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Corporations - Piercing the Corporate Veil

David L. Jackson

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NOTES

Corporations — Piercing the Corporate Veil

Allied Chemical Corporation brought an action against Bell Oil & Gas Company for the debts of Mid-Tex Development Company and Apollo Oil Company.¹ Mid-Tex was an affiliate and Apollo was a subsidiary of Bell. The directorships of all three corporations were intermingled,² and the ownership of both Apollo and Mid-Tex was either directly or indirectly held by the principals in Bell.³ The trial court found no fraudulent representations or activity and no conspiracy or joint venture between Bell and its subsidiary or its affiliate, but the court held that Bell was liable on the ground that Bell had used its control and ownership of Apollo and Mid-Tex to make those companies its agents.

The court of civil appeals affirmed on the basis that the financing of the affiliate and the subsidiary was insufficient, that the management barriers between Bell, Apollo, and Mid-Tex were not sufficiently maintained, and that the corporate structures of Mid-Tex and Apollo were "mere dummies."⁴ *Held, reversed:* The corporate entity should not be disregarded unless the corporate structure is used "to perpetuate fraud, to avoid personal liability, to avoid the effect of a statute, or in a few other exceptional situations." *Bell Oil & Gas Co. v. Allied Chemical Corp.*, 431 S.W.2d 336 (Tex. 1968).

I. THE THEORY FOR PIERCING THE CORPORATE VEIL

The Legal Entity Concept. The corporation is a desirable business organization because it provides limited liability, unlimited and continued life, and opportunity to raise capital through the sale of stock.⁵ Thus, courts will not disregard this fictional legal entity without sufficient reason.⁶ It is reasonably certain that ownership of one corporation by another or ownership of a corporation by one or two persons is not sufficient to justify disregard of the corporate entity.⁷ But where the purpose for which the corporation was created has been clearly abused by obvious dominion and control over the corporation by the parties for their own personal interests, the court is more likely to disregard the corporate entity. Where it is not clear what degree of control has been exercised by the parties, the

¹ The liability in question was for petroleum products advanced to Mid-Tex and Apollo on open account by Allied Chemical Corporation.

² Lubell and Rothstein were the executive vice president and vice president respectively of Bell and were directors in Mid-Tex while serving also as its assistant treasurer and assistant secretary, respectively. Apollo Oil was run by the officers of Mid-Tex which included Lubell and Rothstein.

³ Fifty-one per cent of the stock of Mid-Tex was owned by Lubell and Company, a firm solely owned by Lubell and Rothstein, who also owned the majority of Bell stock. All of the Apollo stock was owned by Bell.

⁴ *Bell Oil & Gas Co. v. Allied Chemical Corp.*, 420 S.W.2d 779 (Tex. Civ. App. 1968).

⁵ See 18 AM. JUR. 2D *Corporations* § 13 (1965).

⁶ Ballantine, *Separate Entity of Parent and Subsidiary Corporations*, 14 CALIF. L. REV. 12 (1925).

⁷ *Id.* See also *Sutton v. Reagan & Gee*, 405 S.W.2d 828, 837 (Tex. Civ. App. 1966), *error ref. n.r.e.*; *Sayers v. Navillus Oil Co.*, 41 S.W.2d 506 (Tex. Civ. App. 1931), *error ref.*

court has to rely upon its own ideas of honesty and justice to resolve the dilemma.⁸ The courts have had difficulty in characterizing this dilemma and in formulating factors sufficient to justify a piercing of the corporate veil.

Factors for Piercing. Two approaches to the dilemma of formulating the factors required to pierce the corporate veil have been advanced. In a 1929 article,⁹ Justice Douglas set out four standards which he felt should be maintained between a parent corporation and a subsidiary or between a corporation and an individual: (1) separate, well-balanced financial structures; (2) separate operations and business records; (3) separate management structures; and (4) representations of separate identities.¹⁰ Justice Douglas argued that if one of the indicia breaks down the corporate veil should be disregarded. If more than one of the standards is not maintained the case for piercing is stronger.

In addition, a "two-pronged" test has been advanced for determining when to pierce the corporate veil.¹¹ The first portion involves a showing of virtual identity between an individual and a corporation or between two corporations. This prong seems to be the equivalent of the test advanced by Justice Douglas. The second prong requires a showing that if the activity causing virtual identity is allowed to continue, inequity and disruption of the purpose of the legal entity will result. In advancing the two-pronged test, the commentator provided sample pleadings¹² which he felt

⁸ *Berkley v. Third Avenue Ry.*, 244 N.Y. 84, 155 N.E. 58, 61 (1926).

⁹ Douglas, *Insulation from Liability Through Subsidiary Corporations*, 39 YALE L.J. 193 (1929).

¹⁰ *Id.* at 196-97. The four standards are:

(1) A separate financial unit should be set up and maintained. That unit should be sufficiently financed so as to carry the normal strains upon it. (2) The day to day business of the two units should be kept separate. And in addition the financial and business records of the two units should be separately kept. (3) The formal barriers between the two management structures should be maintained. The ritual of separate meetings should be religiously observed. The activities of the individuals serving on the two boards can be tagged so that the individuals *qua* directors of the subsidiary can always be distinguished from the same individuals *qua* directors of the parent. Such tagging is not pure fiction. It draws the line that keeps the dual capacities separate and distinct. It conforms to the habit of thought which accepts the fact of dual capacity but which demands a separation of conduct so that each act may be clearly categorized. Separate meetings of the boards are sufficient. The same problem arises in connection with the officers. And the same solution suggests itself. A man may not be indiscriminately one officer or another. The observance of the niceties of business efficiency are normally sufficient. Such demands are not exacting. They merely suffice to keep the record of the business affairs of the two units from becoming hopelessly intermingled. (4) The two units should not be represented as being one unit. Those with whom they come in contact should be kept sufficiently informed of their separate identities.

¹¹ *Kaufers, Pleading Facts Sufficient To Disregard the Corporate Entity*, 40 LOS ANGELES BAR BULL. 131, 148 (1965).

¹² *Id.* Mr. Kaufers believes that the following pleadings are necessary to show identity of corporate units or of individuals and corporate units. None of the pleadings alone is sufficient to show identity but seemingly all must be pleaded and proven.

(a) defendants John and Mary Doe at all times herein mentioned were and now are the owners and holders of all of the stock of defendant Doe Corporation; or: defendant Doe Corporation never issued stock or applied for a permit to issue stock; (b) defendants John and Mary Doe at all times herein mentioned were and now are the only officers and directors of Doe Corporation; [or, control the officers and directors of Doe Corporation]; (c) defendants John and Mary Doe caused Doe Corporation to be formed and to conduct business without adequate capitalization;

would establish identity and dictate piercing if inequity also could be shown.

Piercing the Corporate Veil in Texas. Extenuating circumstances must be present in order to justify disregarding the corporate entity in Texas,¹³ but Texas courts have not agreed as to what these circumstances are. Early Texas decisions established that disregard of the corporate entity was justified upon a showing that the corporation was being used as (1) a means to perpetrate fraud, (2) a "tool" or "business conduit" of another corporation, (3) a means to achieve a monopoly, (4) a vehicle for circumventing a statute, (5) a protection from crime, or (6) a justification of a wrong.¹⁴ However, a few years later the list was limited to the perpetration of fraud and a justification of a wrong.¹⁵

The courts continued to vacillate over the problem, and in 1945, in *State v. Swift & Co.*,¹⁶ the early list of circumstances justifying piercing with some additions and subtractions was reaffirmed. However, the court seemed to indicate that more than a showing of one of the enumerated inequities was required to justify piercing. Thus the court, in addition to specifying the list of inequities, noted four guidelines for determining the identity of parties.¹⁷ The court said that to avoid piercing, a corporate entity operated in conjunction with another corporation must display a separation of finances, of day-to-day business activity, and of management, and representations must not have been made which indicated that the two corporations were one. Thus the court apparently adopted the two-pronged approach, employing a set of guidelines to determine identity of corporate forms (the first prong) and specifying a list of inequities (the second prong).

However, any implied adoption of a type of two-prong test in Texas was soon negated. In 1955 the Texas supreme court held that piercing was possible if a corporation were being used to perpetrate a fraud, avoid a statute, or create some other exceptional situation.¹⁸ Therefore, the

(d) no meetings of stockholders or election for directors of Doe Corporation was ever held; (e) defendants John and Mary Doe own and control all of the assets of Doe Corporation; and (f) defendants John and Mary Doe paid personal debts with funds belonging to Doe Corporation.

Id. at 154-55. See *Minton v. Cavaney*, 56 Cal. 2d 576, 364 P.2d 473, 15 Cal. Rptr. 641 (1961); *Riddle v. Leuschner*, 51 Cal. 2d 574, 335 P.2d 107 (1959); *Automtriz v. Resnick*, 47 Cal. 2d 792, 306 P.2d 1, 3 (1957); *Plott v. Billingley*, 234 Cal. App. 2d 577, 44 Cal. Rptr. 476, 480 (1965); *Rosen v. Losch, Inc.*, 234 Cal. App. 2d 324, 44 Cal. Rptr. 377, 382 (1965); *People v. Clauson*, 231 Cal. App. 2d 374, 41 Cal. Rptr. 691 (1964); *Loughran v. Reynolds*, 70 Cal. App. 2d 241, 160 P.2d 904 (1961); *Shafford v. Otto Sales Co.*, 149 Cal. App. 2d 428, 308 P.2d 428, 431 (1957); *Taylor v. Newton*, 117 Cal. App. 2d 752, 257 P.2d 68 (1953). See also 6 AM. JUR. PL. & PR. FORMS *Corporations* 6:764-766 (1957); 18 AM. JUR. 2D *Corporations* § 14 nn.13, 14 (1965).

¹³ *Pelletier, Corporations, Annual Survey of Texas Law*, 21 Sw. L.J. 134 (1967).

¹⁴ *Pacific Am. Gasoline Co. v. Miller*, 76 S.W.2d 833, 851 (Tex. Civ. App. 1934), *error ref.*; *Continental Supply Co. v. Forest E. Gilmore Co.*, 55 S.W.2d 622 (Tex. Civ. App. 1933), *error dismissed*; *Williams v. Freeport Sulphur Co.*, 40 S.W.2d 817 (Tex. Civ. App. 1930).

¹⁵ *First Nat'l Bank v. Gamble*, 134 Tex. 112, 132 S.W.2d 100 (1939).

¹⁶ 187 S.W.2d 127 (Tex. Civ. App. 1945), *error ref.*

¹⁷ *Id.* at 134. These indicia were originally enunciated by Justice Douglas. See Douglas, *Insulation from Liability Through Subsidiary Corporations*, 39 YALE L.J. 193, 196-97 (1929).

¹⁸ *Pace Corp. v. Jackson*, 155 Tex. 179, 195, 284 S.W.2d 340, 351 (1955).

court retreated somewhat to the original list of requisites for piercing¹⁹ and seemed to apply only the inequity portion of the two-pronged test. Many Texas "piercing" cases have been decided in the last year. The courts have not mentioned a two-pronged test and have generally pierced only upon a clear showing that at least one of the court-approved list of inequities was present.²⁰

II. BELL OIL & GAS CO. v. ALLIED CHEMICAL CORP.

In *Bell* the court of civil appeals determined that identity existed between Bell and Mid-Tex and between Bell and Apollo.²¹ Therefore, the court, looking to the standards set forth by Justice Douglas, freely pierced the corporate veil. However, the Supreme Court of Texas reversed because there was no showing that any of the court-approved inequities existed.²² There was no evidence of incorporation for an illegal purpose, and since business units rather than individuals were involved, there was no question of personal avoidance of liability by use of the corporate form. The issue of fraud was considered by the court, but it concluded that all statements of the Bell directors were made before the issuance of credit for petroleum products purchases by Mid-Tex and Apollo. Even though some statements of guarantee had been made, the court found no statements or representations by Bell upon which Allied had relied in issuing its credit. Thus the supreme court disaffirmed the piercing of a corporate veil upon the mere showing of identity of corporate structures, with no showing of inequity.

Even though the court was reluctant to pierce the corporate veil absent a showing that a fraud had been perpetrated, that a personal liability had been avoided, or that a statute had been avoided by the use of the corporate structure, it emphasized that piercing would still be allowed in certain "other exceptional cases."²³ However, no indication was given as to what these situations might be. The court said nothing of a two-pronged test, but it *implied* that the elements of identity and inequity were necessary to justify piercing the corporate veil. Furthermore, the court seemingly was not ready to narrow the issue of when to pierce, for no standards were enumerated to form a legal basis for piercing.

III. CONCLUSION

It is not certain what Bell means or will mean to the Texas law of piercing the corporate veil. One view is that the court, in disallowing piercing, was merely balancing the equities of the case. Under this view the requi-

¹⁹ See note 14 *supra*, and accompanying text.

²⁰ *Drye v. Eagle Rock Ranch, Inc.*, 364 S.W.2d 196 (Tex. 1962); *Western Rock Co. v. Davis*, 432 S.W.2d 555 (Tex. Civ. App. 1968); *Sapphire Homes, Inc. v. Gilbert*, 426 S.W.2d 278 (Tex. Civ. App. 1968), *error ref.*; *Sutton v. Reagan & Gee*, 405 S.W.2d 828 (Tex. Civ. App. 1966), *error ref. n.r.e.* See also *Pelletier, Corporations, Annual Survey of Texas Law*, 21 Sw. L.J. 134 (1967).

²¹ *Bell Oil & Gas Co. v. Allied Chemical Corp.*, 420 S.W.2d 779 (Tex. Civ. App. 1967).

²² *Bell Oil & Gas Co. v. Allied Chemical Corp.*, 431 S.W.2d 336 (Tex. 1968).

²³ *Id.* at 340.