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The Doctrine of *Alter Ego* – Piercing the Veil – Nevada

DISCLAIMER- This is not intended to be an academic piece exhausting this subject. Rather, it is a casual stroll down the Nevada path with comments that are intended to be helpful.

WHAT IS IT- In the really old days, individuals had unlimited personal liability for the things they did. That changed when laws were adopted allowing people to create limited liability entities to handle their affairs. Initially, it was corporations. In other words, if one followed the legal process, one could limit one's potential loss in the event of failure, to only the investment. But human beings being human, there was the potential for abuse. The equitable doctrine of *alter ego* allows creditors[1] to seek recovery from all the assets of the owners of the entity, that would otherwise be protected by its limited liability shield. This is also known as "piercing the veil". [2]

NEVADA'S STARTING POINT- In *McCleary Cattle Co. v. Sewell*, 73 Nev. 279, 282, 317 P.2d 957, 959 (Nev. 1957), *reversed on other grounds* in *Callie v. Bowling*, 123 Nev. 181, 160 P.3d 878 (Nev. 2007), the Nevada Supreme Court established 3 elements for *alter ego* to apply to corporations. The elements cited were: (1) The corporation must be influenced and governed by the person asserted to be its *alter ego*; (2) There must be such unity of interest and ownership that one is inseparable from the other; and (3) The facts must be such that adherence to the fiction of separate entity would, under the circumstances, sanction a fraud or promote injustice. [3]

These three elements were later codified: NRS 78.747 and NRS 86.376. NRS 78.747, which was enacted in 2001 and modified in 2019, dealt with corporations. NRS 86.376, which was enacted in 2019, dealt with limited liability companies. Several points for consideration: 1) the statutes are clear that the person asking to be held liable is designated as the "alter ego" (some people get confused in the nomenclature), 2) the injustice must be "manifest"[4], and 3) the statutes refer to the alter ego being liable for "a debt or liability" of the entity.[5]

CASE LAW- Much of the caselaw comes to us as motions for summary judgment or motions to dismiss. This makes for hard reading in trying to evaluate a client's claim or what facts to provide in a court, as proper pleading is to be distinguished from what facts actually meet the elements at trial.[6]

The **first element** "influenced and governed by the alter ego" isn't often an issue, as the abuse claimed usually occurs where there is one conspiring individual (or small group) that owns the controlling equity, or is in a management role and receiving abnormal benefits.[7]

In satisfying the **second element** "unity of interest and ownership", recent NV law seems to look to 5 factors, those being: 1) commingling of funds[8], 2) undercapitalization[9], 3) unauthorized diversion of funds[10], 4) treatment of corporate assets as the *alter ego*'s own, and 5) failure to observe corporate formalities[11]. Other jurisdictions require more or less, and one jurisdiction has discussed 23 elements[12]. *Matter of Twin Lakes Village, Inc.*, 2 B.R. 532 (Bankr. Nev. 1980) explains the difficulty judges have in applying the components of the second element as unity of interest and ownership are descriptive, not causational, and undifferentiated listings do not provide guidance on how courts should weigh each factor. [13]

On the causal connection, one must consider how often the failure to keep minutes and records, the failure to document loans (if repaid)[14], the occasional payment of personal expenses, or the making minor or irregular shareholder transfers, cause the injury. As stated in *Matter of Twin Lakes Village, Inc.*, *alter ego* isn't a punishment for being sloppy. On the other side, no bank account, no tax return, and no records, when all the while holding oneself as the same, may be enough.[15] Regarding the impact of the asserting person's own actions/inactions as a defense, the *Leany* [16] and *JSA, LLC*[17] courts observe that smart businessmen could have asked for personal guaranties. Moreover, in *Baer v. Amos J. Walker, Inc.*, 85 Nev. 219, 452 P.2d 916 (Nev. 1969), the Nevada Supreme Court commented that there was no proof that the credit of the corporation was relied upon by the holder of a personal note (a reverse piercing). However, care is required in wording the cause of action as reliance or reasonable expectations may not be required if there is fraud, illegality or unjust business activities as explained in *Soule v. High Rock Holding, LLC*, 514 B.R. 626 (D. Nev. 2014): reliance apparently is <u>not</u> a necessary element under Nevada law.[18]

Some courts start by analyzing the **third element** "fraud or manifest injustice" first. As this element is "equitable" in application, there is no dark line of separation.[19] Perhaps this is to be expected when the premise of the doctrine is to "do justice" and humans are agents of application. It is beyond the scope of this article to discuss what facts cross the threshold of "fraud or manifest injustice".[20]

VARIATIONS- Creditors sometimes seek to hold the entity liable for the obligations of its owners in a reverse *alter ego*. The Nevada Supreme Court conceptually accepted that reverse piercing is not inconsistent with traditional piercing if to prevent abuse of the corporate form[21]. Further, the Court cast aside the fiction that unity of ownership and interest required actual ownership if ultimate authority lay with that individual (and likely some sham ownership or other benefit). *LFC* expressed the need to possibly consider other shareholders and creditors. This is an interesting area to explore, begging the question of who comprises those stakeholders and how are they protected as non-parties to the litigation? *See Manichaean Capital, LLC v. Exela Techs.* (C.A. No. 2020-0601-JRS (Del. Ch. May 25, 2021) for an updated discussion of the issues, applying 8 factors.[22] Note, in a parent/subsidiary situation the distinction must be made between the creditors of the subsidiary seeking access to the parent, as opposed to the creditors of the parent seeking the subsidiary's assets.[23]

The *LFC* analysis might be applicable to the unity of ownership issue in a horizontal piercing where a creditor is after the assets of entities that are brother/sister, and not parent/subsidiary, and there is indirect partial ownership.[24] There is support that horizontal piercing can occur if common ownership is indirect, but that the chain itself must first be pierced.[25]

Sometimes there are no other "owner stakeholders" where one or two owners sometimes seek to protect themselves by placing assets into entities intent on protecting their assets now held by the entity.[26] Courts approach these claims for protection differently, but the common thread is equity based. What was the behavior of the individual(s) claiming that their personal obligations should not be levied on the entity? And, a person in control of an entity shouldn't be enabled to disregard the corporate form.[27] That assumes *alter ego* is an appropriate remedy path, as opposed to alternate remedies such as charging orders, fraudulent conveyance laws, or acquiring the owner's equity to satisfy the obligation.[28]

Nevada's statutes by their wording have the liability flowing up from the entity to a person, so to this author, case law is the path for liability in the reverse if that *alter ego* person is an individual. Not so where an entity is the asserted *alter ego* (ex. a corporation is the *alter ego* for another corporation, and also see *McCleary,* which were brother/sister corporations and was decided in 1957!).

Finally, there is some older research that handicaps the probability of success in asserting *alter ego*.[29]

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[1] One doesn't have to be an actual creditor. See *Beta Soft Systems., Inc. v. Yosemite Group., LLC,* Case No.: 2:16-cv-01748-GMN-VCF, 2017 WL 3707393 (D. Nev. Aug. 25, 2017) (where the court allowed a breach of contract claim to proceed); *Nev. Corp. Headquarters v. Sellers Playbook, Inc.*, Case No. 2:18-cv-01842-JCM-GWF, 2019 WL 3210068 (D. Nev. Jul. 16, 2019) (stating a contract under *alter ego* binds the owners); *Truck Ins. Exch. v. Palmer J. Swanson, Inc.*, 124 Nev. 629, 189 P.3d 656 (Nev. 2008) (rejecting the imposition of an arbitration agreement as there was no finding of *alter ego*); *Choo v. The Eighth Judicial Dist. Court of the State*, 515 P.3d 837, 2022 WL 3336087 (Nev. Aug. 11, 2022) (unpublished) (rejecting *alter ego* to apply the long arm statute); Gardner *v. Eighth Judicial Dist. Court of Nev.*, 133 Nev. 730, 405 P.3d 651 (Nev. 2017) (allowing a negligence claim to proceed against individuals and limited liability companies based on *alter ego*.)

[2] Some commentators offer that piercing the veil may be distinct and different from *alter ego*. See also, *Boyd v. Archdiocese of Cincinnati, 2015 Ohio 1394 (Ohio Ct. App. 2015)*.

[3] The case is ably discussed by William H. Stoddard, Jr. Esq. in Nevada Lawyer December 2012 "Making Sense of Nevada's Alter Ego Doctrine". And, for what not to do see: *No. 8 Mine, LLC v. Eljen Group.*, Case No.: 3:18-cv-00104-WGC, 2020 WL 6273898 (D. Nev. Oct. 26, 2020), where every element seems to be met. Jay Young and other lawyers have blogged this subject.

[4] "Manifest" does not appear in the *McCleary* decision or any of the subsequent decisions. It was also not found in the initial draft of the S.B. 577 (2001), which was introduced, only included the phrase "would sanction fraud" but not "promote a manifest injustice". The minutes from the May 22, 2001 meeting of the Nevada Senate Committee on Judiciary indicates the focus of the bill was regarding fraud. However, consistent with the Nevada Supreme Court's decision in *Polaris Industrial Corp. v. Kaplan*, 103 Nev. 598, 601, 747 P.2d 884 (Nev. 1987), the second reprint included the phrase "promote injustice". Need for the phrase "promote injustice" was raised and discussed at the May 26, 2001 Nevada Senate Session, Nevada Assembly Committee on Judiciary on May 30, 2001, and June 3, 2001 Nevada Senate Session. However, the word "manifest" did not appear until the third reprint. It first appeared on the Nevada Assembly Session on June 4, 2001 without explanation. However, In *re James Giampietro*, 317, B.R.841, 853 (Bankr. D. Nev. 2004), Judge Markell addressed this issue. He also noted that inclusion of the word "manifest", which was not found in *McCleary* and its progeny, but refused "to parse degrees of injustice", reasoning that "if justice is established by a preponderance of the evidence, it is both plain and manifest, especially to the aggrieved party."

[5] To this author, the language needs definition, as it could be read to require as the first step, the affirmation of the entity's debt or liability, as contrasted to an "obligation" or "duty".
[6] *Douglas Coder & Linda Coder Family LLLP v. RNO Exhibitions, LLC*, 3:19-cv-00520-MMD-CLB, 2020 WL 5995495 (D. Nev. Oct. 9, 2020) indicating the standard for Rule 8 is plausibility, which is a little more than a mere possibility.
[7] See *Coder*, infra; but also *Polaris*, infra. For a good discussion separating the actions and roles of a group of persons involved in an entity.
[8] *JSA, LLC v. Golden Gaming, Inc.*, 2013 Nev. Unpub, Lexis 1449; 2013 WL 5437333 (Nev. 2013) (unpublished) (confirming that a parent's use of a single cash management system by itself was insufficient to establish commingling.)
[9] *Am. Asphalt & Grading Co. v. Bowman*, No. 68304, 132 Nev. 939, 2016 WL 4159465 (Nev. 2016) (unpublished) (where under capitalization wasn't a sham and loans to related entities were repaid if not properly approved or documented); *see Magma Holding, Inc. v. Au-Yeung*, Case No.: 2:20-cv-00406-RFB-BNW, 2020 WL 2025365 (D. Nev. Apr. 26, 2020) (undercapitalization isn't a necessary prerequisite).
[10] *Morgan Stanley High Yield Sec. Inc. v. Jecklin*, Case No. 2:05-cv-01364-RFB-PAL, 2019 WL 1440258 (D. Nev. Mar. 31, 2019), along with elements #4 & 5.
[11] *Leany v. Zurich Am. Ins. Co.*, Case No. 2:16-cv-01890-RFB-PAL, 2018 WL 4600287 (D. Nev. Sep. 24, 2018); *Douglas Coder & Linda Coder Family LLLP v. RNO Exhibitions, LLC*, 3:19-cv-00520-MMD-CLB, 2022 WL 377627 (D. NevFeb. 8, 2022). Furthermore, distributions when an entity is winding down has its own subset of factual challenges - see *Leany v. Zurich Am. Ins. Co.*, 2018 WL 4600287 (D. Nev. Sep. 24, 2018) and *First Am. Title Ins. Co. v. Commerce Assocs., LLC*, 2020 WL 3050226 (D. Nev. Jun. 8, 2020).
[12] *Arnold v. Browne*, 27 Cal.App.3d 386, 103 Cal. Rptr. 775 (Cal. Ct. App. 1972).
[13] What is clear is: a) the actions or inactions must cause the injury and b) there is some responsibility on the person claiming injury to avail themselves of existing remedies (after the fact), or to take alternate actions to protect themselves for there to be injustice or fraud. *See Polaris Indus. Corp. v. Kaplan*, 747 P.2d 884, 103 Nev. 598 (Nev. 1987) ; *Casun Invest, A.G. v. Ponder*, Case No. 2:16-CV-2925 JCM (GWF), 2020 WL 59812 (D. Nev. Jan. 6, 2020).
[14] *Am. Asphalt & Grading Co. v. Bowman*, No. 68304, 132 Nev. 939, 2016 WL 4159465 (Nev. 2016) (unpublished)
[15] *No. 8 Mine, LLC v. Eljen Group.*, Case No.: 3:18-cv-00104-WGC, 2020 WL 6273898 (D. Nev. Oct. 26, 2020).
[16] *Leany v. Zurich Am. Ins. Co.*, Case No. 2:16-cv-01890-RFB-PAL, 2018 WL 4600287 (D. Nev. Sep. 24, 2018).
[17] Where no representations of responsibility for the obligation were made.
[18] However, *In re James Giampietro*, 317, B.R.841, 853 (Bankr. D. Nev. 2004), the Court accepted the position that reliance and expectations are important in applying the third element.
[19] Maybe in some cases, the absence of an *alter ego*'s influence and governance may be the easier path if the circumstances (or pleadings) are supportive (*see Polaris* and the analysis of Jerome Kaplan).
[20] *Harper v. Delaware Valley Broadcasters, Inc.*, 743 F. Supp. 1076 (D. Del. 1990), as non-payment of an obligation in it by itself is not sufficient.
[21] *LFC Marketing Group, Inc. v. Loomis*, 116 Nev. 896, 8 P.3d 841 (Nev. 2000).
[22] Note the 8th element is the availability of other remedies at law or in equity.
[23] *Viega GmBH v. Eighth Judicial Dist. Court*, 328 P.3d 1152, 130 Nev. 368 (Nev. 2014).
[24] *Dill v. Rembrandt Grp., Inc.*, 474 P.3d 176 (Colo. App. 2020); *See also Minno v. Pro-Fac, Inc.*, 121 Ohio St. 3d 464 (Ohio Supreme Court 2009) (discussing a sister's need to instigate the other sister's wrongful behavior.)
[25] *Dill v. Rembrandt Grp., Inc.*, 474 P.3d 176 (Colo. App. 2020).
[26] *Brugnara Props. VI v. Internal Revenue Serv.* (In re Brugnara Props. VI), 606 B.R. 371 (Bankr. N.D. Cal. 2019); *Schaefers v. Blizzard Energy, Inc.* (In re Schaefers), 623 B.R. 777 (B.A.P. 9th Cir. 2020).
[27] *Sobayo v. Hein Thi Nguyen* (In re Musonge) (BAP 9th Cir 2021).
[28] For a discussion on alternate remedies first see *Magliarditi v. Transfirst Grp.*, No. 73889, 450 P.3d 911, 2019 WL 5390470 (Nev. 2019) (unpublished) (discussing the interface of *alter ego* with Nevada's Uniform Fraudulent Transfer Act (NUFTA).
[29] Veil-Piercing, Peter B. Oh, 89 Texas Law Review Vol. 89:81 (Pitt Law, Legal Studies Research Paper Series Feb. 2010).