "not raise a genuine factual issue under the instrumentality rule." It showed Turner's "sound business practice" of helping Meserve manage TAC. \textit{Id.} at 162.
\item \textsuperscript{63} \textit{Id.} at 163.
\item \textsuperscript{64} See Edwin K. Williams \& Co., Inc. v. Edwin K. Williams \& Co.—East, 542 F.2d 1053 (9th Cir. 1976) (where multiplicity of control factors were present as between defendant parent corporation and its subsidiary, trial court erred in not treating the two as a single entity); Scarborough v. Perez, Inc., 683 F. Supp. 659, 660 (W.D. Tenn. 1987) (in action by pension fund trustee against sole shareholder of parent corporation of insolvent subsidiary to recover unpaid contributions, court found no allegations of fraud or injustice that would justify piercing corporate veil (applying Indiana law)); Akzona Inc. v. E.I. Du Pont De Nemours \& Co., 607 F. Supp. 227, 237 (D. Del. 1984) (service of process on subsidiary "does not confer jurisdiction over the parent where separate corporate identities are maintained . . . unless the subsidiary is found to be either the alter ego or the agent of the parent"); United States v. Advance Mach. Co., 547 F. Supp. 1083, 1093 (D. Minn. 1982) (quoting list of factors and finding existence of triable issue of fact as to defendant's "control and dominion" over subsidiary manufacturer of allegedly hazardous product); D.L. Auld Co. v. Park Electrochemical Corp., 553 F. Supp. 804, 807 (E.D.N.Y. 1982) (in patent infringement action against subsidiary and parent, court found four specific factors "conspicuously absent" from plaintiff's "list" and refused to pierce veil; "[w]hile no one factor or combination of factors is directly determinative on the question of control, this Court finds that the elements identified by the plaintiff . . . are insufficient as a matter of law . . . ."); United Paperworkers Int'l Union v. Penntech Papers, Inc., 439 F. Supp. 610, 618 (N.D. Me. 1977) (court refused to pierce corporate veil and compel parent corporation to enter into arbitration with union under terms of subsidiary's union contract); Bay Sound Transp. Co. v. United States, 350 F. Supp. 420, 426 (S.D. Tex. 1972) (principal purpose of separate incorporation of barges and vessels held not avoidance or evasion of income tax liability).
\item \textsuperscript{65} 504 F.2d 104 (7th Cir. 1974), \textit{cert. denied}, 421 U.S. 978 (1975).
\item \textsuperscript{66} \textit{Id.} The other plaintiff in the case was GECC Leasing Corp. (GECC), lessor
\end{itemize}
The owner of the small aircraft, a Piper Cherokee, was Forth Corporation (Forth), which operated a flight school and sold, rented and serviced airplanes. Brookside Corporation (Brookside) owned all of the stock in Forth. The Cherokee and Allegheny's aircraft, a DC-9-31, were both destroyed in the collision; no one aboard either airplane survived. Allegheny sued the United States, the student pilot's estate, Forth, and Brookside to recover $3,750,000 for the loss of the DC-9. The district court directed a verdict in favor of defendant Brookside at the close of plaintiffs' case in chief, and plaintiffs appealed. The Seventh Circuit quoted Powell's list of factors from *Steven*, but found no evidence to support plaintiffs' instrumentality theory. Noting that Forth was "a young organization" when the accident occurred, the court reasoned that whatever control Brookside exerted over Forth was justified as a necessary protection of Brookside's investment. Having rejected plaintiffs' control argument, the court did not reach the second and third elements of the instrumentality rule. Accordingly, the court affirmed the directed verdict for Brookside.

---

of one of the engines on the destroyed DC-9. The defendants, in addition to the United States, were Brookside Corporation (Brookside), Forth Corporation (a subsidiary of Brookside), and the estate of the student pilot, Robert W. Carey. *Id.* at 106.

67 *Id.* at 107.
68 *Id.* at 106.
69 *Id.* at 108.
70 *Id.* at 106-07. In addition, GECC sought to recover $250,000 for the engine it owned which was destroyed in the collision. *Id.* The trial court dismissed GECC as a party plaintiff "on the basis that it was not a real party in interest." *Id.* at 111. Defendants argued that GECC sustained no loss because Allegheny had delivered a replacement engine to GECC pursuant to their lease agreement. The Seventh Circuit held the dismissal was erroneous because the collateral source rule "provides that compensation for loss which is received by a plaintiff from a collateral source independent of the wrongdoer cannot be utilized by the wrongdoer in mitigation of damages." *Id.* at 112.

71 *Id.* at 107.
72 *Id.* at 112-13.
73 *Id.* at 113.
74 *Id.* at 112.
75 *Id.* at 113. The court reversed and remanded as to the other defendants, however. *Id.* at 107.
Allegheny and Steven are similar in at least two aspects which the court did not address. First, the most obvious defendant in both cases apparently was not in a financial position to pay a substantial damage award, if any at all. The student pilot arguably was the actor who proximately caused Allegheny's losses, but his estate was presumably inadequate to pay a seven-digit judgment. In Steven, TAC was responsible for the acts of its employees, but TAC owned only one aircraft and employed a single pilot, suggesting that its assets might have been insufficient to satisfy the plaintiff's claim. Most likely, these plaintiffs were looking to the deep pockets of parent corporations to assure satisfaction of their judgments. The limited liability afforded by the corporate entity is one of the major reasons why businesses incorporate, especially in aviation where the risks of personal injury and property loss are inherent and the damages potentially substantial. The preservation of the limited liability concept is the goal behind the courts' reluctance and cautiousness toward disregarding the corporate entity.

The second similarity is that a jury did not decide the corporate disregard question in either case. Although essentially a question of fact because of the many factors to be considered, disregard of the corporate entity is an equitable remedy. Therefore, a plaintiff is not necessarily entitled to a jury trial on the question. In Allegheny, the trial court directed a verdict in favor of the parent corporation at the close of plaintiff's case. In Steven, the district court granted summary judgment for defendant

---

76 The court rejected as clearly erroneous the district court's findings that Allegheny's flight crew was negligent. Allegheny, 504 F.2d at 110-11.
77 Steven, 324 F.2d at 158.
78 "The corporate form . . . is not lightly disregarded, since limited liability is one of the principal purposes for which the law has created the corporation." Krivo Indus. Supply Co. v. National Distillers & Chem. Corp., 483 F.2d 1098, 1102 (5th Cir. 1973).
79 1 W. Fletcher, supra note 1, §§ 41, 41.25.
80 Allegheny, 504 F.2d at 107. None of the other claims were sent to the jury, either. Id.
RTAC. These cases demonstrate that there may be a question of fact about corporate disregard issues. Even where a genuine fact issue exists, however, the facts adduced may be such that no reasonable juror could find for the plaintiff. Furthermore, if the question is presented to the jury, the jury's role is merely advisory because of the equitable nature of the remedy, absent a stipulation by the parties to abide by the verdict on the issue.

Another case in which the corporate disregard question did not go to the jury is *In re Air Crash Disaster at Stapleton International Airport, Denver, Colorado, on November 15, 1987* (hereinafter *Stapleton*). This multidistrict litigation involved numerous personal injury and wrongful death claims arising out of the crash of a Continental Airlines jet. The federal cases were transferred to the United States District Court for the District of Colorado, where the Plaintiffs' Steering Committee selected an exemplar case and tried it to a jury. The original defendants named were Continental Airlines, Inc. (Continental) and its parent holding company, Texas Air Corporation (Texas Air). Plaintiffs based their claims against Texas Air on the theory that Continental was a mere instrumentality of Texas Air and therefore Texas Air was liable for Continental's conduct. Texas Air moved for a directed

---

81 Steven, 324 F.2d at 159.
82 See *In re Air Crash at Stapleton Int'l Airport, Denver, Colo. on Nov. 15, 1987*, 720 F. Supp. 1467, 1484 (D. Colo. 1989); 1 W. FLETCHER, supra note 1, § 41.25.
84 *Id.* at 1471. The aircraft crashed during takeoff from the Denver airport in a heavy snowstorm. Ice accumulation on the wings and fuselage was one cause of the crash, in which 28 persons died and 54 were injured. *Id.*
85 *Id.* at 1472-73.
86 *Id.* at 1469.
87 *Id.* at 1483. Plaintiffs sought compensatory and punitive damages from both defendants. The stipulated trial plan called for bifurcation of the damages issues. In Phase I, the jury would decide under Colorado law whether defendants were liable for compensatory damages and, under Texas law, whether defendants were liable for punitive damages. The jury was instructed to award compensatory damages, if any, in the exemplar case, according to Idaho law (domicile of the exemplar trial plaintiffs). The remaining cases would then be transferred back to the respective plaintiffs' home states for determination of their compensatory damage awards. The exemplar trial did not reach Phase II, determination of the total
verdict, and the court dismissed the claims against it at the close of plaintiffs’ case.88 The jury ultimately awarded compensatory damages to the plaintiffs based on Continental’s negligence. In answer to a separate special interrogatory, the jury found that Continental was not grossly negligent under Texas law and hence no punitive damages were justified.89

After the court discharged the jury, plaintiffs moved for amended judgment or a new trial on several grounds.90 In particular, plaintiffs asserted that the dismissal of their claims against Texas Air had prejudiced their ability to prove the amount of punitive damages to be awarded.91 Because the jury had found no liability for punitive damages, the court held that the measure of punitive damages was “not truly in issue.”92

The court also found that, despite several opportunities to respond to Texas Air’s motion for directed verdict, plaintiffs had failed to establish at trial that Texas Air’s control of Continental caused plaintiffs’ injuries.93 Concerning the “factual predicate” for disregard of the corporate entity, the court cited a Tenth Circuit opinion enumerating eleven “factors to be considered” under the instrumentality rule.94 In addition to proving a parent corporation’s dominance of its subsidiary, the court stated that a plaintiff must show that recognition of the subsidiary’s separate corporate form would promote injustice, il-

amount of punitive damages, because the jury found no liability therefor during Phase I. Id. at 1472-74.
88 Id. at 1474.
89 Id.
90 Id. at 1470. In addition to alleging that the dismissal of Texas Air was erroneous, plaintiffs alleged inconsistencies in the jury’s answers to special interrogatories, and “errors in the application of the stipulated trial plan [which] prejudiced presentation of claims for punitive damages . . . .” Id.
91 Id. at 1483.
92 Id.
93 Id. at 1484.
94 Id. (citing Luckett v. Bethlehem Steel Corp., 618 F.2d 1373, 1378 & n.4 (10th Cir. 1980)). In Luckett, the court listed 11 factors to be considered which are similar to Powell’s factors. See F. Powell, supra note 27, at 9.
legality, or fraud. Not only did the plaintiffs in Stapleton fail to show such injustice, they also failed to show that the court's refusal to pierce the corporate veil adversely affected their ability to recover damages from Continental.

The plaintiffs in Stapleton sought to maximize their recovery by piercing a subsidiary's corporate veil to recover punitive damages from its parent. Under Texas law, a plaintiff can introduce evidence of a defendant's wealth as a factor in measuring punitive damages. By dismissing the claims against Texas Air, plaintiffs argued, the court closed the door to plaintiffs' reliance on Texas Air's wealth as a basis for measuring punitive damages. The issue is likely to arise again, however, in future multidistrict litigation of aviation disasters.

B. The "Reverse Pierce" to Avoid Liability

Just as courts are reluctant to disregard the corporate entity to impose liability on shareholders, so they are cautious where the disregard theory would allow a corporation to escape liability for its conduct. For example, consider a parent corporation which is immune from common-law tort liability to its employees under workers' compensation statutes. A subsidiary of that corporation which is otherwise liable to the parent's employees will not be allowed to pierce the corporate veil "in reverse" to enjoy the parent's immunity. This principle is illustrated in another air crash case, Gregory v. Garrett Corp. Plaintiff, whose husband died with seven others in the crash of the private jet he piloted, sued the aircraft manufacturer and other corporations connected with certain

\footnotesize{95} Stapleton, 720 F. Supp. at 1484.
\footnotesize{96} Id. The Stapleton court also noted that a court normally has the discretion to treat as advisory a jury verdict on the issue of disregarding the corporate entity. Id.
\footnotesize{97} Id. at 1483.
\footnotesize{98} 1 W. Fletcher, supra note 1, § 43.80, at 789; see id. § 41.70.
\footnotesize{99} 578 F. Supp. 871 (S.D.N.Y. 1983) [hereinafter Gregory I].}
critical components alleged to have caused the crash.\textsuperscript{100} Plaintiff's decedent and his copilot were employees of TexasGulf Aviation, Inc. (TGA), a wholly owned subsidiary of TexasGulf, Inc. (TexasGulf).\textsuperscript{101} The six passengers all were employees of TexasGulf; four were residents of Connecticut, TexasGulf's principal place of business, and two resided in North Carolina, where TexasGulf also maintained an office.\textsuperscript{102} All eight decedents' salaries had been paid by TexasGulf, and all were covered by a workers' compensation insurance policy issued to TexasGulf.\textsuperscript{103} Before filing the instant suit, the survivors of the crash victims accepted payment of benefits authorized under the respective state workers' compensation acts.\textsuperscript{104}

The survivors soon realized that the statutory compensation to which they were entitled was meager at best compared with the decedents' salaries.\textsuperscript{105} In the meantime, TexasGulf and TGA had sued the aircraft manufacturer and other corporations connected with the generator control units (GCUs)—components which allegedly caused the crash—for loss of the aircraft.\textsuperscript{106} The survivors filed actions against the same defendants, seeking wrongful death compensation.\textsuperscript{107} Garrett Corporation (Garrett) and the other component-connected

\textsuperscript{100} Id. at 876. Defendants were Lockheed Corporation, the aircraft manufacturer; Phoenix Aerospace, Inc., manufacturer of the generator control units (GCUs) aboard the aircraft, which allegedly failed; Colt Electronics Co., Inc., which modified and sold the GCUs to TGA; The Garrett Corporation, which installed the GCUs in the aircraft; and the United States. The government was named because the FAA had approved the modification and installation of the GCUs, and because it was responsible for the air traffic controllers involved with the fatal flight. Id.

\textsuperscript{101} Id. at 875. J. Morgan Gregory was president and director of TGA and was in command of the aircraft; his copilot, Shanley Sorenson, was listed as "Pilot for TGA." Id.; TexasGulf, Inc. v. Colt Elecs. Co., 615 F. Supp. 648 (S.D.N.Y. 1984).

\textsuperscript{102} Gregory I, 578 F. Supp. at 875.

\textsuperscript{103} Id. at 876.

\textsuperscript{104} Id.

\textsuperscript{105} Id.

\textsuperscript{106} Id. TexasGulf and TGA had filed suit in the same district court nine months after the crash. Id.; see TexasGulf v. Colt, 615 F. Supp. at 650. For a list of the defendant corporations, see supra note 100.

\textsuperscript{107} Gregory I, 578 F. Supp. at 876.
defendants impleaded TexasGulf and TGA, alleging that employees of the latter two companies who serviced the aircraft negligently caused the crash.108 Garrett and the others sought contribution from TexasGulf and TGA to the extent of their liability, if any.109

The basic question presented to the court in Gregory I was whether the statutory immunity of a parent corporation under the exclusive remedy provisions of applicable workers' compensation acts extended to a subsidiary of the parent.110 The question was presented on two alternative theories, one of which was the alter ego theory.111 Moreover, the court had to answer the question in the context of a third-party contribution claim as well as the direct claims of four other survivors.112 The court first decided that New York law, which allows third-party contribution claims in workers' compensation cases, applied to the third-party claims.113

The court then addressed TGA's claim that it was the alter ego of TexasGulf and, therefore, as immune from liability as TexasGulf.114 The court cited a long list of authorities showing the reluctance of courts to indulge the alter ego argument, and summed up in one simple proposition: "[O]ne who has gained the advantages of separate incorporation must also be willing to accept the conse-

---

108 Id. Survivors of four of the passengers sued TGA directly, on the theory that TGA was not protected by TexasGulf's immunity. Id. at 877.
109 Id.
110 Id.
111 Id. The alternative theory asserted as a defense by TexasGulf and TGA was that all of the decedents as well as the aircraft maintenance personnel were co-employees of TexasGulf; therefore, the immunity of TexasGulf under applicable workers' compensation law extended to the TGA "employees." Id.
112 Id. The court entered into an elaborate analysis of third-party claims in workers' compensation cases generally, and a discussion of the conflict of laws question in the instant case, which involved Connecticut, North Carolina, and New York law. Id. at 877-84.
113 Id. at 884. The court found that the law of Connecticut and North Carolina applied to the four direct claims against TGA. Id. at 886.
114 Id. "Whether one looks at this contention as an effort to pierce the corporate veil or as an argument that the parent and subsidiary were actually so intertwined as to be a single entity, it represents a legal theory that has not met with a warm reception in the courts of most states . . . ." Id.
quences of such incorporation.'"\(^1\) Acknowledging the familiar provisions for employer and co-employee immunity in most workers' compensation acts, the court emphasized the other "strong policy" of such acts: "preserving the employee's rights to bring tort claims against ... 'strangers' to the employment relationship."\(^1\)

In other words, even if a parent and a subsidiary were shown to be "so intertwined as to be a single entity,"\(^1\) public policy would be contravened if the limited statutory immunity of an employer could be expanded to protect the employer's parent or subsidiary.

The court in Gregory I ultimately denied TexasGulf's and TGA's motion for summary judgment on all of the claims, both third-party and direct, on the ground that there were questions of material fact to be decided by a jury.\(^1\) The two corporations subsequently moved for a bifurcated trial, asking the court to try their affirmative defenses first, before the issues of liability and damages.\(^1\)

The court granted this motion and conducted a jury trial of TexasGulf's and TGA's defenses of immunity under workers' compensation laws in April 1984.\(^1\) The jury found that TGA was not the alter ego of TexasGulf for workers' compensation purposes, that the employer of the


\(^1\) Gregory I, 578 F. Supp. at 887.

\(^1\) Id. at 886; see supra note 114.

\(^1\) Gregory I, 578 F. Supp. at 889.


\(^1\) Id. at 298.
airplane's flight crew and maintenance personnel was TGA, and that TGA was the operator of the aircraft.

The *Gregory* cases present a policy question of particular interest to the aviation community. The question is whether the citizenship requirements imposed by the FAA on aircraft owners place an unreasonable burden on corporations like TexasGulf by indirectly exposing them to tort liability from which they are directly immune. Briefly, to fulfill FAA registration requirements for an aircraft based in the United States, the corporation which owns it must meet strict criteria: (1) the president and at least two-thirds of the directors and officers must be United States citizens, and (2) United States citizens must hold seventy-five percent or more of the voting interest in the corporation. In other words, regardless of nominal

---

121 The widows of the pilot and copilot later settled their claims. *TexasGulf v. Colt*, 615 F. Supp. at 650 n.1; see supra note 101.

122 *Gregory H*, 589 F. Supp. at 298. The issues were presented to the jury in the form of special interrogatories.

Q.1. Do you find: that at the time of the crash [TGA] functioned solely as the aviation department of Texasgulf; that Texasgulf and [TGA] were so merged that they were really only one entity; that [TGA] had no purpose other than to carry out Texasgulf's business; and that [TGA]'s corporate structure and any right it had to control the flight crews and maintenance personnel were so merged with those of Texasgulf that for purposes of determining the scope of workers' compensation immunity [TGA] should be considered the alter ego of Texasgulf rather than a separate corporate entity?

A. No.

*Id.* (emphasis in original).

123 Section 501(b) of the Federal Aviation Act of 1958, 49 U.S.C. app. § 1401(b) (1988) provides, in pertinent part:

An aircraft shall be eligible for registration if, but only if—

(1)(A) it is —

(i) owned by a citizen of the United States . . . ; or

(ii) owned by a corporation (other than a corporation which is a citizen of the United States) lawfully organized and doing business under the laws of the United States or any State thereof so long as such aircraft is based and primarily used in the United States . . . .

*Id.*

124 14 C.F.R. § 47.2 (1991) defines "U.S. citizen" for purposes of aircraft registration as follows:

(1) An individual who is a citizen of the United States or one of its possessions.
ownership, United States citizens must have actual control
of the corporation. The judge in *Gregory I* acknowledged
the existence of this policy question in analyzing the facts
adduced by TGA in support of summary judgment.125

The judge noted that TGA had been a department of
TexasGulf before the crash, and was at the time of the
hearing again a mere department.126 But for the FAA citi-
zension requirements, the judge observed, TGA probably
would not have been a separate corporation at the time of
the crash.127 The judge found the facts concerning TGA's
corporate identity "rather more compelling" than in the
usual case of this sort.128 The jury in the subsequent trial
obviously did not share the judge's point of view.129

It is beyond the scope of this comment to balance the
FAA's citizenship requirements against the seemingly ar-
bitrary imposition of liability on some corporate aircraft
owners. The public policy goals underlying the citizen-
ship rules may outweigh the risks forced upon corpora-
tions having foreign stockholders, assuming those policy
goals are still valid.130 Nevertheless, after a decade when
foreign investment in United States corporations became
increasingly common, the liability question is one that re-

---

(2) A partnership of which each member is such an individual.
(3) A corporation or association created or organized under the laws
of the United States or of any State, Territory, or possession of the
United States, of which the president and two-thirds or more of the
board of directors and other managing officers thereof are such indi-
viduals and in which at least 75 percent of the voting interest is
owned or controlled by persons who are citizens of the United States
or one of its possessions.

*Id.*

125 *Gregory I*, 578 F. Supp. at 885.

126 *Id.* "[I]t appears that TGA transported primarily, if not solely, [TexasGulf]
employees on official [TexasGulf] business." *Id.*

127 *Id.* On the other hand, the judge also described the FAA statute and regula-
tions as "a consideration extraneous to this case." *Id.*

128 *Id.*

129 *Gregory II*, 589 F. Supp. at 298. For a discussion of the jury's verdict in
Gregory II, see *supra* note 122 and accompanying text.

130 For a thorough analysis of the FAA citizenship rules and underlying policies,
see Stewart, *United States Citizenship Requirements of the Federal Aviation Act — A Misty
quires careful consideration by corporations which operate their own aircraft.

III. DISREGARD OF THE CORPORATE ENTITY IN CONTRACT ACTIONS

As a general rule, courts are even less likely to disregard the corporate entity in contract cases than in tort actions. The reason is simple: in the contract setting, the injured party chose the entity with whom he dealt; in a tort case, the relationship of tortfeasor to injured party generally occurs fortuitously. The Fifth Circuit, sitting en banc, explained the distinction between tort and contract claims in a contract action tried under Texas law. Citing a line of Texas Supreme Court decisions, the Fifth Circuit observed that a contract case "presents added difficulties," such as showing why the aggrieved party to a contract with a corporate subsidiary "should be allowed to look to the parent. As a matter of contract right it is evident he may not." The Fifth Circuit then compared the case with a Texas Supreme Court opinion in a tort claim:

Unlike a suit for breach of contract, the plaintiff in a tort case does not have the burden of justifying a recovery against the parent when he willingly contracted with the subsidiary. The problem in such a case is essentially one of allocating the loss. It is not necessary to establish fraud, and the financial strength or weaknesses of the subsidiary is an important consideration.

This rationale is consistent with the principle stated in Gregory I that one who chooses to enjoy the advantages of separate incorporation also must accept the

---

1 W. Fletcher, supra note 1, § 41.85.

2 Id.

3 Edwards Co. v. Monogram Indus., 730 F.2d 977 (5th Cir. 1984) (en banc).


5 Edwards Co., 730 F.2d at 982 (quoting Gentry v. Credit Plan Corp., 528 S.W.2d 571, 573 (Tex. 1975)).
disadvantages.\textsuperscript{136}

A. Alter Ego and Individual Shareholders

The situation where compliance with federal aviation law necessitates the formation of a separate entity, previously discussed in a tort context, has also surfaced in a contract case.\textsuperscript{137} In a state court action to recover on a debt, \textit{Hilzendager v. Skwarok},\textsuperscript{138} an individual creditor sued the common officers and directors of two related corporations, as well as the corporations themselves.\textsuperscript{139} The factual history of the action began in 1967 with the formation of Holiday Air of America, Inc. (Holiday Air), a North Dakota corporation whose purpose was “to provide travel opportunities to qualified individuals.”\textsuperscript{140} Apparently, the corporation was organized to operate an air travel club as defined in Part 123 of the federal aviation regulations then in effect.\textsuperscript{141} While the court never used the term “air travel club,” the inference is supported by repeated references in the opinion to an “FAA 123 Certificate”\textsuperscript{142} and a quotation from the trial court opinion referring to “members.”\textsuperscript{143}

Summarizing the trial court’s findings, the court noted that under federal regulations, Holiday Air could not own both the “FAA 123 Certificate” and the requisite airplane.\textsuperscript{144} The original directors and incorporators of Holiday Air therefore organized Holiday Leasing and


\textsuperscript{137} For a discussion of FAA citizenship requirements, see supra notes 123-130 and accompanying text. For a case in which corporate liability arose out of the citizenship requirements, see supra notes 99-122.

\textsuperscript{138} 335 N.W.2d 768 (N.D. 1983).

\textsuperscript{139} Id. at 772.

\textsuperscript{140} Id. at 769.


\textsuperscript{142} \textit{Hilzendager}, 335 N.W.2d at 770-71.

\textsuperscript{143} Id. at 770. “[T]he corporation could produce no income without members, there could be no members without a 123 certificate utilization, and there could be no certificate utilization until the plane was operational.” Id.

\textsuperscript{144} Id. The court did not substantiate this finding, and Part 123, then in effect,
Investment, Inc. (Holiday Leasing) as a separate entity to own and operate an airplane which it would lease to Holiday Air. Under the pre-incorporation agreement for Holiday Leasing, six subscribers were to pay $28,000 each into the new corporation. The subscribers never paid the recited consideration, although the stock transfer ledger showed that they did. The stated capital of Holiday Leasing, nevertheless, was $200,000, substantially more than the sum purportedly paid in by the subscribers.

Holiday Leasing encountered financial difficulties from the outset, arising in part from substantial expenses incurred in refurbishing the airplane it had purchased. Two of the directors actually paid most of these expenses. The corporation then began seeking loans from other individuals. Plaintiff, John Hilzendager, loaned $36,000 to Holiday Leasing, secured by a three-year debenture bond.

The record is replete with evidence of commingling of the funds of the two corporations and of failure to observe corporate formalities. Defendant Skwarok, with knowledge and consent of the other directors, obtained title to the airplane (the only significant asset of Holiday

---

is silent on the issue. Presumably, the citizenship requirements discussed above were a factor. See supra notes 123-130 and accompanying text.

145 Id. "Holiday Leasing was to own 80 percent of Holiday Air. The corporate record book for Holiday Air, however, has since disappeared." Id.

146 Id.

147 Id. The debenture provided that Hilzendager was to be a preferred creditor over the corporation's stockholders and general creditors. The debenture was subordinate "only to lending institutions as creditors." Id.

148 Id. at 774.

The corporate minute books of both corporations were not kept current. Many of the corporate records have disappeared. Several of the defendants were unaware of and unconcerned about their various duties as directors and officers. Funds and assets of both corporations were commingled and disbursed haphazardly. The directors of Holiday Leasing allowed the conveyance of its sole significant asset, the airplane, to Skwarok. The ultimate fraud occurred when Skwarok sold the airplane to the college and the other officers and directors failed to take any action to recover the asset or make other provisions for Hilzendager's matured claim. These examples are not an exhaustive recitation of the improprieties which occurred.

Id. at 774-75.
Leasing) and control of both corporate checkbooks.\footnote{Id. at 770-71. Skwarok contracted with the two corporations to acquire the airplane subject to three conditions: (1) he would personally refinance the airplane; (2) he would lease it to Holiday Air "to keep the 'FAA 123 Certificate' valid"; and (3) Holiday Leasing would be able to buy back the airplane. \textit{Id.} at 771.} Six months after Hilzendager's debenture became due, Skwarok sold the airplane. The other directors made no effort to prevent the sale or to recover the airplane.

Hilzendager brought suit to collect his loan. Although he originally named only Skwarok as defendant, he later amended his complaint to join the other directors and both corporations.\footnote{Id. at 772.} The amended complaint alleged commingling and wasting of corporate assets to the detriment of creditors, and a deliberate intent to defraud creditors through the conveyance of the airplane to Skwarok.\footnote{Id. The case was tried to the court without a jury. \textit{Id.}} The trial court found that the directors had defrauded Hilzendager.\footnote{Id.} Curiously, the trial court refused to pierce the corporate veil and hold the individual defendants directly liable to Hilzendager, concluding: "There is no evidence that the plaintiff ever believed he was dealing with the individual defendants in their individual capacity [sic] and not as representatives of either corporation."\footnote{Id. (quoting trial court's conclusions of law).} Rather, the trial court held the directors jointly and severally liable to the corporations for the principal and interest on the note, and in turn held the corporations liable to Hilzendager.\footnote{Id. at 772-73.}

When the individual defendants appealed, the supreme court held that the trial court had erred in its circuitous findings as to liability.\footnote{Id. at 773-74. The court held that the trial court erred in awarding judgment in favor of Holiday Air and Holiday Leasing against the individual defendants, because neither corporation sued the individuals nor made an appearance in the case. \textit{Id.}} In addition, the court agreed with Hilzendager that the facts justified disregarding the
corporate entity. Noting that there are other grounds for piercing the corporate veil besides the one stated by the trial court, the court cited one of its earlier decisions, and a list of significant factors set forth in a Minnesota decision. The North Dakota Supreme Court found so many instances of corporate improprieties that its list admittedly was not exhaustive. The court found that the conduct of Skwarok and the other directors was fraudulent as to Hilzendager, and concluded that "to allow the individual defendants to escape liability because they were doing business under a corporate form would result in allowing them an advantage they do not deserve."

A more recent case in which a court disregarded the corporate entity concerns a breach of contract for the sale of an airplane. In *Trans-Aircraft Sales, Inc. v. K.A. 300 Corp.*, Dr. Leroy A. Pesch, sole stockholder of K.A. 300 Corporation (K.A. 300), was joined as a defendant by plaintiffs who sought to pierce the corporate veil of K.A.

---

157 *Id.* at 774. The trial court had declined to pierce the corporate veil on the basis of a 1932 decision in which the supreme court applied agency law to the question of a corporate officer's liability. *Id.* n.4 (citing Gray v. Edler, 61 N.D. 672, 240 N.W. 477 (1932)).

158 *Id.* at 774. "[B]ut, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons." *Id.* (quoting Schriock v. Schriock, 128 N.W.2d 852, 856 (N.D. 1964) (citation omitted)).

159 *Id.* The court stated:

It has also been held that factors considered significant in determining whether or not to disregard the corporate entity include: insufficient capitalization for the purposes of the corporate undertaking, failure to observe corporate formalities, nonpayment of dividends, insolvency of the debtor corporation at the time of the transaction in question, siphoning of funds by the dominant shareholder, nonfunctioning of other officers and directors, absence of corporate records, and the existence of the corporation as merely a facade for individual dealings.

*Id.* (citing Victoria Elevator Co. v. Meriden Grain Co., 283 N.W.2d 509, 512 (Minn. 1979)).

160 *Id.* at 774-75. For the court's list of improprieties, see *supra* note 149.

161 *Id.* at 775.

Plaintiff Trans-Aircraft Sales, Inc. (Trans-Air) acted as agent for plaintiff Proctor & Gamble, Inc. (P&G) in negotiating the purchase of an airplane from K.A. 300. Pesch was the sole shareholder of both K.A. 300 and Avro Aviation Corporation (Avro). Pesch originally purchased the airplane from Beech Acceptance Corporation (Beech), and later transferred title in the airplane to K.A. 300. Pesch personally guaranteed his note to Beech when he purchased the airplane; he also pledged the aircraft itself as security both for the purchase price and for other pre-existing debts that Pesch owed Beech. K.A. 300 became a co-obligor on the note as consideration for the title transfer. K.A. 300 thereafter leased the airplane to Avro under a written lease providing a minimum monthly rent and requiring Avro to insure the airplane.

Trans-Air offered to purchase the airplane from K.A. 300 on behalf of P&G. K.A. 300 accepted the offer, a sales agreement was signed, and Trans-Air paid K.A. 300 a "non-refundable deposit" of $25,000 pursuant to the agreement. While the airplane was being modified to suit P&G, Beech seized and sold it to satisfy its lien. Trans-Air and P&G won a default judgment against K.A. 300 in April 1988 for breach of contract. Plaintiffs then sought to reach Pesch by disregarding the corporate form of K.A. 300, which was insolvent.

The court examined a number of facts in reaching its decision: (1) Pesch was the sole shareholder of both K.A. 300 and Avro; (2) K.A. 300 did nothing to enforce the aircraft lease agreement with Avro when Avro stopped paying rent; (3) rather than enforcing the insurance requirement in the lease, K.A. 300 bought insurance on the airplane; and (4) the insurance policy and all other operations of K.A. 300 were funded with loans Pesch made to the corporation. The court concluded from this evi-

163 Id.
164 Id. at 2.
165 Id. at 3-5.
166 Id. "Pesch treated the assets and business of K.A. 300 as his own... Pesch
dence that the inaction of K.A. 300 was the result of Pesch's personal desire to keep Avro profitable. Moreover, the court found that K.A. 300 was grossly undercapitalized for its intended business purpose, and that Pesch had intermingled his personal affairs with the business of K.A. 300 by pledging the airplane to Beech as security not only for the purchase price but also for his pre-existing obligations. In light of all the facts, the court concluded that recognition of K.A. 300 as a separate corporate entity would "promote injustice or inequitable consequences." Therefore the court pierced the corporate veil and granted plaintiffs' summary judgment motion, holding Pesch personally liable for damages.

Other courts faced with actions on breach of contract to purchase an airplane have refused to pierce the corporate veil. A comparison of these cases to Trans-Aircraft Sales reveals factual distinctions, but, more importantly, it reveals varying interpretations of the standards for invoking the veil-piercing remedy. In Transportes Aereos de Angola v. Ronair, Inc., a foreign state-owned corporation sued two United States corporations and the sole director of one of them. Addressing the plaintiff's motion for summary judgment against the director, Winfield, the court stated that "courts will not entirely disregard the corporate form," and that if they do the circumstances must be spe-

167 Id. at 6.

168 Id. at 8-9. The initial capitalization of K.A. 300 was $1,000, the statutory minimum. The airplane at issue was the corporation's sole asset. The "cross-collateralization and Pesch's failure to satisfy his personal debts to Beech prompted Beech to seize the airplane, causing K.A. 300 to breach its contract with Trans-Aircraft and Proctor & Gamble." Id. at 7-8.

169 Id. at 9.

170 Id. at 13.


172 Id. at 103. Named defendants were Ronair, Inc. (Ronair), Jet Traders Investment Corp. d/b/a Commercial Air Transport Sales (Jet Traders), and Nigel Winfield. Id. at 102.
sific and unusual. The court then quoted the familiar litany supporting disregard of the corporate entity: "to prevent fraud, illegality, or injustice, or when recognition of the corporate entity would defeat public policy . . . ." The plaintiff, Transportes Aereos de Angola (TAAG), alleged that Winfield used Jet Traders as a conduit for his personal business and to perpetrate a fraud. In support of these allegations, TAAG introduced two corporate documents of Jet Traders. Neither of the documents persuaded the court to find Winfield personally liable. The court denied plaintiff's motion for summary judgment.

An appellate court in Florida reversed a trial court decision to the extent that it pierced the corporate veil of an aircraft dealership, but not without dissent. Charter Air Center, Inc. v. Miller was an appeal from a breach of contract action brought by Dr. Fred Miller to recover the $11,000 deposit he had paid on a contract to purchase a Piper airplane from Charter Air Center, Inc. (Charter Air). The jury found both Charter Air and its president, Cousins, liable to Miller and awarded compensatory and punitive damages. On appeal, the court found that Cousins was not involved in any dealings with Miller, nor did he sign any papers relating to the transaction. Furthermore, the court found that Miller failed to allege and

---

175 Id. at 111 (emphasis added) (citing Anderson v. Abbott, 321 U.S. 349, 362 (1944); Zubik v. Zubik, 384 F.2d 267, 273 (3d Cir. 1967)).
177 Ronair, 693 F. Supp. at 111.
178 Id. at 111-12. The first document was a memorandum agreement signed by Winfield and the only other officer of Jet Traders. It provided that Winfield accepted sole responsibility for disposing of the proceeds of the breached contract. The second document, a corporate resolution of Jet Traders, provided that all profits and losses on the contract were to be Winfield's alone. The court found these factors inadequate to establish domination of Jet Traders by Winfield. Id. at 112.
179 Id. at 112.
180 Id. at 615.
181 Id. at 617.
prove that Charter Air was the alter ego of Cousins or that the corporation was used for fraudulent purposes.\textsuperscript{182} The dissenting opinion in *Charter Air* supported the jury's findings concerning both compensatory and punitive damages.\textsuperscript{183} The dissenting judge emphasized Charter Air's misrepresentation to Miller (made at Cousins' instance) that it was an authorized Piper dealership.\textsuperscript{184} The judge also noted additional evidence which supported an inference of intentional fraud, including bank records of Charter Air and testimony of the airplane salesman concerning Cousins.\textsuperscript{185}

**B. "Reverse" Disregard Revisited**

In *Hilzendager*, individual shareholders were held personally liable on a corporate debt through disregard of the corporate entity.\textsuperscript{186} In contrast, if the debt is a personal obligation of an individual shareholder who uses the corporation to secrete assets in order to avoid personal liability, the corporation may be held liable.\textsuperscript{187} The court will pierce the corporate veil and hold the corporation liable on the debt when the creditor can prove that controlling shareholders "used the corporation to deceive or defraud personal creditors."\textsuperscript{188} This remedy is known as "reverse disregard" because, instead of holding shareholders liable for ostensibly corporate acts or obligations, the purpose is to hold the corporation liable for the acts or obligations of a shareholder.\textsuperscript{189}

In *Lambert v. Farmers Bank*,\textsuperscript{190} William Lambert bor-
rowed $20,000 from Farmers Bank on a promissory note which Lambert signed individually and in his capacity as president of Agricultural Aerial Applicators, Inc. (AAA). To obtain credit from the bank, Lambert represented that he owned and controlled another corporation, Lambert Enterprises, Inc. When Lambert defaulted on the loan, the bank successfully sued Lambert and AAA. ¹⁹¹ When the bank attempted to execute the judgment, however, the sheriff discovered that Lambert’s purported assets were not held in his name. The bank then filed a motion alleging that Lambert had manipulated “several corporate entities” to defraud creditors. The trial court found that Lambert Enterprises, Inc., was the alter ego of Lambert and that its assets were actually Lambert’s personal assets. ¹⁹² Therefore, the “corporate” assets were subject to execution to satisfy Lambert’s personal debt. ¹⁹³

On appeal, the court noted that the corporate form may be disregarded where an individual has used it fraudulently as a shield from liability to third parties. ¹⁹⁴ Despite Lambert’s testimony to the contrary, the court found that Lambert was the sole shareholder of Lambert Enterprises, Inc., when the loan in question was made, and that he exercised complete control over the corporation. ¹⁹⁵ The court held that the trial court properly disregarded the corporate entity. ¹⁹⁶

C. Personal Liability of Promoters of Corporations

Before a corporation actually becomes a legal entity separate from the persons who form it, a promoter often

¹⁹¹ Id. at 746.
¹⁹² Id. at 746-47.
¹⁹³ Id. at 747.
¹⁹⁴ Id. “As a general rule, Indiana courts are reluctant to disregard corporate identity . . . .” Id.
¹⁹⁵ Id. at 748. Lambert’s testimony was inconsistent with the business records of Lambert Enterprises, Inc. “The evidence tended to show that Lambert owned all the corporate stock, treated corporate assets as his own, used the corporation to procure goods and services for himself, and that he generally governed all the corporate affairs.” Id.
¹⁹⁶ Id. at 748-49.
enters into contracts on behalf of the future corporation. The promoter may make agreements to incorporate or to obtain financing for the nascent entity.\textsuperscript{197} The personal liability of a promoter on such contracts is a matter of concern for any person in the process of forming a corporation. Depending upon the facts, promoters may be personally liable under established agency law.\textsuperscript{198} The common law and the corporation codes of some states address the issue.\textsuperscript{199}

At least one court has invoked the alter ego doctrine in holding a promoter individually liable on contracts he signed prior to the formation of the corporation to be bound. \textit{Doyn Aircraft, Inc. v. Wylie}\textsuperscript{200} was an action for breach of contract, fraud and conversion by a promoter. Plaintiff Doyn Aircraft, Inc. (Doyn) entered into a contract with defendant James Wylie to make Wylie's as-yet-unformed corporation the exclusive distributor for Doyn's airplane conversion kits. Doyn held seventeen FAA supplemental type certificates (STCs) in connection with its business of manufacturing the kits.\textsuperscript{201} To finance the venture, Wylie agreed to lend $25,000 to Doyn. Wylie took the STCs as security for the proposed loan. He re-registered the STCs in his name, but refused to fund the loan or perform the contract. Wylie kept the STCs as "security" for a pre-existing debt that Doyn owed him, and then permitted his new corporation, Atlas Aviation Sales, Inc. (Atlas) to make conversion kits pursuant to the STCs.\textsuperscript{202}

\textsuperscript{197} See 18 C.J.S. Corporations §§ 67, 68, 76 (1990); 1A W. Fletcher, supra note 1, § 204 (rev. perm. ed. 1983); Ballantine, supra note 16, § 35.

\textsuperscript{198} An agent cannot bind a non-existent principal and so is liable unless the agent's contract is later ratified by the principal. Restatement (Second) of Agency §§ 82, 326 (1958).


\textsuperscript{200} 443 F.2d 579 (10th Cir. 1971).

\textsuperscript{201} Id. at 580. "STCs are issued by the Federal Aviation Administration for the purpose of allowing modification work to aircraft." Id. at 580 n.1; see also 49 U.S.C. app. § 1423 (1988) (authorizing FAA to issue aircraft certificates); 14 C.F.R. §§ 21.111-21.119 (1991) (procedural requirements for STCs).

\textsuperscript{202} Doyn Aircraft, 443 F.2d at 581.
Wylie had signed the contract as trustee for Atlas, and therefore he argued that he should not be held individually liable on the agreement. The court found that the contract by its own express terms was fatal to his defense; in order to escape personal liability, Wylie was required to assign the contract to Atlas. Wylie admitted that he never fulfilled this condition.

The court then discussed the trial court’s use of the alter ego doctrine to fasten liability on Wylie. By finding Wylie liable on the basis of the contract alone, the Tenth Circuit strongly suggested that it deemed the application of the alter ego doctrine unnecessary. Nevertheless, the court upheld the lower court’s findings that the identities of Wylie and Atlas had merged and that separating them would be inequitable.

Doyn Aircraft does more to confuse than to clarify the standards for determining when to disregard the corporate entity. The court exhibited no general reluctance to pierce the corporate veil. The Tenth Circuit observed that Wylie clearly was liable under the terms of his contract with Doyn. Nevertheless, the court declined to disturb the trial court’s application of the alter ego doctrine because it did not “detect clear error.”

The question thus arises why the trial court invoked the alter ego doctrine, when basic contract law provided an adequate remedy. Perhaps the answer lies in the fact that

---

203 Id. at 583. The contract provided:

"It is expressly agreed and understood that this contract is being made by JAMES C. WYLIE for the benefit of a corporation to be formed, and all rights hereunder of the Distributor are assignable by the said WYLIE, and upon such assignment and assumption of liabilities by the assignee, the said WYLIE shall not have any liability hereunder."

Id. (emphasis by the court).

204 Id.

205 Id. at 584.

206 Id. "In the dealings here relevant, the identities of the individual and the corporation [sic] merged, and to segregate them as appellant desires would cause an inequitable result. We cannot detect clear error in the trial court's findings."

Id.

207 Id. at 583.

208 Id. at 584.
the corporation was in its formative stage when the breach of contract occurred, thus leading the court to conclude that Wylie's intention in forming Atlas was not the legitimate limitation of personal liability, but a fraudulent evasion of liability. Apparently, the court decided as a matter of public policy that the need to prevent fraud or injustice outweighed the need to follow the general rule—to recognize and uphold the corporate entity. Perhaps the court decided that, because Atlas did not exist at the time Wylie signed the contract, the need to recognize the corporate entity was less important than it would have been had Wylie signed the contract as agent of a de jure corporation. In any event, the trial court's application of the alter ego doctrine seems unnecessary to the finding of personal liability in this case, as the Tenth Circuit's opinion implies.\(^{209}\)

The cases examined in this section reveal some inconsistency among jurisdictions in the standards courts use to decide whether to pierce the corporate veil. In Illinois the corporate form will be disregarded at law as well as in equity, provided certain "variables are coupled with some element of injustice or fundamental unfairness";\(^{210}\) however, how many variables and which ones must be proved is not clear. In Delaware the courts "will not entirely disregard" the corporate entity except when "unusual circumstances [so] require."\(^{211}\) In the Gregory I case in New York, the federal judge seemed inclined to apply the alter ego theory as a matter of law, but left the question to a jury on the facts.\(^{212}\) As stated in Lambert, Indiana's standard for reverse disregard is comparatively lax. A plaintiff

\(^{209}\) Id. at 583-84.


\(^{211}\) Ronair, 693 F. Supp. at 111. The Ronair court did not define the requisite unusual circumstances, but spoke only in general terms of "abuse[s] of the corporate form." It did, however, dismiss as unpersuasive allegations of domination of corporate transactions, "oscillation" of funds, and gross undercapitalization. \textit{Id.} at 111-12. For a discussion of the case, see \textit{supra} notes 171-177 and accompanying text.

\(^{212}\) Gregory v. Garrett Corp., 578 F. Supp. 871 (S.D.N.Y. 1983). For a discus-
"must show both ownership and control of the corporation by the shareholder."

The Tenth Circuit affirmed a more tenuous application of reverse disregard on purely procedural grounds in Doyn. Applying Kansas law, the district court found that courts could invoke the alter ego doctrine when an individual knowingly used a corporation to perpetrate fraud or injustice "on third persons dealing with the corporation." The stated standard was simply not applicable in Doyn, which involved a contract with the individual promoter of an as yet unformed corporation. At least one treatise states that "[w]hen all material facts are undisputed, application of the alter-ego doctrine is a question of law.... However, ... each case in which the issue is raised should be regarded as sui generis, to be decided in accordance with its own underlying facts...." Many courts recite Powell's list of significant control factors in one form or another when deciding whether to disregard the corporate entity. Unfortunately, quite a few of those courts have become enshrouded in Justice Cardozo's mists of metaphor, and have lost sight of the guideposts Powell provided. The factors are not obscure legal propositions, but rather, basic facts concerning the formation, ownership and operation of a corporation. According to Powell, some of the factors are more important than others as evidence of complete dominion and control. Yet courts often list the factors as if all the factors carried equal weight. These courts ignore Powell's valuable analysis, and instead apply their own generally unarticulated formulas to decide whether the proper combination of "factors" (read, "facts") is present in each.

---

1 Lambert, 519 N.E.2d at 747. The facts of the case revealed substantial identity of the corporation and Lambert individually. Id. at 748; see supra note 195.

2 Doyn, 443 F.2d at 584.

3 Id.

4 Fletcher, supra note 1, § 41.95.

5 For a discussion of Powell's factors and guidelines, see supra notes 29-34 and accompanying text.
case. Some courts also seem to weigh the control factors against the gravity of the alleged injustice or wrong, as if the egregiousness of the corporation's conduct has some bearing on the degree of control exercised over the corporation.

Courts should avoid such ad hoc determinations because they serve to obscure the standards for disregarding the corporate form, rather than building on what by now should be a well settled equitable doctrine. A better approach would be a return to the basics set forth by Powell. The control factors should be examined in accordance with his priority guidelines. Courts should categorically decide the question of dominion and control before proceeding to the second and third elements of the instrumentality or alter ego test, namely, fraud or injustice as a proximate cause of actual injury. The Seventh Circuit Court of Appeals has been noticeably more diligent in this approach than other courts, and its veil-piercing opinions should be regarded as exemplary.²¹⁸

IV. PIERCING MANAGEMENT'S CORPORATE VEIL IN LABOR RELATIONS CASES

Labor-management relations constitute a specialized area of law which affects, in varying degrees, every major air carrier in the United States. One important aspect of this body of law deals with the contracts between airline corporations and the unions representing their employees. The Railway Labor Act²¹⁹ (RLA) sets forth the rules governing the representation of airline employees for collective bargaining purposes,²²⁰ and further provides for dispute resolution when representation questions arise. The National Mediation Board (NMB) is the exclusive fo-

²¹⁸ For an analysis of two Seventh Circuit cases, see supra notes 47-75 and accompanying text.
²²⁰ The provisions of the RLA were made applicable to the fledgling airline industry in 1936. Act of 1936, ch. 166, § 201, 49 Stat. 1189, 1189 (codified as amended at 45 U.S.C. § 181 (1988)).
rum for representation dispute resolution under the RLA; therefore, a federal court must dismiss such disputes for want of subject matter jurisdiction.

The Second Circuit Court of Appeals affirmed such a dismissal in *Air Line Pilots Association International v. Texas International Airlines*. Noting that district courts may have jurisdiction in a proper case to enforce a carrier's duty to bargain, the Second Circuit characterized this case as "neither a pure representation dispute . . . nor a pure interference claim . . .," the latter claim being justiciable. The court then discussed the union's claim in the context of applicable law, but held merely that it lacked subject matter jurisdiction.

Air Line Pilots Association (ALPA) alleged that a corporate reorganization involving Texas International Airlines, Inc. (TXI) and a newly formed corporation, New York Airlines, Inc. (New York Air) was designed to frustrate ALPA's representation of TXI's pilots. More specifically, the Second Circuit said that ALPA's allegations were based on the assumption "that TXI and New York Air should be treated as a single carrier," the very question which the trial court had refused to decide.

The court primarily cited and discussed NMB decisions where the Board had pierced the corporate veil for labor representation purposes. Of the NMB decisions cited by the court, the matters of *Republic Airlines, Inc.*

---

221 Section 2, Ninth of the RLA provides that the exclusive forum for resolution of disputes concerning who are the authorized representatives of a carrier's employees shall be the National Mediation Board. Railway Labor Act, § 2, Ninth, 45 U.S.C. § 152, Ninth.*

222 656 F.2d 16 (2d Cir. 1981) [hereinafter ALPA v. TXI].

223 Id. at 18.

224 Id.

225 Id. at 22-24.

226 Id. at 17.

227 Id. at 19.

228 Id. at 22. The court also stated that TXI could not "permissibly transfer existing business flown by ALPA pilots to a newly formed corporate alter ego for the purpose of displacing the work of ALPA pilots." Id. at 19, (citing Ruby v. TACA Int'l Airlines, 439 F.2d 1359 (5th Cir. 1971)).

Pan American World Airways, Inc. are particularly relevant here.

In Republic, the issue was whether the CAB-approved acquisition of Hughes Airwest (Airwest) by Republic Airlines, a transaction deliberately structured to preserve the corporate identity of Airwest, resulted in a single carrier for labor representation purposes. The NMB so found, and stated tersely: "The CAB may approve of a two corporation set-up for purposes of economic regulation, however, this Board may pierce the corporate veil for purposes of rational labor-management relations. A finding that Republic West is a separate carrier would exalt form over substance."

In Pan American, the NMB denied a request from the airline to dismiss a representation dispute filed by the Air Line Employees Association (ALEA) after a corporate reorganization of Pan Am. The Board advised Pan Am that, in effect, it would pierce the corporate veil of the reorganized airline in order to protect the bargaining rights of employees under the RLA.

---


231 Republic, 8 N.M.B. No. 15, at 50. The ALPA v. TXI opinion unfortunately obscures the issue by referring to the acquisition as a "merger." Although the word appropriately describes the practical effect of the acquisition, the issue at hand would have been rendered moot by a legal merger of the two corporations. See ALPA v. TXI, 656 F.2d at 22.

232 Republic, 8 N.M.B. No. 15, at 55-56 (emphasis added). "Republic West" was the legal name of the newly-acquired subsidiary; however the CAB applications revealed that Republic sought "to operate Airwest as a subsidiary known as 'Republic West d/b/a/ Republic.' Republic also applied for unlimited authority to transfer assets between Republic and Republic West, and to have common directors." Id. at 52; cf. F. Powell, supra notes 27-28, at 9, and accompanying text (list of factors for determining parent's control over subsidiary).

233 Pan American, 7 N.M.B. No. 92, at 170. ALEA applied to the NMB for an investigation of a representation dispute among employees of "Pan American U.S.A. Inc." ALEA's transmittal letter "clearly indicate[d] the intent to seek an election among employees of the carrier entity resulting from the merger of Pan American World Airways, Inc. and National Airlines, Inc." Id.

234 Id.

The [RLA] does not contemplate that carriers will be able to frustrate such rights by the use of corporate shells which were in fact created for other purposes and the National Mediation Board will look behind such devices to determine the appropriate operating en-
Even though the NMB decisions discussed above came early in the era of airline deregulation, the Board clearly stated its position on the recognition of related corporate entities in the 1980 Republic findings. In essence, the Board stated that it intended to learn from its mistakes, or at least its lack of sophistication, in dealing with the effects of railroad mergers and acquisitions on labor representation. The Board went on to adopt a policy of judging each case on an ad hoc basis to avoid, as far as possible, fostering a “pattern of representation in the airline industry” similar to that in the railroad industry. Thus, in the field of labor relations the National Mediation Board follows the sui generis approach often seen in court adjudications: where the question whether to pierce the corporate veil arises, the facts of each individual case are controlling.

V. RECENT DEVELOPMENTS IN THE LAW CONCERNING CORPORATE DISREGARD

In 1986, the Supreme Court of Texas broke new ground in the area of disregard of the corporate entity with its decision in Castleberry v. Branscum. The 5-4 decision provoked immediate criticism for its relaxation of the requirements for finding shareholders liable to corporate creditors. In 1989, the Texas Legislature limited the impact of the decision by amending the Texas Business

---

Id. at 170, cited with approval in ALPA v. TXI, 656 F.2d at 22.

235 Republic, 8 N.M.B. No. 15, at 54-56.

236 Id. “The pattern of representation which has resulted in the railroad industry has, in the Board’s judgment led to uneven representation, duplication of effort, and confusion . . . .” Id. at 54.

237 Id. at 55. “In the absence of compelling facts, judged in each instance on a case-by-case consideration of the situation presented, the Board does not intend to foster a similar pattern of representation in the airline industry.” Id. (emphasis added).

238 See 1 W. FLETCHER, supra note 1, § 41.95.


240 Shearn, Must Contract Creditors Only Show Inequity to Pierce the Corporate Veil?, 6 CORP. COUNS. REV. 43 (1987) (edited version of amicus brief submitted to Texas Supreme Court in support of motion for rehearing).
Corporation Act to protect shareholders from personal liability on the specific grounds underlying the Castleberry holding.\(^{241}\)

Castleberry was an action to collect a promissory note related to a stock purchase agreement. In 1980, Castleberry and the two individual defendants, Branscum and Byboth, formed the corporate defendant, Texan Transfer, Inc. Each individual owned one third of the stock. In 1981, Castleberry sold his stock back to the corporation, taking a promissory note signed by Byboth in his capacity as president of the corporation. After the corporation defaulted on the note, Castleberry sued the corporation and the two remaining owners. The jury found the corporation was the alter ego of Branscum and Byboth and held them personally liable on the note.\(^{242}\) The court of appeals reversed as to the individual defendants, finding inadequate grounds for piercing the corporate veil.\(^{243}\) The supreme court reversed again and affirmed the trial court’s judgment.\(^{244}\)

The supreme court, however, distinguished alter ego as only one of several theories for disregarding the corporate entity, and stated that the applicable theory here was “a sham to perpetrate a fraud.”\(^{245}\) The court construed the sham theory to encompass constructive fraud, which it defined as “the breach of some legal or equitable duty which . . . the law declares fraudulent because of its tendency to deceive others, to violate confidence, or to injure public interests.”\(^{246}\) The court also cited an earlier decision in an alter ego case in which it held that it would “disregard the corporate fiction when the ‘facts are such


\(^{242}\) Castleberry, 721 S.W.2d at 271.


\(^{244}\) Castleberry, 721 S.W.2d at 277.

\(^{245}\) Id. at 272. The trial court’s instruction to the jury included “sham to perpetrate fraud” as an alternative element of the alter ego theory. Id. at 275-76.

\(^{246}\) Id. at 278; see also Shearn, supra note 240, at 50 (“The majority appears to have created a new equitable doctrine, a ‘sham to perpetrate a constructive fraud,’ . . . .”).
that adherence to the fiction would promote injustice and lead to an inequitable result.'”

After reviewing the facts, the court held that there was “some evidence of a sham to perpetrate a fraud,” and affirmed the jury’s verdict. Much of the majority opinion dealt with perceived procedural defects in the trial and appeal, an approach the dissent characterized as “hypertechnical.”

In an obvious response to 

Castleberr
ty and its progeny, the Texas Legislature amended article 2.21 of the Texas Business Corporation Act in 1989. The legislature expanded the Act to expressly preclude shareholder liability in contract cases on the grounds used in Castleberry. The public policy of encouraging business formation and capital investment was too vital to the troubled Texas economy to allow the court’s decision to stand as a dangerous new precedent for shareholder liability.

Prior to 1989, article 2.21(A) provided for limited liability of shareholders and subscribers as follows:

A holder of a certificate of shares or a subscriber whose subscription has been accepted shall be under no obligation to the corporation or to its creditors with respect to such shares other than the obligation to pay to the corporation the full amount of the consideration, fixed as provided by law, for which such shares were issued or to be issued.

The 1989 amendments added language which expressly precludes shareholder liability on “contractual obligation[s] of the corporation on the basis of . . . constructive

---

247 Castleberry, 721 S.W.2d at 273 (citing First Nat'l Bank v. Gamble, 134 Tex. 112, 122, 132 S.W.2d 100, 105 (1939)).
248 Id. at 275.
249 Id. at 281 (Gonzalez, J., dissenting).
251 See TEX. BUS. CORP. ACT ANN. art. 2.21 (Vernon Supp. 1991).
252 See Shearn, supra note 240, at 52-53.
253 TEX. BUS. CORP. ACT ANN. art. 2.21(A) (Vernon 1980) (amended 1989). Section B concerned liability of assignees of shares; section C limited personal liability of trustees and other fiduciaries; and section D addressed “holder[s] of shares as collateral security.” Id.
fraud, or a sham to perpetrate a fraud..."\textsuperscript{254} The same clause provides an exception in cases of actual fraud, but the plaintiff must prove intent, causation, and "direct personal benefit" on the part of the defendant shareholder.\textsuperscript{255}

In addition, the amended statute precludes shareholder liability based on any non-observance of corporate formalities; this clause is also limited to contractual obligations of the corporation.\textsuperscript{256} Because the statutory amendments are limited to contractual obligations of corporations, the legislature did not disturb Texas's corporate disregard theory in tort and other non-contractual

\textsuperscript{254} Article 2.21 now reads, in pertinent part, as follows:

A. A holder of shares, an owner of any beneficial interest in shares, or a subscriber for shares whose subscription has been accepted shall be under no obligation to the corporation or to its obligees with respect to:

(1) such shares other than the obligation to pay to the corporation the full amount of the consideration, fixed in compliance with Article 2.15 of this Act, for which such shares were or are to be issued;

(2) any contractual obligation of the corporation on the basis of actual or constructive fraud, or a sham to perpetrate a fraud, unless the obligee demonstrates that the holder, owner, or subscriber caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, owner, or subscriber; or

(3) any contractual obligation of the corporation on the basis of the failure of the corporation to observe any corporate formality, including without limitation: (a) the failure to comply with any requirement of this Act or of the articles of incorporation or bylaws of the corporation; or (b) the failure to observe any requirement prescribed by this Act or by the articles of incorporation or bylaws for acts to be taken by the corporation, its board of directors, or its shareholders.

B. Nothing contained in this article shall limit the obligation of a holder, owner, or subscriber to an obligee of the corporation when:

(1) the holder, owner, or subscriber has expressly assumed, guaranteed or agreed to be personally liable to the obligee for the obligation; or

(2) the holder, owner, or subscriber is otherwise liable to the obligee for the obligation under this Act or another applicable statute.

\textsuperscript{255} Id. art. 2.21(A).

\textsuperscript{256} Id. art. 2.21(A)(3).
cases. In retrospect, the legislative response to Castleberry was little more than a codification of pre-1986 Texas common law on corporate disregard theory. Nevertheless, the current Texas statute goes well beyond any other state's corporation statutes towards limiting liability of shareholders.

The Model Business Corporation Act (MBCA) is a useful benchmark for comparing state statutes. Section 6.22(a) of the MBCA provides:

A purchaser from a corporation of its own shares is not liable to the corporation or its creditors with respect to the shares except to pay the consideration for which the shares were authorized to be issued (section 6.21) or specified in the subscription agreement (section 6.20).257

Article 2.21(A) of the pre-1989 Texas statute was substantively the same as the MBCA provision.258 According to the statutory comparison included in the annotated MBCA, all states have statutes comparable to section 6.22(a).259 Section 6.22(b) of the MBCA further provides for the traditional limited liability of shareholders as to corporate creditors, but it also contains an exception leaving the door open to pierce the corporate veil.260


258 Cf. TEX. BUS. CORP. ACT ANN. art. 2.21(A) (Vernon 1980) (amended 1989); see supra note 252 and accompanying text.


260 REV. MODEL BUSINESS CORP. ACT § 6.22(b) provides:

Unless otherwise provided in the articles of incorporation, a shareholder of a corporation is not personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct.

Id. The historical background in the annotation explains:

The present section 6.22(b) was . . . added to make express the basic rule of nonliability of shareholders for corporate obligations. . . . Shareholders may . . . become liable for corporate obligations by their voluntary actions or by other conduct under the common law doctrine of "piercing the corporate veil."

1 MODEL BUSINESS CORPORATION ACT ANNOTATED, supra note 259, at 387. Only nine states—Arkansas, Georgia, Indiana, Kentucky, Mississippi, North Carolina, South Carolina, Tennessee and Wyoming—have adopted section 6.22(b). Id. at 390.
Nowhere but Texas has a legislature specifically limited the applicability of the doctrine of piercing the corporate veil.261 Whether other states will enact similar legislative protection for corporate shareholders will depend, as it did in Texas, upon how far their courts will go in creating exceptions to the well-established rule of limited liability.

VI. Conclusion

Because the law regards the corporation as a legal entity separate and distinct from its shareholders, the general rule is that shareholder liability is limited to the consideration paid (or agreed to be paid) for corporate stock.262 But, because the entity concept is an elaborate legal fiction, equity provides an exception to the general rule of limited liability by allowing courts to pierce the corporate veil in appropriate cases.263 The difficulty for plaintiffs and defendants alike lies in identifying "appropriate" cases.

Courts often cite a laundry list of factors to be considered in deciding whether to disregard the corporate fiction. Unfortunately, very few courts define the "proper combination" of factors that a litigant must show.264 Aside from the general reluctance of courts to make exceptions to the rule of limited liability, what is clear through the "mists of metaphor" is that many courts decide each case sui generis.265 This ad hoc approach is puzzling, because the original source of the factors which courts frequently cite also includes guidelines for interpreting those factors. Few courts recognize and follow the guidelines. A great deal of confusion and uncertainty about the proper grounds for veil piercing could be eliminated if all courts would adhere to the same basic guide-

---

261 A survey of the corporation statutes of the other 49 states, as listed in 1 Model Business Corporation Act Annotated, supra note 259, at 387-89, reveals no such provisions.
262 See supra notes 1-3 and accompanying text.
263 See supra notes 4-7 and accompanying text.
264 See supra notes 27-34 and accompanying text.
265 See supra notes 210-218 and accompanying text.
lines. Such a uniform approach might discourage overreaching by plaintiffs and thus reduce unnecessary litigation.

Most courts will not pierce the corporate veil of a subsidiary in a defensive posture. In other words, a subsidiary usually cannot claim identity with its parent corporation in order to enjoy the statutory immunity of the parent from tort actions provided by workers' compensation acts. Thus, a serious concern exists for corporations that elect to own and operate private aircraft. The federal government requires aircraft based in the United States to be owned and registered by United States citizens. If substantial ownership or control of the corporation vests in aliens, the corporation must transfer the aircraft to another entity that fulfills the citizenship requirements, typically a subsidiary. Once the new subsidiary leaves the womb, it loses the protection of the parent's statutory tort immunity.

Whether Congress should modify or abolish aircraft registration citizenship requirements, in light of the realities of modern business relationships, is a current issue with ramifications beyond the scope of this comment. At least on the question of corporate veil-piercing, however, courts ought to look through form to substance and examine the reasons underlying the formation of a subsidiary. If the only reason was compliance with federal aircraft registration regulations, and in all other respects the subsidiary is a mere department of its parent, a court should not penalize the subsidiary by imposing on it liability from which it would otherwise be immune.

From a plaintiff's perspective, "reverse disregard" is a means of holding a corporation liable for the acts or obligations of a shareholder. A creditor suing an individual

---

266 See supra notes 98-122 and accompanying text.
267 See supra notes 123-124 and accompanying text.
268 The subsidiary, of course, has its own immunity vis-a-vis its own employees, but this provides little comfort if the subsidiary's primary business is transporting employees of the parent corporation.
269 See supra notes 187-196 and accompanying text.
debtor may allege that the debtor's corporation is merely an alter ego that the debtor used fraudulently to shelter personal assets. This approach has been more successful than the defensive "reverse pierce," but the question arises whether it is necessary to pierce the corporate veil if the transfer of assets to the corporation was fraudulent as to creditors ab initio. Given the statutory and common-law remedies for fraudulent transfers, the "reverse pierce" here seems to be no more than one of the enslaving metaphors of which Justice Cardozo warned.

In any case where law or equity provides an adequate remedy without piercing the corporate veil, the courts should refrain from the extraordinary step of abrogating limited liability. The public policy supporting limited liability of corporations is as valid today as it was in Justice Cardozo's time. If courts truly mean to advance that policy, they should make every effort to find remedies for injured plaintiffs that preserve corporate identity.

The National Mediation Board has pierced the corporate veil in the context of airline labor relations. Piercing the corporate veil for collective bargaining purposes is not inconsistent with a general policy of respecting corporate identity. The policy question in labor relations cases is whether recognition of technically separate corporate entities exalts form over substance. The issue here turns on the statutory duty to bargain, and is not a question of liability for injury or wrong. Efficient exercise of an airline's duty to bargain demands that the economic realities of the corporate hierarchy take precedence over the technical form.

If the typical language of corporation statutes is any indication, most state legislatures seem to regard judicial reluctance to apply the corporate disregard doctrine as

---

270 See supra notes 192-193 and accompanying text.
271 See supra notes 207-209 and accompanying text.
272 For Justice Cardozo's discussion of metaphors, see supra notes 22-24 and accompanying text.
273 See supra notes 219-238 and accompanying text.
adequate protection of shareholders' limited liability.\textsuperscript{274} The Texas Legislature, however, decided in 1989 that the Texas Supreme Court had gone too far in a recent veil-piercing case.\textsuperscript{275} In response, the legislature amended the Texas Business Corporation Act to expressly exclude certain grounds for holding shareholders liable.\textsuperscript{276} Whether other states will follow Texas in providing more explicit statutory protection for shareholders remains to be seen. Each legislature should examine the current state of authority in corporate veil adjudications with a watchful eye for any trend toward a relaxation of standards for imposing shareholder liability. Such a trend may well be a signal to the legislature to reaffirm its policy on limited liability, perhaps by explicitly defining a threshold of conduct necessary to disregard the corporate entity.

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{274} See supra notes 257-261 and accompanying text.
\item \textsuperscript{275} Castleberry v. Branscum, 721 S.W.2d 270 (Tex. 1986); see supra notes 239-249 and accompanying text.
\item \textsuperscript{276} See supra notes 241, 250-256 and accompanying text.
\end{enumerate}
\end{footnotesize}
Casenotes and Statute Notes