

Asset Recovery in Commercial Litigation: Litigating Piercing the Corporate Veil, Alter Ego, Successor Liability, UVTA

Strategies for Plaintiffs and Defendants to Maximize Recovery or Protect Assets

TUESDAY, JULY 11, 2017

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Asset Recovery In Commercial Litigation:

Piercing the Corporate Veil, Alter Ego, Successor
Liability, UVTA

July 11, 2017

Overview

- Piercing the corporate veil
- Circumstances of reverse piercing to collect damages awards
- Factors considered when applying alter ego theory and piercing the corporate veil
- Successor liability
- Minimizing and uncovering fraudulent conveyances
- Burden of proof and standard of proof for claims and defenses under the UVTA
- Recovery actions against foreign entities

PIERCING THE VEIL

Piercing the Veil

- The factors to pierce the corporate veil vary by state, but the most common factors include:
 1. Corporation is the alter ego of its owners and/or shareholders
 2. Corporation is used for illegal purposes
 3. Corporation is used as a sham to perpetrate a fraud
 4. Damages suffered by the complaining creditor arising from this illegal or improper conduct

Piercing the Veil: Personal Jurisdiction

- Jurisdiction over an individual or a corporation may be obtained by piercing the veil
- “Further, the piercing-the corporate-veil test for attribution of contacts, i.e., personal jurisdiction, is less stringent than for liability.”
 - *TransFirst Group, Inc. v. Magliarditi*, 3:16-CV-1918-L, 2017 WL 660638, at *6 (N.D. Tex. Feb. 15, 2017).
- There remain standing issues related to veil piercing in debt collection

REVERSE PIERCING

Reverse Piercing to Collect Damages

- Outside reverse piercing:
 - Third party seeks veil piercing to hold the entity liable for the debt of an individual shareholder.
 - Third party seeks veil piercing to hold the subsidiary for the debts of the parent.
- Texas and Florida apply the inverse method of reverse piercing—applying the same factors it does for traditional piercing cases
 - Note, where undercapitalization of a subsidiary may be a factor supporting traditional piercing, overcapitalization of a subsidiary may likewise be a factor supporting reverse piercing.
- Other states do not permit reverse piercing
- Veil piercing developed in the common law to assist creditors of entities where the entities' owners had undercapitalized or looted it; these circumstances are not present where a person's liabilities are sought to be imputed to an entity

Reverse Piercing in Texas

- Most states are more hostile/restrictive to reverse piercing
- Courts likewise are reluctant to use reverse piercing
- Generally, reverse piercing “should only be applied when it is clear that it will not prejudice non-culpable shareholders or other stakeholders (such as creditors) of the corporation.” *In re Moore*, 379 B.R. 284 (Bankr. N.D. Tex. 2007).
- Courts will consider *de facto* ownership (where the debtor is not an owner, but, for example, his/her spouse/child is)
- Corporations and LLCs may both be subject to reverse piercing

ALTER EGO THEORY

Alter Ego Theory

- Varies by jurisdiction
- Fact intensive analysis
- Equitable remedy for exceptional circumstances
- “Under alter ego theory, courts disregard the corporate entity when there exists such unity between the corporation individual that the corporation ceases to be separate and when holding only the corporation liable would promote injustice.”
 - *Mancorp, Inc. v. Culpepper*, 802 S.W.2d 226, 228 (Tex. 1990)
- “The elements for finding an alter ego are:
 1. The corporation must be influenced and governed by the person asserted to be the alter ego;
 2. There must be such unity of interest and ownership that one is inseparable from the other;
 3. The facts must be such that adherence to the corporate fiction of a separate entity would, under the circumstances, sanction [a] fraud or promote injustice.”
 - *Clapper v. American Realty Investors, Inc.*, 3:14-CV-2970-D, 2015 WL 3504856, at *10 (N.D. Tex. June 3, 2015)

Alter Ego in Texas Statutes

Corporation

- For contract-based claims, alter ego applies only if: “the obligee demonstrates that the holder, beneficial owner, subscriber, or affiliate **caused the corporation to be used for the purpose of perpetuating and did perpetuate an actual fraud on the obligee primarily for the direct personal benefit of the holder, beneficial owner, subscriber, or affiliate.**”
- Tex. Bus. Orgs. Code § 21.223

LLC

- Same rules apply for LLCs
- Generally applies to single-member LLCs as well
- Tex. Bus. Orgs. Code § 101.002(a)

Alter Ego: Parent/Subsidiary

- When piercing the veil from a subsidiary to the parent, courts in Texas consider the degree of separation between them.
 1. Common stock ownership
 2. Common directors and officers
 3. Common business departments
 4. Consolidated financial statements and taxes
 5. Parent's financing of the subsidiary
 6. Parent's incorporation of the subsidiary
 7. Undercapitalization of the subsidiary
 8. Parent's payment of subsidiary's liabilities
 9. Whether the subsidiary does business with non-parent entities
 10. Common use of property
 11. Common daily operations
 12. Lack of corporate formalities of the subsidiary
 13. Actions of D&O of subsidiary (best interest of parent?)
 14. Basis of underlying suit (was parent's employee, director, officer involved?)

SUCCESSOR LIABILITY

Successor Liability

- Similar concept, but distinct from piercing the veil
- What liabilities of the seller will be imputed to the buyer?
 - Known liabilities—express provisions of the contract will control
 - Unknown/unforeseen liabilities—tougher question
 - Stock Acquisition: Liabilities go with ownership (the entity remains, simply new stock owners)
 - Merger: Liabilities go with ownership (new entity, but liabilities assumed)
 - Asset Purchase: Liabilities apportioned according to contract

Successor Liability: Asset Purchase

- Jurisdictions differ in how they deal with liabilities
- Disfavored in Texas—Bus. Org. Code 10.254
 - “A disposition of all or part of the property of a domestic entity...is not a merger or conversion for any purpose.”
 - “[A] person acquiring property described by this section may not be held responsible or liable for a liability or obligation of the transferring domestic entity that is not expressly assumed by the person.”
- Possible exceptions based on federal law
 - Environmental law
 - Employment law
 - Disability law

UVTA BURDENS

UVTA-Defined Burdens

- The UFTA left confusion and unpredictability in the courts related to burdens of proof
- The UVTA standardizes the burdens and offers clarity:
 1. Insolvency: Debtor has the burden to rebut the presumption. UVTA § 2(b)
 2. Evidentiary standard for claim (present/future creditors): Preponderance of evidence burden on creditors. UVTA § 4(c)
 3. Evidentiary standard for claim (present creditors): Burden on creditors except as provided in § 2(b). UVTA § 5(c)
 4. Defenses, liability, and protection of transferee or obligee: Burden on the party asserting the defense. UVTA § 8(g)
 5. Avoidable transfers: Burden on creditor. UVTA § 8(b)
 6. Evidentiary standard of § 8: Preponderance of the evidence (the same as the rest of UVTA). UVTA § 8(h)

FRAUDULENT CONVEYANCES

Fraudulent Conveyances in Texas

- Texas considers “badges of fraud”
 1. Transfer to an insider
 2. Retained possession/control post transfer
 3. Concealment
 4. Pendency or threat of legal action
 5. Volume of assets transferred (substantially all?)
 6. Debtor absconded
 7. Removal or concealment of assets
 8. Fair market value vs. actual transfer payment
 9. Insolvency
 10. Time of transfer relative to incurring the debt
 11. Transfer of essential business assets to lienor who transferred to debtor’s insider
 - Tex. Bus. & Com. Code § 24.005(b)(1-11)

Combating Fraudulent Conveyances

Prior to/During Litigation

- Targeted discovery requests
- TRO/TI
- Sequestration
- Attachment
- Garnishment

After Litigation

- Post-judgment discovery
- Prompt execution of judgment
- Garnishment
- Turnover order

RECOVERY ACTIONS AGAINST FOREIGN ENTITIES

Recovery Actions against Foreign Entities

- Uniform Enforcement of Foreign Judgments Act
 - Based on the full faith and credit clause
 - Adopted by 47 states/territories
 - Not adopted in California, Vermont, Puerto Rico, Massachusetts (introduced for enactment in 2017, pending)
 - Requires the judgment creditor to domesticate the judgment through a court of competent jurisdiction in the foreign entity's state
 - Minority—Some states require that a default or agreed judgment be domesticated through an action on the judgment in that state
 - Once domesticated, all of that state's recovery procedures are available to the judgment creditor
 - Federal judgment enforcement and considerations

Questions?



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