BY KENT A. HALKETT

Piercing the Mystique of the Alter Ego Doctrine

THE CONCEPT OF AN ALTER EGO pervades American culture and law. The public readily comprehends the significance of the connection between Dr. Jekyll and Mr. Hyde as well as Superman and Clark Kent, among numerous literary and pop culture examples. Law students are versed in the theory of piercing the corporate veil. Trial lawyers routinely assert the alter ego doctrine on behalf of their clients.

Despite this familiarity, the practical utility of the alter ego doctrine in litigation actually is widely misunderstood and overestimated. Indeed, California courts recognize that "[a]lter ego is an extreme remedy, sparingly used."[1]

The alter ego doctrine is essentially an equitable device used by the courts to prevent abuses by those improperly using the legal shield provided to a corporate entity:

> Ordinarily, a corporation is regarded as a legal entity separate and distinct from its stockholders, officers and directors. Under the alter ego doctrine, however, where a corporation is used by an individual or individuals, or by another corporation, to perpetrate fraud, circumvent a statute, or accomplish some other wrongful or inequitable purpose, a court may disregard the corporate entity and treat the corporation's acts as if they were done by the persons actually controlling the corporation.[2]

These abuses are inherently fact-specific and subject to interpretation. California courts have developed two threshold requirements for the application of the alter ego doctrine and identified several relevant factors to be considered. In *Sonora Diamond Corporation* v. *Superior Court*, the California Court of Appeal delineated the "two conditions that must be met before the alter ego doctrine will be invoked" and listed other determinative elements:

> First, there must be such a unity of interest and ownership between the corporation and its equitable owner that the separate personalities of the corporation and the shareholder do not in reality exist. Second, there must be an inequitable result if the acts in question are treated as those of the corporation alone. "Among the factors to be considered in applying the doctrine are commingling of funds and other assets of the two entities, the holding out by one entity that it is liable for the debts of the other, identical equitable ownership in the two entities, use of the same offices and employees, and use of one as a mere shell or conduit for the affairs of the other." Other factors…include inadequate capitalization, disregard of corporate formalities, lack of segregation of corporate records, and identical directors and officers. No one characteristic governs, but the courts must look at all the circumstances to determine whether the doctrine should be applied.[3]

Federal common law is very similar to California common law, and federal courts draw upon it for guidance.[4]

Raising the Issue

Litigants often include alter ego allegations in their pleadings as an attempt to expand the number of potentially liable individuals or entities and to extend the courts' jurisdictional authority over those additional parties. The initial pleading requirements for alleging alter ego status in California courts are minimal.[5] In federal court, by contrast, "[c]onclusory allegations of 'alter ego' status are insufficient to state a claim. Rather, a plaintiff must allege specifically both the elements of alter ego liability, as well as the facts supporting each."[6] Nonetheless, state and federal courts uniformly hold that an alter ego claim cannot be maintained simply by alleging that it may be difficult for the injured party to enforce a judgment or recover losses from the wrongdoers.[7]


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The alter ego issue is commonly raised and decided by a procedural challenge at the outset of an action, including motions to quash service of process or dismissal for lack of personal jurisdiction.[8] Foreign individuals and entities challenging personal jurisdiction in California are afforded greater deference since state and federal courts recognize that "[g]reat care and reserve should be exercised

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Los Angeles 310.772.7700 | San Diego 858.550.0191 | San Francisco 415.876.6210 | Toll-Free 866.JEFF UNGER when extending [American] notions of personal jurisdiction into the international field."[9]

Reported decisions actually applying or upholding the application of the alter ego doctrine to establish liability are rare.[10] The recent federal decision in *Shanghai Automation Instrument Company, Ltd.* v. *Kuei* illustrates the proper application of the doctrine and the significance of detailed pleadings. In *Shanghai Automation*, a Chinese corporation and two individuals from California formed a joint venture to assemble laptop computers in China for export to California. A California corporation owned and controlled by the individuals received 7,000 computers from the joint venture but failed to pay for them. The Chinese corporation commenced an action in federal court in California against the individuals and their corporation under claims for breach of contract, conversion, and several other theories. Based upon the factual allegations in the complaint and the documentary evidence submitted by the plaintiffs, the district court found that the alter ego doctrine was applicable because the individual defendants used their California corporation as a "mere shell" in an attempt to avoid personal liability.[11] The court entered a default judgment in excess of $22 million against the corporate defendant and one of the individual defendants (the action was stayed against the other individual defendant, who had sought bankruptcy protection).

State and federal courts also may apply the alter ego doctrine to amend a judgment to add additional judgment debtors.[12] The rationale for this type of postjudgment relief is that "the court is not amending the judgment to add a new defendant but is merely inserting the correct name of the real defendant."[13] However, to satisfy due process concerns, the judgment creditor must establish the existence of an alter ego relationship and "that the new party controlled the litigation, thereby having had the opportunity to litigate."[14]

Alternative Theories

Resourceful litigants often combine their allegations based on the alter ego doctrine with alternative theories of liability, including agency, the "representative services doctrine" (a form of agency), aiding and abetting, and ratification.[15] The factual circumstances may favor and support an agency theory over an alter ego theory of liability since "[u]nlike liability under the alter ego or veil-piercing test, agency liability does not require the court to disregard the corporate form."[16]

In 1994, the California Legislature enacted the Beverly-Killea Limited Liability Act—codified as Corporations Code Sections 17000 through 17655—to govern limited liability companies. These companies are hybrid business entities that provide their members with "limited liability to the same extent enjoyed by corporate shareholders, but permit the members to actively participate in the management and control of the company."[17] Recognizing the potential for abuse, the legislature included a statutory provision specifically stating that a "member of a limited liability company shall be subject to liability under the common law governing alter ego liability...."[18]

There are no reported decisions applying the alter ego doctrine in the context of a limited liability company under the Beverly-Killea statutory scheme. However, in 2005, a California court held that while "managers of limited liability companies may not be held liable for the wrongful conduct of the companies *merely* because of the manager's status, they may nonetheless be held accountable under Corporations Code section 17158, subdivision (a) for their personal participation in tortious or criminal conduct, even when performing their duties as manager."[19] The law delineating liability under an alter ego theory in these situations awaits future development in the courts.

Litigants often invoke the alter ego doctrine but are rarely successful. Still, under the proper circumstances, it can be a powerful and effective equitable device for litigants before and after judgment. ■

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[1] Sonora Diamond Corp. v. Superior Court, 83 Cal. App. 4th 523, 539 (2000) (citation omitted); *accord* Dole Food Co. v. Patrickson, 538 U.S. 468, 475 (2003) ("The doctrine of piercing the corporate veil...is the rare exception, applied in the case of fraud or certain other exceptional circumstances."); Katzir's Floor & Home Design, Inc. v. M-MLS.Com, 394 F. 3d 1143, 1149 (9th Cir. 2004) (quoting Dole).

[2] Communist Party v. 522 Valencia, Inc., 35 Cal. App. 4th 980, 993 (1995) (citations omitted).

[3] Sonora Diamond, 83 Cal. App. 3d at 538-39 (citations omitted); *see also* Associated Vendors, Inc. v. Oakland Meat Co., 210 Cal. App. 2d 825, 838-40 (1962) (cataloging undesirable characteristics or factors).

[4] *See, e.g.*, Bowoto v. Chevron Texaco Corp., 312 F. Supp. 2d 1229, 1236-37 (N.D. Cal. 2004) (explaining the distinctions between procedural and/or jurisdictional issues and liability issues under state and federal law).

[5] *See, e.g.*, Shekhter v. Seneca Structural Design, Inc., 18 Cal. Rptr. 3d 83 (2004) (review denied) (depublished).

[6] Neilson v. Union Bank of Cal., N.A., 290 F. Supp. 2d 1101, 1116 (C.D. Cal. 2003) (citation omitted).

[7] *See, e.g.*, VirtualMagic Asia, Inc. v. Fil-Cartoons, Inc., 99 Cal. App. 4th 228, 245 (2002); Sonora Diamond, 83 Cal. App. 4th at 539; Bowoto, 312 F. Supp. 2d at 1247; Neilson, 290 F. Supp. 2d at 1117.

[8] *See, e.g.*, Sonora Diamond, 83 Cal. App. 4th at 537-40 (motion to quash); American Tel. & Tel. Co. v. Compagnie Bruxellis Lambert, 94 F. 3d 586, 591 (9th Cir. 1996) (motion to dismiss). In addition, while the issue may be raised by demurrer in state court, reported appellate decisions are scarce because unsuccessful litigants rarely appeal such preliminary procedural decisions.

[9] F. Hoffman–La Roche v. Superior Court, 130 Cal. App. 4th 782, 795-96 (2005) (quoting Asahi Metal Indus. Co. v. Superior Court, 480 U.S. 102, 115 (1987)); *see also* Dorel Indus., Inc. v. Superior Court, 134 Cal. App. 4th 1267, 1275 (2005) (same).

[10] *See, e.g.*, Shanghai Automation Instrument Co., Ltd. v. Kuei, 194 F. Supp. 2d 995, 1001-03 (N.D. Cal. 2001); Lyons v. Stevenson, 65 Cal. App. 3d 595, 606-07 (1977).

[11] Shanghai Automation, 194 F. Supp. 2d at 1001-03.

[12] CODE CIV. PROC. §187; Carr v. Barnabey's Hotel Corp., 23 Cal. App. 4th 14, 20-22 (1994); In re Levander, 180 F. 3d 1114, 1121-23 (9th Cir. 1999); *see also* NEC Elecs. Inc. v. Hurt, 208 Cal. App. 3d 772, 778 (1989); Katzir's Floor & Home Design, Inc., v. M-MLS.Com, 394 F. 3d 1143, 1148 (9th Cir. 2004).

[13] NEC Elecs., 208 Cal. App. 3d at 778 (citations omitted).

[14] In re Levander, 180 F. 3d at 1121 (citation and internal punctuation omitted).

[15] *See, e.g.*, Bowoto v. Chevron Texaco Corp., 312 F. Supp. 2d 1229, 1241-48 (N.D. Cal. 2004) (explaining the agency, aiding and abetting, and ratification theories); F. Hoffman-La Roche v. Superior Court, 130 Cal. App. 4th 782, 797-99 (2005) (explaining agency and the representative services doctrine); Dorel Indus., Inc. v. Superior Court, 134 Cal. App. 4th 1267, 1275-80 (2005) (same); Sonora Diamond Corp. v. Superior Court, 83 Cal. App. 4th 523, 540-46 (2000) (same).

[16] Bowoto, 312 F. Supp. 2d at 1238.

[17] PacLink Communications Int'l, Inc. v. Superior Court, 90 Cal. App. 4th 958, 963 (2001) (citations omitted).

[18] CORP. CODE §17101(b).

[19] People v. Pacific Landmark, 129 Cal. App. 4th 1203, 1213 (2005) (emphasis in original).