DEFENDING AGAINST EXOTIC PROPERTY THEORIES

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I. INTRODUCTION

What do you do when the wolf is at the door and his lawyer is screaming the she is going to pierce the corporate veil, and that you have constructed a fraud, breached a duty, diverted an opportunity, etc.?? This paper will discuss alter ego, piercing the corporate veil, constructive fraud, breach of fiduciary duty, conflicting fiduciary duties and other exotic claims fro a defensive standpoint. In other words, how can you successfully prove a negative?

This paper is intended to demonstrate the only meaningful patterns that can be found in the application of this doctrine in the family law context. Of necessity, we will illuminate the present deficiencies of the law on this subject matter. Finally, we intend to illustrate the correct application of the doctrine in the family law context and proceedings presently before the Court. We will thus begin by discussing what is still regarded by many as the leading case in Texas on the doctrine, *Castleberry,* and then move into an analysis of the handful of family law decisions that substantively address the doctrine. Next, although we believe our analysis will demonstrate that the only means upon which the corporate veil may be pierced in a domestic relations case is by applying the "alter ego" doctrine, we will out of an abundance of precaution discuss the use and meaning of the "unfair device" theory as an alternate basis for disregarding the corporate form. Finally, we will demonstrate that four (4) theories often plead by the a party trying to pierce the corporate veil, as a means to disregard the corporate form are in fact separate and distinct remedies that require proof of their own clearly defined elements. This paper contains an in depth analysis of the most important cases regarding defending the corporate veil. The family law practitioner needs to be fully aware of these cases.

In the history of law, there has perhaps never been a doctrine whose application has vexed jurists, attorneys, litigants, and business persons like disregarding the corporate structure. The doctrine is so devoid of any consistent and workable definition that it is best analogized to an amoeba. It is a doctrine that is in constant transition. Once invoked, like the amoeba, the doctrine feeds itself by completely engulfing its prey. The doctrine is also much like a parasite in that it is dependent upon a host for its survival. In this regard, the doctrine is inextricably intertwined with the minds of the persons attempting to apply it to any particular set of facts. It is thus painfully susceptible to result-oriented decisions. This point is evidenced and invited by the almost complete absence of any meaningful pattern in the reported decisions. Moreover, this dilemma is exacerbated by the Texas Supreme Court's sanction of a fact specific approach to the doctrine. *Castleberry v. Branscum*, 721 S.W. 2d. 270, *overruled in part by Texas Bus. Corp. Act, Art. 2.21* (Tex. 1986). As a result, business persons and potential investors who choose to resort to the corporate structure as a means to limit their liability are unable to predict with any reasonable degree of certainty if and when their conduct will cross the ill defined line that will invite a challenge to the corporate form.

Regrettably, the vagaries of the doctrine contravene one of the most fundamental principles in American jurisprudence: rules of law should be consistent and fair in their application. The necessity of consistency has long been noted as paramount by the most respected of jurists. As Justice Cardozo wrote in *The Paradoxes of Legal Science*: "[w]hat has once been settled by a precedent will not be unsettled overnight, for certainty and uniformity are gains not lightly to be sacrificed. Above all is this true when honest men have shaped their conduct on the faith of the pronouncement." Benjamin Cardozo, *The Paradoxes of Legal Science*, (1928). Nonetheless, the application of the doctrine of disregarding the corporate structure is far from certain and uniform. As a result, the doctrine continues to vex those whose fortunes are staked upon the protections intended to be afforded by the corporate form.

Although attempted invocations of the doctrine are common and vexatious, its actual use is exceptional. When used, the doctrine's effect is brutal and often misguided. Indeed, scholars have noted: the law of piercing the veil, "like lightning . . . is rare, severe, and unprincipled. There is a consensus that the whole area of limited liability, and conversely of piercing the corporate veil, is among the most confusing in corporate law." Stephen B. Presser, *Piercing the Corporate Veil*, § 1.01 at 7 (1997). (citation omitted).

Nowhere is the use of the doctrine more unprincipled and confusing than in the context of domestic relations cases. Perhaps this should not come as a great surprise because the use of the doctrine in this context is a perversion of the theory. In the first instance, it must be remembered that the doctrine was originally conceived as a creditor's remedy to preclude the avoidance of just and lawful debts. It is not nor has it ever been a means by which one is or should be entitled to routinely seek to enhance the extent of the community estate for purposes of property division. Hence, the

application of the doctrine, especially in this context, is an even greater exception to the rule of limited liability than in the typical debtor-creditor context. This point is most clearly demonstrated by considering the paucity of reported family law decisions that substantively address the doctrine of disregarding the corporate entity in the State of Texas.[1] Of the few cases actually addressing the issue in a substantive manner, only two (2) have actually placed their imprimatur on the use of the doctrine in the family law context. As will be shown below, these cases presented the most egregious of circumstances to the Courts rendering the decisions and lend substantial credence to Justice Holmes' admonition that "great cases like hard cases make bad law."[2]

A second instance supporting the notion that the use of this theory in the domestic relations context adulterates its intended purpose and function is that in order to invoke its use in the reported domestic relations cases, the Courts have had to "inversely pierce" the corporation. In the normal state of affairs, the doctrine is applied to enforce an obligation of the corporate entity by circumventing the limited liability of the corporate entity and holding an individual shareholder accountable. However, in the instance of the reported domestic relations matters, the converse is true. The party is seeking to enforce an obligation of an individual by resorting to the funds contained within the confines of the corporation. For this reason, Courts, especially in the context of domestic relations cases, have held that it is a condition precedent to "piercing the corporate veil" that a Court find the individual to be the "alter ego" of the corporation before allowing a "reverse piercing" of the corporate veil. *Zahra Spiritual Trust v. United States*, 910 F.2d. 240, 244 (5th Cir. 1990). As will be discussed in more detail below, this is not to say that Courts addressing the reverse piercing issue completely ignore a recitation of the unfair device doctrine articulated in *Castleberry.* However, from a practical perspective, there appears to be no reported decision in which a corporate entity has been disregarded in the domestic relations context, absent a showing of "alter ego."

Of course, this virtually begs the question of what the Courts mean when they use metaphors like "alter ego," "unfair device," "dummy corporation," and the myriad of amorphous terms similar in meaning. While the question is easily stated, history is replete with proof that despite the attempts of many great jurists to solve the puzzle, the solution remains a mystery. In this regard, it is instructive to note Justice Douglas' comments regarding the hollow metaphors used in this context some seventy (70) years ago. Justice Douglas wrote:

> **These concepts themselves need defining. At best they merely state results and the results are significant only in light of the facts. The conclusion that the parent will be held liable only when the use of the subsidiary is a "cloak for fraud," "or is "inequitable," "unjust," or "unconscionable," also falls short of describing the standards of conduct which the facts of most of the cases permit. The facts deal with the manner and method of organization and operation. It is with those facts that we are concerned. They vary and appear in many combinations. In order to ascertain the proper combination which will assure the parent the desired insulation and to reveal those combinations that have proved fatal to limited liability, an analysis of the many types of organizations is essential.**

William O. Douglas & Carrol M. Shanks, *Insulation from Liability through Subsidiary Corporations*, 39 Yale L.J. 193, 195-96 (1929).

Like other judicial authorities, the Texas Supreme Court has attempted to bring order to this area of law. Although the Court has articulated a two (2) prong "test" to determine whether one person or corporation can be said to be the "alter ego" of another, it is fair to conclude from a detailed analysis of the reported decisions, especially in the family law context, that the application of the doctrine remains akin to a lightning strike. As a result, one must conclude today, as did Justice Cardozo some seventy years

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[1] A Westlaw query that searched for the terms "piercing," "marriage," and "alter ego" within the body of all Court Opinions in the State of Texas yielded only forty-four (44) decisions. Of these decisions, five (5) were not for publication and thus have no precedential value pursuant to Tex. R. App. P. 47.7. Of the remaining thirty-nine (39) decisions, only thirteen (13) appear to set forth any substantive discussion of the "alter ego" doctrine. Note that, almost without fail, the reported decisions in this state that apply the doctrine in the family law area, are predicated upon the "alter ego" theory. Thus, discussion in this paper is almost exclusively limited to that theoretical concept.

[2] *Northern Sec. Co. v. United States*, 193 U.S. 197, 400 (1904).

before this writing, that this area of law remains enshrouded "in the mists of metaphor." *Berkey v. Third Avenue R.Y. Co.,* 155 N.E. 58, 64, 244 N.Y. 84 (1926). Courts are thus well advised to heed Justice Cardozo's admonition that:

> **metaphors in the law are to be narrowly watched, for starting as devices to liberate thought, they often end by enslaving it. . .. All of 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.**
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> **Id.**

It is because of history's lesson regarding the uncertainty of the precise meaning and application of this doctrine that we submit that this Court should approach the application of this doctrine to the case at bar with great trepidation. For the terms set forth in the decisional law in this state remain replete with vague phraseology that virtually invites a Court to render a decision inconsistent with the fundamental principles upon which the doctrine of disregarding the corporate entity is predicated.

We now turn to the substantive discussion of our paper.

II. *CASTLEBERRY V. BRANSCUM:* AN ATTEMPT TO BRING ORDER TO A CHAOTIC DOCTRINE

In the most recognized case[3] on the subject of disregarding the corporate entity in the State of Texas, *Castleberry v. Branscum*, 721 S.W. d. 270, *overruled in part by* Texas Bus. Corp. Act, Art. 2.21(b)(3) (Tex. 1986), the Texas Supreme Court articulated distinct bases upon which the corporate entity may be destroyed. Although the precise facts of the case are largely irrelevant to an analysis of the facts in the case before the Court at the present time, before embarking on a detailed analysis of the opinion, we will briefly outline the pertinent facts and claims that were advanced by the parties in the case.

***Castleberry* originated from a suit on a promissory note by one (1) business partner against two (2) other partners in their individual and corporate capacities. *Castleberry*, 721 S.W. d. at 274. Initially, the parties, Branscum, Byboth, and Castleberry, were partners in a business organized to move furniture. Shortly thereafter, the partners incorporated the business under the name Texas Transfer, Inc. Each person held a one-third (1/3) ownership interest in the corporation. Following the incorporation by the three business partners, one (1) partner, Branscum, formed a competing moving business, Elite Moving. Upon discovering the formation of the new business, Castleberry filed an assumed name certificate, which enraged Branscum. As a result, Branscum stated if Castleberry did not relinquish the name, he would see to it that Castleberry never got anything from the business.**

In July 1981, Castleberry sold his stock back to the corporation, at the urging of Byboth, in exchange for a promissory note in the amount of $42,000. The note was endorsed by Byboth in his capacity as President of Texan Transfer, Inc. After making only one payment under the terms of the note, Texan Transfer, Inc. defaulted on the remaining $41,000. Following the buyout, Elite moving began to take over more of Texan Transfer, Inc.'s business. Later, another company, Custom Carriers, began to take over a substantial portion of the business. Each business operated out of the residence of Branscum. Despite the absence of any written rental agreement between the companies, the vehicles of Texan Transfers, Inc. were frequently used by Elite Moving. There was no accounting kept of the mileage placed upon the vehicles. Finally, while Elite Moving Co.'s business increased, there was a precipitous decline in the business of Texan Transfers, Inc.

Following the initiation of the suit to recover the money owed to Castleberry, Branscum told his wife that Castleberry would not get a dime and that Branscum would thwart Castleberry's collection efforts by taking bankruptcy. *Castleberry*, 721 S.W.2d at 275. At trial, Byboth conceded Custom Carriers was formed because of the pending lawsuit. Finally, Joe Freed, an owner of a furniture company with which Texan Transfers, Inc. did a substantial portion of its business testified that his contract with Texan Transfers, Inc. was terminated

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[3] In response to the *Castleberry* decision, the Texas Legislature amended the Business Corporation Act to make clear that a corporate entity cannot be disregarded, unless there is a showing of actual fraud. Further, the legislature has made clear that the mere failure to observe "corporate formalities" is insufficient to justify disregarding the corporate form. Texas Bus. Corp. Act, Art. 2.21. Notwithstanding the amendments that overruled *Castleberry*, the decision continues to be erroneously cited as authoritative by state and federal courts. See *Western Horizontal Drilling, Inc. v. Jonnet Energy Corp.,* 11 F.3d 65 (5th Cir. 1994); *Sims v. Western Waste Indus.*, 918 S.W.2d 682 (Tex. App.----Beaumont, writ denied 1996).

by Byboth and Branscum and reinitiated for the benefit of Custom Carriers.

The Texas Supreme Court held that the foregoing facts were sufficient to support a finding that the corporate form was used as a sham to perpetrate fraud. The court noted, however, that while the facts might not be sufficient to demonstrate actual fraud, they were sufficient to support a finding of constructive fraud and therefore the corporate form should be disregarded. *Castleberry*, 721 S.W.2d at 275. This holding that a corporate entity could be disregarded upon a showing of less than actual fraud was the impetus for subsequent legislative amendments that overruled this portion of the *Castleberry* opinion.

In the portion of the Court's opinion that discussed the law that remains germane to the issues before the Court today, the Supreme Court noted generally that "we disregard the corporate fiction, even though corporate formalities have been observed and corporate and individual property have been kept separately, *when the corporate form has been used as part of a basically unfair device to achieve an inequitable result." Castleberry*, 721 S.W. d. 270, 271 (citing *Bell Oil & Gas v. Allied Chemical Corp.*, 431 S.W. d. 336, 340 (Tex. 1968) (emphasis added). The Court's next sentence attempts to clarify the amorphous and unworkable general rule by holding:

> *Specifically*, we disregard the corporate fiction: (1) when the fiction is used as a means of perpetrating fraud; (2) where a corporation is organized and operated as a mere tool or business conduit of another corporation; (3) where the corporate fiction is resorted to as a means of evading an existing legal obligation; (4) where the corporate fiction is employed to achieve or perpetrate monopoly; (5) where the corporate fiction is used to circumvent a statute; and (6) where the corporate fiction is relied upon as a protection of crime or to justify wrong.

Castleberry, 721 S.W. d. at 272 (citations omitted) (emphasis added).

It is apparent from the language used by the Court, that the statement the corporate entity will be disregarded when the corporate form is used as a "basically unfair device to achieve an inequitable result," is the Court's rendition of the general rule to be applied in this setting. There is no indication from the Court's opinion that the "unfair device" language is intended to act as a separate means to justify the disregarding of the corporate entity. Indeed, as a matter of logical and grammatical interpretation, the Court's decision to follow the statement containing the "unfair device" language with a sentence that enumerates a "specific" set of rules supports this proposition.

The Court next notes, quite correctly, that the "distinction between alter ego and the other bases for disregarding the corporate fiction" have been blurred to such an extent that the term "alter ego" is frequently referred to as "a synonym for the entire doctrine of disregarding the corporate fiction."[4] *Castleberry*, 721 S.W. d. at 272 (citing, e.g., *William B. Roberts, Inc. v. McDrilling Co.*, 579 S.W.2d 335 (Tex. Civ. App. ---- Corpus Christi 1979, no writ); *Dunn v. Growers Seed Ass'n*, 620 S.W.2d 233, 236-37 (Tex. Civ. App. ---- Amarillo 1981, no writ). The Court then expounded on the proper characterization and statement of the rule of law for "alter ego" by noting that *"alter ego" is only one (1) of the bases for disregarding the corporate fiction*: 'where a corporation is organized and operated as a mere tool or business conduit of another corporation.'" *Castleberry*, 721 S.W.2d at 272 (citing *Pacific American Gasoline Co. v. Miller*, 76 S.W. d. 833, 851 (Tex. Civ. App. ---- Amarillo 1934, writ ref'd) (emphasis added).

In addition to citing to its second enumerated basis for disregarding the corporate entity under the unfair device doctrine as a means to support a finding of "alter ego" between corporations, the Court attempted to articulate a precise rule of law to be applied to putative "alter egos."

> Alter ego applies when there is such unity between corporation and individual that the separateness of the corporation has ceased *and* holding only the corporation liable would result in injustice.
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> *Castleberry,* 721 S.W. d. at 272 (citing *First Nat'l Bank v. Gamble*, 134 Tex. 112, 132 S.W.2d 100, 103 (1939) (emphasis added).

Finally, the Court noted that no single factor will or should be dispositive of the decision to apply the "alter ego" doctrine. Instead, "it is to be shown from the *total dealings* of the corporation *and* the individual." *Castleberry*, 721 S.W.2d at 272 (emphasis added). In analyzing the total dealings of the corporation and the individual, the Court mentioned four factors Courts can consider when

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[4] Ironically, although the Court is critical of the blurring of the "alter ego" doctrine with the unfair device doctrine, the Court itself obfuscates the doctrines in its analysis by intermingling the "alter ego" doctrine with the unfair device doctrine.

applying the "alter ego" doctrine: (1) the degree to which corporate formalities have been followed;[5] (2) the degree to which corporate and individual property have been kept separately;[6] (3) the amount of financial interest, ownership, and control the individual maintains over the corporation; and (4) whether the corporation has been used for personal purposes.

***Castleberry*, 721 S.W. d. at 272 (citations omitted).**

The rationale for the application of the doctrine of "alter ego" is "if the shareholders themselves disregard the separation of the corporate enterprise, the law will also disregard it *so far as is necessary to protect individual and corporate creditors*." *Castleberry*, 721 S.W.2d at 272 (citing Ballantine, *Corporations* § 123 at 294 (1946) (emphasis added). Thus, it is clear that the fundamental purpose for which the doctrine of "alter ego" was created was to protect creditors, not spouses.

Although deservedly criticized for its reasoning, the Court's opinion remains one of the most cited pronouncements of the "alter ego" and "unfair device" doctrines. Despite its shortcomings, the opinion does render one of the clearest statements of the meaning of the term "unfair device." The term "unfair device," embodies a statement of general application. It is not an independent term of art upon which the corporate entity may be disregarded, i.e., it does not stand alone. Thus, in order to have a finding of an "unfair device," it is a necessary condition that one of the six (6) independent bases specifically enumerated in *Castleberry* must be found. The "alter ego" doctrine is not synonymous with the "unfair device" doctrine and thus, one must remember to treat the doctrine for what it is: a separate and distinct means by which the corporate entity may be disregarded. While this interpretation follows, *a fortiori*, from a critical reading of *Castleberry,* it is also supported by the Texas Pattern Jury Charge, wherein the instruction relating to "unfair device" provides:

> **A corporation is an entity distinct from its shareholders. The distinct corporate identity of the corporation may be disregarded even though the corporate formalities have been observed and even though corporate assets have been kept separated from individual property if the *corporate form has been used as a sham to perpetrate a fraud*, resulting in an inequitable result insofar as the complaining spouse is concerned.[7]**
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> **Tex. PJC 205.2**

The commentary to this jury charge notes that the Supreme Court in *Castleberry* enumerated six (6) separate bases to disregard the corporate form and that the instruction just cited includes only one of the articulated bases. In the event other bases for disregarding the corporate form are plead and supported by the evidence, "any of the other five . . . may be substituted or added to this instruction." Tex. PJC 205.2 Comment, *Rewording Instruction*. Nowhere in the commentary to this instruction is it suggested that "alter ego" is to be used as a means to support a finding of "unfair device." This is perhaps best explained by recalling that unlike the six (6) bases for disregarding the corporate form enumerated within *Castleberry*, the "alter ego" doctrine contains its own prong that relates to "injustice." Hence, it simply is not necessary to

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[5] As previously noted herein, this factor has been overruled by the Texas legislature. See Texas Bus. Corp. Act, Art. 2.21. Further evidence of the legislative disapproval of this element is evidenced by Texas Bus. Corp. Act Article, 12.37 (F), which provides that in a closely held corporation formed under the appropriate provisions of the Act, the failure of the corporation to observe the ordinary corporate formalities shall not "(1) . . . be a factor in determining whether to impose personal liability on the shareholders for the close corporation's obligations by disregarding the separate entity of the close corporation; (2) is grounds for invalidating an otherwise valid shareholder's agreement; or (3) shall affect the status of the close corporation under this Act or in law."

[6] This factor, is closely related to the issue of corporate formalities. For example, if there is a commingling of assets of the individual and the corporation, it is in essence only an error in accounting that can be readily corrected. Thus, the same shroud of doubt that exists upon the corporate formalities basis should be applied to this factor as well.

[7] Note that in the PJC cited herein, the Committee drafting the instruction implies that the observance of corporate formalities is a relevant factor in determining whether to disregard the corporate form. Following the legislative amendments to the Business Corporation Act, this is plainly not the case.

include the "alter ego" doctrine within those elements that support a finding of an "unfair device." We shall now turn our attention to an analysis of those cases which substantively address the issue of disregarding the corporate structure. Throughout this discussion, our focus will remain upon the "alter ego" doctrine. For within the reported decisions in the family law context, there is only one purported invocation of the "unfair device" doctrine. See *Zisblatt v. Zisblatt*, 693 S.W.2d 944 (Tex. App. ---- Fort Worth 1985, writ dism'd). *Zisblatt*, however, is an anomaly and whether the Court relied upon the "unfair device" doctrine or the "alter ego" doctrine to justify disregarding of the corporate entity in that case is open to serious debate. In any event, what will be shown to be clear is that *Zisblatt* is yet another example of a Court blurring the distinction between the two (2) separate doctrines that exist.

The holding in *Castleberry* caused great concern in the business community due to its implications on shareholder liability. As a result, Article 2.21, Section A, of the Texas Business Corporation Act was amended in several respects, effective August 28, 1989. The effect of the amendment is the elimination of constructive fraud as a basis for imposing personal liability on shareholders for corporate contractual obligations. An obligee of a corporate debt must prove actual fraud by a shareholder for the shareholder's direct personal benefit.

III. ALTER EGO IN THE DOMESTIC RELATIONS SETTING: A DOCTRINE OUT OF PLACE

A. Introduction

As previously noted in our introductory comments to this paper, the authorities in this jurisdiction that engage in any substantive analysis of the application of the "alter ego" doctrine are few. Although counsel believes there to be only about fifteen (15) published decisions that legitimately discuss the issue in some fashion, this figure must be qualified by the following factors: (1) many of the opinions fail to conduct any useful analysis; (2) no decision sanctioning the disregarding of the corporate form in the family law context is reported following the *Castleberry* decision; (3) no decision sanctioning the disregarding of the corporate form in the family law context is reported following the legislative amendments that were enacted in the wake of *Castleberry;* (4) a number of the decisions incorrectly state the present rule of law to be applied in these cases; and (5) the decisions must be qualified by the realization that the term "alter ego" is often used only in dicta and thus some of these opinions lack any real precedential value. In this portion of our discussion, we will endeavor to point out those cases that suffer from the aforestated deficiencies and to correctly set forth the rule of law to be applied in this context.

B. *Dillingham v. Dillingham*[8]

The use of the "alter ego"doctrine in the domestic relations setting began inauspiciously in the case of *Dillingham v. Dillingham*. In *Dillingham*, the Court decided whether the trial court erred insofar as it treated the husband's allegedly separate corporate assets as community property for purposes of property division. The lower court decision was predicated, at least in part, on the notion that the property was not in fact the separate property of the husband. *Dillingham*, 434 S.W.2d at 461.

As support for its decision, the appellate court relied upon a 1945 Attorney General's Opinion. Strangely enough, the Attorney General's opinion was actually responding to the issue of whether to apply "inheritance tax on one-half of accumulated surplus of a corporation when all of such corporation's stock was owned prior to, during, and after marriage by the surviving spouse who transacted personal business through the corporation." *Dillingham*, 434 S.W.2d at 461. The Court adopted the reasoning contained therein and stated that analysis of the Attorney General's opinion demonstrated that "the corporation was merely the husband's instrumentality for the conduct of his business affairs or a method of operation therefor; indeed that it might be viewed as no more than a method of accounting." *Dillingham*, 434 S.W. d. at 462.

In affirming the lower court decision, the Texas Civil Court of Appeals sitting in Fort Worth stated in a conclusory fashion that in the case pending before the Court, there was sufficient evidence to find that the *wholly owned* corporation was the husband's alter ego and as such any increase in value of the corporation was community property. *Id.* Noticeably absent from the Court's analysis was any discussion of the particular facts of the case that supported a finding of "alter ego." Further, the Court's opinion overlooked what was already, at that time, the well-settled rule regarding "alter ego" doctrine contained in *First Nat'l Bank v. Gamble*, 134 Tex. 112, 132 S.W.2d 100, 103 (1939). It will be remembered from our discussion of *Castleberry*, that *First Nat'l* held that "alter ego"

[8] 434 S.W.2d 459 (Tex. Civ. App. ---- Fort Worth 1968, writ dism'd).

exists when there is "such unity between corporation and individual that the separateness of the corporation has ceased and holding only the corporation liable would result in injustice." *Id.* Thus, although the appellate court upheld the trial court's decision to disregard the corporate entity, it is fair to question the precedential value of the case as it appears to apply an incorrect rule of law. In this regard, *Dillingham* failed to discuss what injustice would result if the corporate entity continued to be treated as a separate entity. Therefore, the second prong of the "alter ego" test was ignored.

C. *Bell v. Bell*[9]

The next mention of "alter ego" in the domestic relations context came from the Texas Supreme Court in *Bell v. Bell*. Unfortunately, the opinion offers little guidance as the issue actually considered by the Court was whether the trial Court abused its discretion in awarding all of the corporate assets, together with their increase in value, since the date of marriage to the husband. *Id.* at 22. The Court did not engage in any substantive analysis of the "alter ego" doctrine. It simply held that the trial court did not abuse its discretion. Therefore, this opinion must be classified as one which provides limited assistance in ascertaining the correct application of the "alter ego" doctrine in the family law context.

***Bell* is, however, noteworthy due to its clear rejection of the intermediate appellate court's theory that an increase in value of a separate property corporation is to be taken into account in a property division. Specifically, the Court noted:**

> **The law of this case stated simply is, if one spouse is the owner of property through the vehicle of incorporation, and transacts business through such corporation, upon a divorce and division of their estate, the trial court shall take into consideration the increase in value of the corporate assets by reason of the business transacted through such corporation during the term of the marriage. This rule is not founded upon fraud, but rather upon the broad principles of equity.**

***Bell v. Bell*, 504 S.W.2d 610, 611-12 (Tex. Civ. App. ---- Beaumont 1974) *rev'd* Bell v. Bell 513 S.W.2d 20 (Tex. 1974).**

[9]513 S.W.2d 20 (Tex. 1974).

D. *Uranga v. Uranga*[10]

The next reported decision referencing the "alter ego" doctrine in the family law context came from the Court of Appeals sitting in San Antonio in the case *Uranga v. Uranga*. Unfortunately, rather than providing a thorough analysis of the subject matter, the Court rendered a cursory opinion and rather surprisingly stated that the husband's corporation could not be found to be his separate property as it must be "presumed" to be the husband's "alter ego." It is unclear whether the Court used the term "presumed" in its colloquial sense or if it was attempting to pronounce a rule of law that would establish a presumption of "alter ego" under the facts of the case. If it were the latter, the decision is clearly inconsistent with the settled law of this jurisdiction that places the burden of proof of a right to ignore the corporate form upon the Plaintiff in a particular suit. *Smith v. Dainichi Kinzoku Kogyo Co.*, 680 F. Supp. 847, 855 (W.D. Tex. 1988) (citing *Lucas v. Texas Indus., Inc.,* 696 S.W.2d 372, 274 (Tex. 1984)). In any event, the scant facts contained within the opinion are important to a complete understanding of the "alter ego" doctrine in the family law context. First, the husband was the owner of 99 ½ percent of the outstanding shares of the corporate entity. *Uranga*, 527 S.W.2d at 764. Second, the husband had "borrowed" in excess of $330,000.00 from the corporation. Finally, the husband used just one checking account and a portion of his salary "was used for the purpose of defraying the corporation's operating expenses." *Uranga*, 527 S.W.2d at 765.

Although the Court was not confronted with the issue of whether the corporation was in fact the "alter ego" of the husband and hence the case cannot fairly be considered an "alter ego" decision per se, these facts will be useful in comparing and contrasting the decisions that actually engage in a substantive analysis of the doctrine. In this regard, it will be seen that the near complete ownership of all shares of stock is one of the few unifying factors found in all of the Courts' decisions that authorize the corporate form to be disregarded under the auspices of the "alter ego" doctrine.

E. *Goetz v. Goetz*[11]

The first real pronouncement of the "alter ego" doctrine came from the Court of Appeals sitting in Dallas. In *Goetz*, the Court of Appeals

[10]527 S.W.2d 761 (Tex. Civ. App. ---- 1975, writ dism'd).

[11]567 S.W. d. 892 (Tex. Civ. App. ---- Dallas 1978, no writ).

discussed, *inter alia*, whether the trial court's decision to Order the husband to pay $36,000 to his wife from a debt owed to his separate property corporation was erroneous. In holding that the trial Court erred in ordering the payment of the debt owed to the corporation, the Court of Appeals determined the evidence was insufficient to support a finding that the corporate form had been *improperly used to the detriment of the wife*. *Goetz*, 567 S.W. 2d. at 896. (emphasis added). In support of its holding the court noted:

> **the only evidence adduced at trial was that appellant [husband] was the *sole shareholder* and president of Goetz Oil Company, and that there had been indiscriminate transfers of funds between appellant, J.H.G. Corporation, and Goetz Oil Company, *which were not properly documented in the corporate records.***
>
> ***Goetz*, 567 S.W.2d at 896. (emphasis added).**

Significantly, the Court went on to note that: "[s]ole ownership and control does not justify disregarding the corporate entity . . . and even if undocumented fund transfers were made, there is no evidence that the transfers were made for an improper purpose, such as to defraud creditors or evade a statutory purpose." *Id.* (citations omitted).

From this opinion, one can discern the Court's reluctance to disregard the corporate form, absent an extremely compelling reason. Also, the Court made clear that there is an explicit requirement of direct harm resulting from the conduct complained of by a party seeking to disregard the corporate form. Moreover, the Court was not concerned about the lack of formal documentation in the transfer of funds between the two (2) corporations.

F. *Humphrey v. Humphrey*[12]

The next decision to grapple with the "alter ego" doctrine in a family setting came from the Court of Civil Appeals sitting in the 14th District in Houston. In *Humphrey*, the Court considered, *inter alia*, whether the trial court erred in refusing to instruct the jury on the "alter ego" doctrine. *Id.* at 825. In affirming the trial court's decision to deny the instruction, the Court noted there was no evidence in the record to suggest that there "is such unity between appellee and the corporation and that separateness of the corporation has ceased to exist." *Id.* at 826. Moreover, the Court noted that there was no evidence that the conduct of the appellee "as president and *sole stockholder* has resulted *in any fraud upon or injustice to appellant* . . . ." *Id.* (emphasis added). In the absence of evidence of the foregoing, the court noted that there cannot be a finding of "alter ego." *Id.*

Prior to moving forward with our analysis of the relevant decisional authorities, it is important to note the facts present in *Humphrey* as they arguably intimate certain factors that are not relevant to a finding of "alter ego." In *Humphrey,* the husband was the sole owner of a corporate entity and one of three directors of the company. *Id.* at 825. The number of persons employed by the entity varied in accordance with the number of projects in which the company was involved. *Id.* at 826. The corporation's books were kept in a manner "acceptable to various government agencies, including the Internal Revenue Service." *Id.* The corporation had two other directors besides the appellee, thus indicating that the appellee did not have exclusive dominion and control over the corporate affairs or the fixing of bonuses and salaries. *Id.* The corporation frequently paid the appellees' personal debts, which were set up as accounts receivable and repaid. *Id.* From the foregoing it is apparent that the Court was unmoved by the dispensation of corporate formalities such as proper accounting methods and upkeep of corporate books for governmental agencies. Thus, this Court, like the *Goetz* Court and the Texas Legislature evince a passionate disdain for the decimation of the corporate form as a result of trivial formalities that do not result in a person being harmed. Therefore, the Court's decision demonstrates the continued reluctance of Courts to allow a corporate structure to be disregarded, absent the most egregious and unfair circumstances.

G. *Duke v. Duke*[13]

The next treatment of the issue before this Court came from the Texas Court of Civil Appeals sitting in El Paso and represents a fine example of the Court's reluctance to allow the corporate form to be disregarded. In *Duke*, the Court decided "[w]hether the Court erred in piercing the corporate veil and declaring it the alter ego of a husband." 605 S.W. d. at 409. The pertinent facts relied upon by the trial court in finding the corporation to be the "alter ego" of the husband were: (1) all stock was in Appellant's [husband's] name; (2) Appellant [husband] controlled all financial aspects of the corporation; (3) the incorporation was used for tax purposes; and (4)

[12] 593 S.W.2d 824 (Tex. Civ. App. ---- Houston [14th Dist.] 1980, no writ).

[13] 605 S.W. d. 408, 409 (Tex. Civ. App. ---- El Paso 1980, writ dism'd).

Appellant used corporate funds to make four monthly alimony *pendente lite* payments to Appellee. *Id.* at 412.

In reversing the trial court's finding of "alter ego," the Court first noted that the above items are not "evidence of 'sham to perpetrate a fraud' or 'to avoid personal liability' or 'avoid the effect of the statute.'" *Id.* Notwithstanding its apparent initial confusion of the "unfair device" doctrine and the "alter ego" doctrine, the Court went on to cite the correct rule of law for the application of the "alter ego" doctrine, which provides:

> **[t]here must be such unity that the separateness of the corporation has ceased and an adherence to the fiction of the separate existence of the corporation would, under particular circumstances, sanction a fraud or promote injustice.**

***Id.* (citing *First Nat'l Bank v. Gamble*, 134 Tex. 112, 132 S.W.2d 100 (1939); *Sidran v. Tanenbaum,* 391 S.W.2d 93 (Tex. Civ. App. ---- Dallas 1965, no writ).**

In applying the correct rule of law, the Court held that the facts of the case do not support a finding of "alter ego."

***Duke* is germane to a lot of issues pending before a trial court because it illustrates that the presence of certain facts alleged to be nefarious are insufficient evidence to support a finding of an "alter ego." In *Duke*, despite the husband's sole ownership, the corporate form was not disregarded. In *Duke*, a corporation was used for the enjoyment of legitimate tax benefits. Also, in *Duke* there is evidence of some expenditures of corporate funds for the personal benefit of the parties. The Court in *Duke* held that the foregoing factors did not constitute sufficient evidence to disregard the corporate structure. A litigant defending the corporate veil with such facts, should thus argue that the factors in their case should be applied to the Court's rationale in *Duke* it would lead to the same result----these factors are insufficient to justify disregarding the entity structure.**

H. *Brooks v. Brooks*[14]

Next in our chronological discussion of authorities addressing the "alter ego" doctrine in the family law context is *Brooks v. Brooks*. The decision is particularly worthy of our attention because of the discussion regarding "alter ego" and the deficit of cases engaging in such a substantive discussion. Further, it demonstrates that disregarding the corporate form and dividing all the assets contained therein as community property does not follow from a simple finding of "alter ego."[15]

At the time of the parties' marriage, each possessed a significant separate estate. *Brooks*, 612 S.W.2d at 234. During the course of the marriage, appellant [Mrs. Brooks], her children from a prior marriage, and the appellee [Mr. Brooks] were all supported out of funds derived from Mr. Brooks' corporation, Brooks Construction Company, Inc.. *Id*. Mr. Brooks was operating the corporation prior to the date of the marriage and he was the *sole* owner. *Id.* Prior to conducting an analysis of the issue presented to the Court, the Court reviewed the trial court's order awarding and making provision for the disposition of certain properties. The only one of the findings by the trial court that is pertinent to our analysis is the portion of the Order that states:

> **the court finds that Brooks Corporation Company, Inc., is a corporation and was used in the capacity as an alter ego, *as Cecil S. Brooks was the owner of all of the stock of the said corporation*, and the same was his separate property and estate, owed by him prior to marriage. That there is hereby awarded out of these funds to Cecil S. Brooks for Brooks Construction, Company, Inc., the sum of $48,020.88 which represents the loss in corporate assets suffered by the corporation during the marriage and used for the purchase and payment of the community assets now owned by the parties.**
>
> **612 S.W.2d at 235.**

In addition, the trial court vested title to the corporation and its assets, including a 1976 Cadillac car in Mr. Brooks' name. *Id.* at 235-36.

In rejecting Mrs. Brooks' contention that the

[14] *Brooks v. Brooks*, 612 S.W.2d 233 (Tex. Civ. App. ---- Waco 1981, no writ).

[15] It is important to note at the outset, however, that the issue before the Court was not whether the corporation was in fact the "alter ego" of the individual. Rather, the issue presented to the appellate court was whether the trial court abused its discretion in awarding $48,020.88 from the proceeds of a sale of community property to reimburse the "alter ego" corporation of the husband.
Brooks, 612 S.W. d. at 234.

trial court abused its discretion and that the evidence failed to support a right to reimbursement to the corporate entity from proceeds of the sale of the community home, the Court noted that Brooks Construction Co. originated in 1966 and further that it was a going concern for many years prior to the marriage of the parties. *Id.* at 236-37. The Court further noted that the evidence presented to the trial court was sufficient to support its finding of a right to reimbursement because the corporation was the source of living expenses for the parties and Mrs. Brooks' children from a prior marriage, as well as the source of funds for the acquisition of community property acquired during the six (6) year marriage. *Id.* at 237. In addition, the Court noted that corporate funds were used to make payments on the following: "the store building in Calvert, Texas, . . . the merchandise and inventory of 'Accent Collections' (the community business enterprise located in the Calvert store building operated by Mrs. Brooks), . . . payments on the home place in Hearne, Texas, . . . car payments, and furniture and other personal property were acquired and paid for." *Id.* The Court concluded that *every community asset in existence was purchased and paid for by the corporation*. *Id.* (emphasis added).

The Court also noted that during the course of the marriage, the parties had drawn $166,575.00 to pay living expenses and to acquire community assets. *Id.* Finally, the court noted that at the time of marriage, the net worth of the corporation was $63, 266.00, while at the time of divorce, the net worth of the entity had been reduced to $15,245.12. *Id.* The Court concluded that not only did the parties withdraw all of the corporate income earned during marriage, but in addition, an additional $48,020.88 from the initial "corpus or capital structure of the corporation" was used to pay the expenses noted above. *Id.* Therefore, the Court deemed it equitable to allow a reimbursement to the husband in the amount of the depleted capital structure of the corporation.

Although the issue of the existence of an "alter ego" was not before the Court and thus the rationale for the conclusion that an "alter ego" existed unclear, one can discern from this opinion the utter domination and commingling of corporate and personal affairs that is necessary to render a decision that one corporation is to be regarded as the alter ego of an individual. In the absence of complete and utter domination to the point that there is no virtually no community estate, there is not a decision in this jurisdiction that has legitimately invoked the doctrine of disregarding the corporate structure in the domestic relations context. This point will be brought to fruition when we discuss *Zisblatt v. Zisblatt*, 693 S.W.2d 944 (Tex. App. ---- Fort Worth 1985, writ dism'd).

I. *Spruill v. Spruill*[16]

The next reference to the "alter ego" issue and another example of the severity of facts necessary to support such a finding is found in *Spruill v. Spruill.* In *Spruill*, the Court discussed the trial court's findings that lead to a decision to declare a husband's corporation to be his "alter ego."[17] Nevertheless, as noted, a brief discussion of the facts is instructive insofar as it demonstrates the type of conduct that must be present prior to a court entering a finding of "alter ego" in the family law context.

At the time of marriage, Mr. Spruill owned 48% of the Larry Spruill Company, Inc. *Id.* at 696. After the time of marriage, the husband acquired the remaining shares of outstanding stock by expending community funds to purchase them. *Id.* There was no dispute that Mr. Spruill was a successful mobile home dealer and that the corporation owned the dealership. Additionally, Mr. Spruill had a fifty (50) percent interest in four (4) other corporations that were involved in the mobile home business. *Id.* The evidence established that prior to marriage *Mr. Spruill had paid all of his ordinary living expenses out of the Larry Spruill Company, Inc. or another of his corporations. Further, every motor vehicle, item of furniture, and other asset normally associated with being acquired by the community estate were purchased by the corporation. Id. The Court noted: "the husband even paid for the food and other necessities of life from a corporate account." Id.* (emphasis added).

In 1976, according to the testimony of the husband, at the approximate time when the divorce suit was filed, his business took an unexpected downturn. As a result, the husband made several promissory notes in favor of his business partner and as security, he pledged all of the stock in the

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[16] 624 S.W.2d 696 (Tex. Civ. App. ---- El Paso 1981, writ dism'd).

[17] Note, however, the Court did not reach the issue of whether the trial court was correct in its findings as it held that it did not have jurisdiction over the corporate entity because of the corporation's failure to file an appeal bond. *Id.* at 697. Thus, the Court's discussion relating to the "alter ego" doctrine, while illustrative of the complete and utter domination and commingling necessary to support a finding of an "alter ego" in the domestic relations setting, it is dicta.

companies. *Id.* Later, the partner filed suit to foreclose his liens upon the corporate stock that the husband and wife owned, presumably after the husband defaulted under the terms of the promissory note. *Id.* Judgment was rendered in favor of the Mr. Spruill's business partner and as a result, the community was "wiped out." According to Mr. Spruill, they "lost the house, the furniture, all of the mobile home inventory, all monies, the motor vehicles, and every other conceivable community asset." *Id*.

Suspiciously, following the foreclosure the husband was hired by his business partner to continue acting as President of Larry Spruill Company, Inc. for a salary of $1,000.00 per month. *Id.* Notwithstanding the partner's conduct that resulted in impoverishing the husband, wife, and children, Mr. Spruill testified that he considered his business partner to be his friend. *Id*. As if the foregoing were insufficient to raise suspicions about his conduct, the husband executed a second lien note and deed of trust covering the home and during the divorce proceedings, he abandoned his wife and children to move in with his girlfriend. *Id*. The trial Court held that Mr. Spruill and the Larry Spruill Company Inc.,

> **were one and the same; that the Defendant corporation became the alter ego of the husband; and that the notes executed by the husband in favor of his business partner and the pledging of the corporate stock of the various corporations were all done by the husband to create a false community debt with the intent to defraud the wife of her community interest in the stock.**
>
> ***Spruill*, 624 S.W.2d at 696.**

The Court thus confronted with having nothing to award the wife, awarded the interest of the husband, if any, of each corporation to the wife. This case is another example of the draconian fact patterns that must exist before a Court will enter a finding that a corporation is the alter ego of an individual. The case also illustrates that there mere finding of "alter ego" does not, of necessity, lead a court to disregard the corporate form, unless there is also a showing of direct injury.

J. *Martin v. Martin*[18]

The next appellate decision to entertain any discussion of the "alter ego" doctrine was one of the few to be discussed in this paper wherein the Court had the opportunity to squarely address the issue of the proper application of the doctrine in a domestic relations case. In *Martin v. Martin*, the Court of Appeals sitting in Fort Worth reviewed the property division portion of the divorce action and reversed and remanded the cause on the basis of the Court's treatment of Burk Motor Freight Lines as the "alter ego" of the husband. Unfortunately, although afforded the opportunity to squarely expound on the doctrine, the Court's analysis is cursory and unconvincing in that it appears to misstate the law of "alter ego." In this regard, the Court fails to state the precise rule of law to be applied to these cases and in a conclusory manner holds that the evidence was insufficient to support the trial court's finding of "alter ego." Thus, this opinion must be categorized as another in a litany of decisions that render a perfunctory analysis and hence it is not very useful to an understanding of the doctrine. It is, however, useful to demonstrate the reluctance of Courts to dispense with the protections afforded by the corporate entity.

K. *Zisblatt v. Zisblatt*[19]

The Zisblatt case contains an excellent discourse on disregarding the corporate fiction in a divorce case. In 1985, the Court of Appeals sitting in Forth Worth was presented with another opportunity to squarely address the issue of "alter ego" in the family law context. Although a myriad of facts were presented within the body of the Court's opinion, the controlling factor in the Court's analysis is that Mr. and Mrs. Zisblatt literally owned nothing, except the clothes on their backs. Indeed, the effect of the husband's actions in *Zisblatt* was to pour every community asset, including his salary, into an ostensibly separate property corporation (owned 100% percent by the husband), thereby creating a fraud upon the community estate. A critical review of the Court's decision leads one to the appropriate conclusion that the egregiousness of the *Zisblatt* fact pattern is illustrative of the type of conduct necessary for a finding that a separate property corporation ought to be disregarded.

In beginning its analysis of resolving the issue of whether the lower court erred in holding that Dispo was not the "alter ego" of Mr. Zisblatt, the Court, began be stating the "unfair device" doctrine. Thus, the Court wrote "the corporate fiction may be disregarded:"

> **(1) where it is used as a means for**

[18] 628 S.W.2d 534 (Tex. App. ---- Fort Worth 1982, no writ).

[19] 693 S.W.2d 944 (Tex. App. ---- Fort Worth 1985, writ dism'd).

> **perpetrating fraud; (2) where the corporation is organized and operated as the mere tool or business conduit of another corporation; (3) where resort is made to the corporate fiction in order to avoid an existing legal obligation; (4) where the corporate form is used to achieve or perpetrate monopoly; (5) where the corporate structure is used as a vehicle for circumventing a statute; or (6) where the fiction is invoked in order to protect crime or justify wrong.**
>
> **693 S.W.2d at 950 (citations omitted).**

In further discussion, regarding the persons to whom the doctrine should be applied, the Court cited another decision which held: *"there seems little reason to punish errant shareholders, unless their actions are directed toward defrauding another party." Id.* (citation omitted) (emphasis added). It thus appears that the Court is recognizing that which should be self evident----a person seeking to invoke the doctrine must be able to demonstrate some direct harm as a result of the allegedly errant conduct of shareholders.

Regarding the issue of "alter ego," the Court initially restated the rule of law that was traditionally applied to non-family law cases, which provides that the corporate form will not be disregarded unless:

> **(1) it is made to appear that there is such a unity that the separateness of the corporation has ceased to exist; *and* (2) the facts are such that an adherence to the fiction of the separate existence of the particular corporation would, under the particular circumstances, sanction fraud or promote injustice.**
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> **693 S.W.2d at 950 (quoting *Mortgage and Trust, Inc. v. Bonner & Co.,* 572 S.W.2d 344, 349 (Tex. Civ. App. ---- Corpus Christi 1978, writ ref'd n.r.e.) (emphasis added).**

The Court next addressed the applicability of the piercing doctrine to divorce actions by referencing a number of decisions rendered by various Courts of Appeals. Specifically, the Court cited *Vallone v. Vallone*, 618 S.W.2d 820, 824 (Tex. Civ. App. ---- Houston [1st Dist.] 1981), *rev'd* 644 S.W. d. 455 (Tex. 1983);[20] *Duke v. Duke*; 605 S.W.2d 408, 411 (Tex. Civ. App. ---- El Paso 1980, writ dism'd); *Humphrey v. Humphrey*, 593 S.W.2d 824, 826 (Tex. Civ. App. ---- Houston [14th Dist.] 1980, writ dism'd); *Goetz v. Goetz*, 567 S.W.2d 892, 895 (Tex. Civ. App. ---- Dallas 1978, no writ); *Spruill v. Spruill*, 624 S.W.2d 694 (Tex. App. ---- El Paso 1981, writ dism'd); and *Bell v. Bell*, 504 S.W.2d 610 (Tex. Civ. App. ---- Beaumont 1974), *rev'd* 513 S.W.2d 20 (Tex. 1974).

In reference to the Supreme Court's opinion in *Vallone*, the Court readily acknowledged that the majority opinion is "lacking in any direction for the lower courts on the issue of alter ego in divorce cases. . ." *Zisblatt*, 693 S.W.2d at 952. However, the Court cited what it proclaimed to be the sound judicial reasoning of Justice Sondock's dissenting opinion in *Vallone*. In her dissenting opinion, Justice Sondock wrote:

> **I would hold that in a divorce case where a non-owner spouse proves that a spouse's time, talent, and toil are primarily responsible for the increase in the value of a business operated as a corporation, *the increase in the value* is community property, even though a business or a part thereof is separate property.**
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> ***Id.* (citing *Vallone v. Vallone*, 644 S.W.2d 455, 466 (Tex. 1983)) (footnotes omitted).**

It is important to note at this point that the rule of law urged by Justice Sondock has never been adopted as the rule of law in this jurisdiction and indeed the Court of Appeals did not adopt the rule in its rendition of the *Zisblatt* opinion. In rendering its decision, the Court found:

> **it unnecessary to hold that there is such a unity between Jack and Dispo that the separateness of the corporation has ceased to exist because the evidence conclusively shows that Dispo, from its inception, never had an existence**

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[20] Note that while the Court is correct in its assertion that the Court of Appeals in *Vallone* discussed the doctrine of piercing the corporate veil in the family law context, a discussion of this decision has not been included in this paper because the opinion was ultimately reversed by the Supreme Court of Texas. In reversing the decision, the Supreme Court refused to reach the issue of alter ego and thus the opinion is of limited value in the analysis of the proper application of the rule of law to the present case. It is only noteworthy because the Texas Supreme Court mentioned the term "alter ego" in a family law context. Each of the other opinions cited by the *Zisblatt* court have already been discussed herein.

> **separate and apart from that of Jack.**[21]
>
> ***Zisblatt*, 693 S.W.2d at 955.**

The Court's specific holding in the case rested upon a finding that Mr. Zisblatt had used the corporate form to "evade an existing legal obligation to devote his time, talent, and industry to the community." More specifically, the Court held:

> **that to uphold the fiction of Dispo as an entity separate from Jack Zisblatt would be a clear and material prejudice to the rights of Irene and the community estate and an evasion of an existing legal obligation of Jack to devote his time, talent, and industry to the community. *Id.* at 955.**

Finally, the Court noted that an underlying problem with Mr. Zisblatt's conduct was that a spouse was attempting to alter the character of earned income through the formation of a corporation and subsequent deposit of the income into the corporate accounts. *Id.* at 958. According to the Court, Dispo "was nothing more than a series of accounts into which were deposited the majority of commissions earned by Jack over the course of the marriage. This is clearly a fraud on the rights of the community." *Id.*

***Zisblatt* is the quintessential example of a Court reaching to find a remedy to right a wrong. It is also a factual scenario that demonstrates the degree of impropriety that is necessary for a Court to disregard the corporate entity in a divorce proceeding. A practice tip for the family lawyer is to assert and argue to the court that in applying the articulated doctrines to your case, the importance of the absence of intentional wrongdoing and harm to the opposing party, at the hands of your client, cannot be overstated.**

L. *Robbins v. Robbins*[22]

Although it is not a divorce action, but a probate action, the case of *Robbins v. Robbins* is instructive insofar as it adopts the rules used in the application of disregarding the corporate form in an action to dissolve a marriage and demonstrates the interpretation of *Zisblatt* by other Courts of Appeal. In *Robbins*, the Court noted that *Zisblatt* approved the application of the "alter ego" doctrine to a divorce action "where a spouse attempted to change the character of earned income by forming a corporation and then depositing the income into the corporate accounts. The Court held that such actions were 'clearly a fraud on the rights of the community.'" 727 S.W.2d at 745 (citing *Zisblatt v. Zisblatt*, 693 S.W.2d 944 (Tex. App. ----- Fort Worth 1985, writ dism'd).[23] It would thus appear that at least some courts have limited the holding of *Zisblatt* to those cases wherein a corporation was formed by a spouse who was attempting to alter the character of his income by forming the corporation to shelter the proceeds of his income in a corporate account. 727 S.W.2d at 745. The Court went on to note that:

> **the Courts of this state have been reluctant to pierce the corporate veil and impose personal liability upon an individual (such as a chief executive officer and controlling shareholder) thereby destroying an important fiction under which so much of the business of the country and have done so only under compelling circumstances.**
> **727 S.W. d. at 746 (citations omitted).**

Thus, the Court reiterated the long-standing rule of law that a sole shareholder's domination of corporate affairs is insufficient in itself to justify disregarding the corporate form. *Id.* (citations omitted). Further, the Court noted that mere unity of financial interest is equally insufficient in itself to

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[21]The Court's recitation in this portion of its opinion is an obvious reference to what the *Castleberry* Court would later properly characterize as the first prong of the "alter ego" test. Thus, the Court in rendering its holding appears to have been loosely intermingling measures to support a finding that the "unfair device" doctrine with the separate "alter ego" doctrine. Thus, *Zisblatt* suffers from the same infirmity of many of the decisions in this area of law. It fails to keep the two (2) doctrines separate. In addition, this discussion of the Court disregards an earlier statement it made in its opinion that the case would be disposed of upon a finding of "alter ego." In reality, a review of the opinion makes it difficult, if not impossible, to discern whether the driving force behind the Court's finding was the "unfair device" doctrine or the "alter ego" doctrine.

[22]727 S.W.2d 743 (Tex. App. ---- Eastland 1987, writ ref'd n.r.e.).

[23]Note that the Court's analysis in this regard suffers from the infirmity of failing to draw a bright line between the two (2) separate doctrines that will justify the destruction of a corporate entity.

justify the invocation of the remedy. *Id.* (citations omitted). Therefore, it is clear that in all contexts in which the issue has been addressed, debtor-creditor, domestic relations, and probate, there must be a showing of harm to the person seeking to eviscerate the corporate form before a Court will destroy one of the most fundamental concepts to the American economy. For these reasons, the Court of Appeals in *Robbins*, reversed the lower court's finding that the entity should be disregarded.

M. *Thomas v. Thomas*[24]

The next pertinent reference to the "alter ego" doctrine in the domestic relations context came in *Thomas v. Thomas*, 738 S.W.2d 342. Although the Court did not substantively address the doctrine, the case is instructive for purposes of the present litigation because of its reiteration of the well-settled rule that provides "unless [a] corporation is a spouse's alter ego . . ., a court upon divorce may award only shares of stock, and not corporate assets." 738 S.W.2d at 343 (citing *Vallone v. Vallone*, 644 S.W.2d 455 (Tex. 1982)).

An interesting argument to make to a trial judge is that the opposing party, who is trying to pierce the corporate veil, has plead alternative bases to pierce the corporate entities. One of these bases is indeed an allegation of "alter ego." However, none of the other bases can be used as a basis to award the opposing party any corporate asset. Thus, if the Court accepts the your theory that there must be a finding of "alter ego" before there can be an "inverse piercing" of the corporate veil, the Court is precluded from awarding any corporate asset.

Another section of the Court's opinion is worthy of mention at this point, although it is somewhat out of order. In addition to the Court's holding regarding the divestiture of stock absent a finding of "alter ego," the Court had occasion to consider the state law ramification of the election of Subchapter S status by a corporate entity. In this regard, the Court noted that simply because the community pays taxes on the earnings when S status is selected, this is not sufficient to transform the retained earnings of the corporate entity into community property. *Id.* at 344. This result follows from the generally recognized principal that "a Subchapter S corporation may distribute its income, but, like any other corporation, it is not required to do so. Corporate distributions, *regardless of form* are controlled by state law." *Id.* (emphasis added). As the Court noted, the effect of intermingling the state and federal law would:

> tend to engraft upon our community property system the manifest complexities of federal tax law. . . . The bright line dividing the corporate estate from the marital estate would be dimmed. Such a result would not bode well for the future of this highly desirable corporate form.
>
> *Id.* at 345.

N. *Southwest Livestock Trucking Co. v. Dooley*[25]

The next significant pronouncement on the application of the "alter ego" doctrine came from the Texas Court of Appeals sitting in San Antonio in the case of *Southwest Livestock Trucking Co. v. Dooley*. In *Southwest Livestock*, although the Court was not actually presented with the issue of whether the doctrine was applicable to proceedings before the Court, it did engage in some discussion of the doctrine and established an estoppel defense for a party defending another's claim to have the protective structure ignored. Hence, its inclusion in our paper. Since a proper application is heavily laden with a detailed analysis of the facts involved, we shall include a detailed rendition of the factual circumstances in this case.

In 1967, Southwest Livestock was formed by Neil, Darrell, and Joe Earl Hargrove. 884 S.W. 2d. at 808. Neil's interest in the corporation was purchased by Darrell and Joe Earl Hargrove and a second corporation, Southwest Livestock and Trucking Company was formed. The latter entity was a wholly owned subsidiary of Southwest Livestock. Joe took the position of chief executive of Southwest Livestock and Darrell took the position of chief executive of Southwest Trucking. *Id.* Joe's spouse Nadine Hargrove passed away and her interest in the corporation passed to the children of Joe and Nadine. *Id.*

Joe then married Jonnye Glee Hargrove. At the time the couple was married, Joe owned twenty-five (25) percent of Southwest, twenty five (25) percent was owned by Joe and Nadine's children, and the remaining fifty (50) percent was owned by Darrell. *Id.* Following his marriage to Jonnye, Joe purchased an additional sixteen (16) percent of stock in Southwest Livestock from the estate of Nadine. Thus, his interest in Southwest Livestock was then forty-one (41) percent. The remaining nine (9) percent is in trust for the children born of

[24] 738 S.W.2d 342 (Tex. App. ---- Houston [1st Dist.] 1987, writ denied).

[25] 884 S.W.2d 805 (Tex. App. ---- San Antonio 1994, writ denied).

the marriage of Joe and Nadine. *Id.*

Jonnye began working at Southwest Livestock and she became the office manager. Ultimately, she was elected as treasurer and secretary of the corporation and to the board of directors. Further, she took over the bookkeeping responsibilities. *Id.*

Southwest Livestock and Southwest Trucking shared one checking account and the account further accommodated the personal needs of Joe and Jonnye. Each spouse had access to the account. Although the company internally accounted for the personal expenditures to segregate the personal items from the corporate, it was largely ignored. *Id.* Joe was authorized and drew a salary of $5,000.00.

In addition to their work for Southwest Livestock and Southwest Trucking, Joe and Jonnye owned a ranch separate from the entities. Corporate funds were, however, used for labor expenses and travel associated with the operation of the ranch. *Id.* At the time of marriage, Jonnye owned a new Lincoln Continental. Shortly thereafter, Jonnye transferred the car to the corporation. Just prior to filing for divorce, Jonnye withdrew $32,000.00 from the corporate account and purchased a Cadillac in her name. *Id.*

In addition to the foregoing non-corporate expenditures, the parties used the corporate account for various personal expenses. Among those expenditures were expenses for the Yacht Club Hotel and Bridgeport Condominiums at South Padre, gambling debts, dry cleaning, a small vitamin supply company was paid for out of corporate funds. *Id.* The expenditures just referenced were accounted for as travel and entertainment expenses, freight and buying commissions, corporate expenses, and corporate veterinary supplies, respectively. *Id.* Any profits derived from the vitamin venture were kept solely by Jonnye.

Prior to filing for divorce, Jonnye wrote herself two (2) checks, one for $21,000.00 and one for $25,000.00. After being confronted by Joe, she returned one of the checks. Following her departure, an investigation of the corporate records revealed that Jonnye had written herself checks in the amount of $94,000.00. Some of the money was placed in a brokerage account and in insurance and $75,000.00 of the corporate funds were used to purchase stock in her name at Hondo National Bank. *Id.*

At trial, Joe did not contest that $420,000 in personal expenses had been mischaracterized as corporate expenditures. He explained in a rather simple manner that was just the way they did things. *Jonnye attempted to escape scrutiny by saying she was just complying with instructions.* Id. at 809 (emphasis added). However, the Court did not accept this assertion as it noted "she withdrew funds designated as 'gifts,' invested in her personal account at Shearson, Lehman, and withdrew money for the purchase of a new Cadillac." *Id.* at 809.

Jonnye next attempted to have the trial court's property division award affirmed upon a finding that the corporation was the "alter ego" of Joe. This was an assertion the Court was unwilling to accept. In rejecting Jonnye's theory, the Court first reiterated the now familiar rule regarding the applicability of the "alter ego" doctrine and then held that Jonnye was not entitled to avail herself of the equitable remedy:

> **when she participated in the very act which gave rise to her cause of action, disregarding the corporate structure. Both Joe and Jonnye have personally enriched themselves, to the detriment of the remaining stockholders. This is contrary to the concept which is essential to equitable relief: a person seeking equity must come with clean hands.**
>
> **884 S.W. d. at 810 (citations omitted).**

In addition to establishing an affirmative defense to the invocation of the doctrine of "alter ego," the case is further instructive in that it demonstrates that simply because there exists a finding of the first prong of the "alter ego" test, the unity of interest prong, in the absence of a finding that injustice will result to the party seeking to invoke the doctrine if it is not applied, the doctrine is inapposite.

Another practice tip is to argue that while opposing counsel has attempted to demonstrate through a variety of personal expenditures and errors and omissions in accounting procedures that the third-party defendants are the alter ego of each other, she has failed to articulate any direct harm resulting from the personal expenditures or improper accounting entries. There is no authority to suggest that any of these companies owed her a duty. Further, you should argue that the evidence in your case has demonstrated that the opposing party has personally participated in and benefitted from the expenditure of corporate funds. Nevertheless, she comes to this court with tarnished hands and prays that the entity be disregarded as a result of the precise type of conduct in which she encouraged, participated, and benefitted from. To allow her to do so would contravene the Court of

Appeals' holding in *Southwest Trucking*[26] and also reward her for her own misconduct by sanctioning the use of a double standard.

O. *Parker v. Parker*[27]

Finally, in one of the latest pronouncements on the application of "alter ego" in the domestic relations field, the Court of Appeals sitting in Forth Worth rendered perhaps the most cursory decision imaginable. In *Parker v. Parker*, the Court was confronted with the issue of whether the evidence was legally and factually sufficient to support a finding of disregarding the corporate form. Rather than engaging in any analysis of the evidence that purported to support the finding, the Court merely concluded that the evidence was sufficient to support the lower court's finding. The closest the Court came to articulating the rule of law to be applied in the case was the inclusion of two (2) footnotes citing to *Zisblatt* for the circumstances that justify an application of the doctrine. 897 S.W.2d 918, 934, n.11, n. 12. Therefore, we must conclude that the Court's opinion in *Parker* cannot fairly be included in the limited number of cases that engage in a serious analysis of the issue.

One final note on the *Parker* case, the statutory mandate repudiating constructive fraud in the corporate context raised the question of whether the theory would remain viable in the divorce context. In *Parker* the trial court's award of a money judgment based on alter ego was upheld. The court further noted, in determining whether liens imposed on particular tracts of real estate were valid, that the assets of the corporation became part of the property division through the application of the alter ego doctrine, ... and that the " trial court could properly characterize some of Share's assets as part of the community estate." The court stated that assets that came into Share during the time of marriage would generally be characterized as community property, but that property Share before the time of marriage would generally constitute separate property. Citing *Zisblatt*, 693 S.W.2d at 950-52.

IV. THE UNIQUE NATURE OF "REVERSE PIERCING" AND THE CONCOMITANT NECESSITY FOR AN AFFIRMATIVE FINDING OF AN "ALTER EGO" AS A CONDITION PRECEDENT TO THE USE OF THE DOCTRINE

It will be recalled at this point that in our introductory comments, we noted that in the normal course of events the issue of disregarding the corporate entity arises in the context of a creditor seeking to reach through a defunct corporate entity to reach the assets of the individual. This is the conventional use of the doctrine. However, through time, a separate and distinct use of the doctrine has emerged whereby a litigant seeks to satisfy an indebtedness of an individual by resorting to the assets of a corporate entity. This latter doctrine is what is referred to in the cases and literature as "Reverse Piercing."

As a result of the unique nature of the "reverse piercing" doctrine, there are special factors that must be considered before its use may be properly justified. Specifically, the Courts have held that in order to invoke the doctrine, there must be an affirmative finding that the corporate fund from which assets are sought is the "alter ego" of the individual. Perhaps in no other area of cases invoking the "reverse piercing" doctrine is the use of the doctrine an intrinsic precursor to a justifiable piercing of the corporate entity like it is in the family law context. This conclusion follows, *a fortiori*, from the fact that in the reported family law cases in this State, where one is seeking to have the corporate entity disregarded, one spouse is always attempting to enhance the value of the community estate by subjecting corporate assets to a just and proper division of property under the Texas Family Code. Hence, every attempt to pierce in this context is properly characterized as an attempt to pierce the veil inversely.

It is interesting to note that despite the Texas Supreme Court's attempt to provide a comprehensive and thorough analysis of the doctrine of disregarding the corporate form, the Court never once mentioned explicitly or implicitly that inverse piercing is an appropriate remedy in the State of Texas. See *Castleberry v. Branscum*, 721 S.W.2d 270 (Tex. 1986). This is not to say, of course, that Texas Courts have never allowed the inverse piercing of a corporate entity, it merely supports the notion that the application of the doctrine is the exception, rather than the rule. And, as with most exceptions to rules, they are narrowly circumscribed. Thus, it is not surprising that the limited jurisprudence on the subject in this state appears to have limited "inverse piercing" to those cases in which there is an affirmative finding of "alter ego."

This assertion is amply supported in the case of *Zahra Spiritual Trust v. United States*, 910 F.2d. 240, 244 (5th Cir. 1990). In *Zahra*, the United States Court of Appeals for the 5th Circuit specifically discussed the Texas Court of Appeals' decisions in

[27] 897 S.W.2d 918 (Tex. App. ---- Fort Worth, writ denied).

Dillingham **and** ***Zisblatt*** **and concluded that in the State of Texas, "a reverse piercing case [like** ***Dillingham and Zisblatt***] **requires the creditor to establish an alter ego relationship between the individual debtor and corporation in order to treat them as one and the same." 910 F.2d. at 244 (citing** ***Zisblatt v. Zisblatt***, **693 S.W.2d 944, 945 (Tex. App. ---- Fort Worth 1985, writ dism'd);** ***Dillingham v. Dillingham***, **434 S.W.2d 459, 462 (Tex. Civ. App. ---- Fort Worth 1968, writ dism'd)). Although the Fifth Circuit opinion is not controlling on this Court, one would do well to remember that when a Circuit Court is applying state law in a case, it is presumed to be interpreting the law as pronounced by the highest Court of the state. Therefore, in light of the logical consistency of the reasoning contained herein as well as in the Fifth Circuit's opinion, it is clear that in order to "inversely pierce" a corporation, there must be an affirmative finding of "alter ego."**

V. THE NECESSITY OF A FINDING OF A MAJORITY INTEREST IN A CORPORATE ENTITY AS A PRECONDITION TO ESTABLISHING ALTER EGO

In the third section of our paper, we devoted a substantial amount of time to exhaustively analyzing the cases discussing and permitting the corporate form to be disregarded in a divorce proceeding. As one can readily discern from a review of each of those cases, there is no situation in which the corporate form has been disregarded in a divorce action under a theory of "alter ego" in the absence of a finding that the individual found to be the "alter ego" is the majority shareholder of the corporation. When one considers the fundamental nature of the "alter ego" doctrine, it is not surprising to find that a necessary precondition to the use of the doctrine, whether stated explicitly or implicitly, is that the spouse must be the majority shareholder. For in the absence of such a finding, it would be difficult to assert that one's utter domination of the corporate entity could destroy the separateness of the corporation to such an extent that one could legitimately find that the separateness of the corporation from the individual "ceased to exist." Indeed, in each reported decision discussed herein where there was a finding of "alter ego," the spouse was always a majority shareholder and generally the sole shareholder.

In addition to the support found for this proposition in the Texas Common Law, this position finds support in an opinion rendered by the Fifth Circuit in 1994. In ***Western Horizontal Drilling v. Jonnet Energy Corp.***, **11 F.3d 65, 69 (5th Cir. 1994), the Court was confronted with the issue of whether summary judgment was properly granted on the issue of "alter ego." In upholding the District Court's rendition of summary judgment, the Court noted that the appellants did not "proffer[] or point[] to any summary judgment evidence, or even allege[] any fact,** ***tending to indicate they [the appellants] [held] no (or only a minority) ownership in Jonnet . . ."*** ***Id.*** **(emphasis added). Although admittedly falling short of directly stating this was an explicit requirement for a finding of "alter ego," it strongly suggests that the a minority shareholder cannot be found to be the "alter ego" of a corporation.**

VI. BREACH OF FIDUCIARY DUTY IS NOT A SEPARATE MEANS TO INVOKE THE DOCTRINE OF DISREGARDING THE CORPORATE FORM

In the third section of our paper, we carefully and extensively analyzed the myriad of means by which one may seek to convince a court to disregard the corporate entity under the law of the State of Texas. In that analysis, all potential theoretical means that will support the exercise of this extreme and unusual remedy were discussed. Absent from that discussion was any discussion that tended to indicate that a breach of fiduciary duty, denuding the corporation, the trust fund doctrine, simple actual or constructive fraud, or an appreciation during the course of the marriage of separate property business will authorize a Court to disregard the corporate entity. Nevertheless, at this point, we must engage in some analysis of these issues.

When defending such a claim, the attorney should argue that he is not so presumptuous as to proclaim the ability to precisely know the mental impressions of the opposition and her counsel, however you assert that you are able to deductively reason that some of their claims are likely derived from a misinterpretation of a footnote contained within ***Castleberry v. Branscum***, **721 S.W.2d 270, 271 n.1 (Tex. 1986). In footnote 1 to that decision, the Texas Supreme Court stated:**

> **other doctrines besides disregarding the corporate fiction have been used in cases similar to this: fraudulent conveyance,** ***Texas Sand Co. v. Shield***, **381 S.W.2d 48, 52-53 (Tex. 1964) and Tex. Bus. & Comm. Code Chap. 24 (Vernon Supp. 1986); the trust fund doctrine,** ***Henry I. Siegel Co., Inc. v. Holliday***, **663 S.W.2d 824 (Tex. 1984); breach of fiduciary duties,** ***International Bankers Life Ins. Co. v. Holloway***, **368 S.W.2d 567, 577 (Tex.**

> **1963); and the denuding theory, *World Broadcasting System, Inc. v. Bass*, 328 S.W.2d 863, 866 (Tex. 1959).**
>
> **These four doctrines *and* disregarding the corporate fiction *have different elements and remedies, and they protect different parties and interest at different times; but they serve very similar ideals and principles*. R. Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 Harv. L. Rev. 505, 540-54 (1972) (emphasis added).**

A simple reading of the entire footnote in the opinion directs one to the only logical conclusion: these four (4) doctrines are independent means to protect creditors. They are separate and distinct from the doctrine of disregarding the corporate entity. Thus, although the doctrine of disregarding the corporate entity and the four (4) remedies articulated in footnote 1 share the common thread of protecting creditors, each one requires evidence of separate and distinct elements and thus the proof of a right to one does not establish the right to another. It therefore follows that one cannot in good faith allege that any of the four (4) constitute a separate basis to disregard the corporate entity.

VII. A SEPARATE PROPERTY CORPORATE STRUCTURE CANNOT BE DISREGARDED MERELY BECAUSE OF AN ENHANCEMENT OF THE ENTITY'S VALUE

One final allegation often alleged, but not mentioned in the footnote of *Castleberry* quoted above, is that the party arguing to pierce the veil should be awarded a fair share of any appreciation during marriage of such alleged separate property. Often times this allegation is unmeritorious and finds no support in the law of the State of Texas. The attorney defending the corporate veil should present to the court that it appears that the opposing party is seeking to use a theory that was embraced by Justice Sondock in her dissent in *Vallone v. Vallone*, 644 S.W.2d 455, 465 (Tex. 1983). In that case, Justice Sondock in dissent wrote:

> **Basic principles and policies of community property support the proposition that the earnings of a spouse-owned business to which one or both spouses devote, time, talent, and toil should be subject to division on divorce. . . . I would hold that in a divorce case where a non-owner spouse proves that a spouse's time, talent, and toil are primarily responsible for the increase in value of a business operated as a corporation, *the increase in the value is community property,* even though a business or a part thereof is separate property. (citations omitted) (emphasis added).**

Justice Sondock's dissent has never been adopted by the Supreme Court as the rule of law nor has it been adopted by any Court of Appeals, notwithstanding at least one Court's opportunity to do so.[28] Therefore, the Court should disregard this alleged justification for disregarding the corporate entity as it is not the law of this jurisdiction.

VIII. DENUDING THE CORPORATION IS NOT A SEPARATE MEANS TO DISREGARD THE CORPORATE FORM

In the seminal case in the State of Texas on the theory of denuding the corporation, it is clearly stated that before a litigant may rely upon this doctrine to impose personal liability upon a corporate shareholder, he must first show the corporation: (1) ..."distributed all its assets; (2) by distributing them among the shareholders; and (3) [that at the time of distribution there existed an] unsatisfied claim." *World Broadcasting System, Inc. v. Bass*, 328 S.W. d. 863 (Tex. 1959), at 864 (quoting *Pierce v. United States*, 255 U.S. 398 (1920). Prior to engaging in an analysis of the inapplicability of the denuding theory to the present case, we believe it prudent to detail the factual setting in which the doctrine was adopted to assist the Court in discerning the blatant inapplicability of the doctrine to the present action for the dissolution of marriage.

There were three shareholders of all of the stock in Bonham Publishing Co., Inc., a Delaware corporation. In 1954, those shareholders entered into an agreement, in their *individual capacities*, to sell to a Mr. Miller or a corporation to be formed by him, their entire interest in the stock of the Delaware corporation. (emphasis added). The terms of the sale included, *inter alia*, $20,000 cash payment, and a note payable in the aggregate amount of $67,500 in favor of the three shareholders. In addition, the note was to be

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[28] We refer here to the Texas Court of Appeals' Decision in *Zisblatt*, wherein the Court finds Justice Sondock's reasoning to be sound, but then refuses to adopt her statement as the rule of law to be applied in such cases. *Zisblatt v. Zisblatt*, 693 S.W.2d 944, 952 (Tex. App. ---- Fort Worth, 1985).

secured by all of the stock of the new corporation to be formed by Mr. Miller. Finally, the contract required the purchaser to "*dissolve* the Delaware corporation as soon as he had secured a charter for the corporate entity he agreed to organize." In accord with the agreement, Mr. Miller obtained a charter for the new Texas corporation in a timely manner. On the date of the closing of the sale (December 31, 1954), the three shareholders transferred their entire interests in the capital stock in the Delaware corporation and all of its assets to the newly formed Texas corporation. The stockholders of the new Texas corporation then elected a new set of directors and the Delaware corporation was dissolved by corporate action of January 12, 1955.

On October 7, 1952, prior to the agreement which resulted in the transfer of its capital assets, the Delaware corporation had entered into an agreement with World Broadcasting Systems, wherein World agreed to supply materials and services to a radio station owned by the Delaware corporation. The radio station was later sold and the purchasing party agreed to compensate World pursuant to the terms of the prior agreement made between World and the Delaware corporation. On December 1, 1953, the purchaser of the radio station defaulted on the payments to World. World then brought suit against the Delaware corporation to collect under the service agreement. Judgment was rendered in favor of World on February 13, 1956, which was after the dissolution of the corporation. The appellate record did not indicate the date when suit was filed against the Delaware corporation. In any event, World sought to have, and the Court found, the three shareholders of the Delaware corporation to be liable to the extent of the assets received in their individual capacities only.

In rendering its opinion, the Court relied on, *inter alia*, a United States Supreme Court opinion, a Texas Supreme Court opinion, and a Texas Court of Civil Appeals opinion. *Pierce v. United States*, 255 U.S. 398 (1920); *National Bank of Jefferson v. Texas Inv. Co.,* 74 Tex. 421, 12 S.W. 101 (1889); and *Love v. Gamer*, 64 S.W.2d 393 (Tex. Civ. App. 1933, writ dism'd). In holding that the three individuals were personally liable to the extent they received funds, there were three common threads in the Court's analysis: (1) a distribution of assets to the individual shareholders, resulting from the sale or transfer of all corporate assets to the individual shareholders; (2) a taking of the assets by the shareholders in their capacity as individuals, and (3) a knowledge of an outstanding claim or indebtedness of the corporation to some third party. It therefore follows, *a fortiori*, that to plead and prove a *prima facie* case for denuding the corporation each of these elements need to be present or the claim must fail as a matter of law.

The theoretical underpinnings of the doctrine of denuding a corporation are predicated upon the fundamental principle that creditors should be protected from actions which prevent them from recovering claims against corporate entities. Hence, in order to be applicable in any given proceeding, it must be shown that the claimant is a creditor of the corporation and that it has either a liquidated claim or unliquidated claim against the corporation for a debt owed.

IX. THE TRUST FUND DOCTRINE IS NOT A SEPARATE MEANS TO DISREGARD THE CORPORATE FORM

It has been the settled statutory law in this jurisdiction for more than a century that the assets of a corporation that is insolvent or ceases to do business are deemed to be held in trust by the corporate officers and directors. See *Lyons---- Thomas Hardware Co., v. Perry Stove Mfr.*, 24 S.W. 16 (Tex. 1893). Today, the doctrine has changed in form through statutory amendments, but not substantively. The doctrine thus remains a statutory creature. In its present form, the doctrine is embodied in Art. 6.04 A(3) of the Texas Business Corporation Act. Article 6.04 A(3) provides:

> **Before filing articles of dissolution . . . the Corporation shall proceed to collect its assets, dispose of such of its properties as are not to be distributed in kind to its shareholders, pay, satisfy, or discharge all of its debts, liabilities, and obligations, or make adequate provision for payment, satisfaction or discharge thereof, and do all other acts required to liquidate its business and affairs, except that if the properties and assets of the corporation are not sufficient to pay, satisfy, or discharge all of the corporation's debts, liabilities, and obligations, the corporation shall make adequate provision for such application. After paying, satisfying, or discharging all of its debts, liabilities, and obligations, or making adequate provision for payment, satisfaction or discharge thereof, the corporation shall then distribute the remainder of its properties and assets, either in cash or in kind, to its shareholders according to their respective rights and interests.**

The plain language of the statute provides that

a necessary precondition of the invocation of the doctrine is the dissolution of an entity or at least the cessation of the ordinary course of business. Not surprisingly, therefore, the Texas Supreme Court has noted that the correct construction of Article 6.04 A(3) of the Texas Business Corporation Act and the trust fund doctrine is: "the last board of directors of a *dissolved* corporation is charged with a duty to manage the corporate assets and wind up corporate affairs. Among its duties in this regard is *the duty to make a just and equitable distribution of assets to the creditors* and then to the stockholders." *Henry I. Siegel Co.*, *v. Holliday*, 663 S.W.2d 824, 827 (Tex. 1984) (emphasis added).

The trust fund doctrine was narrowly constructed by the legislature to enable the judiciary to protect creditors of a corporate entity upon the dissolution of the corporation. In the absence of dissolution or at least the cessation of ordinary business, the doctrine is simply inapposite.

X. CONCLUSION

Through detailed analysis we have been able to discern a few factors that were common in the few cases that sanctioned the use of the doctrine.

First, the doctrine is applied in appropriate cases only as an equitable remedy to protect against manifest injustice. Second, there is utter and complete domination of the corporate affairs in every case where piercing occurred. Third, there is no case that allows an entity to be pierced on a theory of "alter ego" when the putative "alter ego" is not also the majority shareholder. Fourth, in the cases that disregarded the entity structure, there was a virtual absence of any community asset, i.e., all things that would be expected to be found in a community estate were suspiciously found within the alleged separate property corporation of the husband spouse. Fifth, in every instance that an entity was disregarded on a theory of "alter ego," the husband was found to be the "alter ego." This arguably suggests some latent bias towards males that may run afoul of the Equal Protection Clause.