REIMBURSEMENTS REVISITED: SEPARATE PROPERTY COMPANIES; *JENSON* CLAIMS; ALTER EGOS; REVERSE PIERCING; AND REPRESENTING THE SPOUSE WHO DOES NOT RUN THE COMPANY

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CHAPTER 38

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- Speaker and Co-Author on "Reimbursements Revisited: Separate Property Companies; Jenson Claims; Alter Egos; Reverse Piercing; and Representing the Spouse Who Does Not Run the Company"; State Bar of Texas 35th Annual Advanced Family Law Course, San Antonio, Texas, August 5, 2009.

- Speaker and Co-Author on "Effective Cross-Examination of Mental Health Experts: Re-Shrinking the Experts"; The University of Texas Law School; 2009 Family Law on the Front Lines Seminar, San Antonio, Texas, June 18 - 19, 2009.

- Speaker and Co-Author on "Working with the Psychologist"; State Bar of Texas 34th Annual Advanced Family Law Course, San Antonio, Texas, August 11, 2008.

- Speaker and Co-Author on "Daubert / Experts"; Ultimate Trial Notebook: Family Law, New Orleans, Louisiana, December 7-8, 2006.

- Speaker and Co-Author on "Parenting Plans (Who, What, When, Where & Why)"; State Bar of Texas 32nd Annual Advanced Family Law Course, San Antonio, Texas, August 15, 2006.
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- Speaker on "Forensic Psychiatry: Pitfalls and Practices"; UT Southwestern Medical Center at Dallas, Dallas, Texas, February 15, 2005.

- Speaker and Co-Author on "Rubbish or Rembrandt: The Art of Evaluating a Custody Case"; State Bar of Texas 30th Annual Advanced Family Law Course, San Antonio, Texas, August 11, 2004.

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- Planned and chaired the first ABA Family Law Advanced Trial Advocacy Institute, University of Denver College of Law relocated to the University of Houston, from 1987 through 1993.
- Council member ABA Family Law Section, 1988-91; and State Bar Family Law Council , 1982-84.
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American Journal of Family Law, Valuing Professional Practices & Licenses: A Guide for the Matrimonial Practitioner, 2005 - 2009 Supplement, "Celebrity Divorce – Representing Big Hitters" (co-authored with Katherine A. Kinser)

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"Back in the Garage; Concluding the Divorce Action," National Business Institute, November 2008

"Case Assessment – Does the Emperor Have Clothes?" Family Law Advanced Course Boot Camp, August 2008

"Developing the Attorney/Client Relationship" 8th Annual Family Law on the Front Lines, June 2008

"Preparation for Temporary Orders Hearings – What To Do in the Last 100 Days/Hours/Minutes - Burdensome Limitations," Marriage Dissolution Institute, April 2008

"Guaranteed Pay: What a Deal, or Is It?" - Characterization of Unusual Employment Contracts", New Frontiers in Marital Property Law, October 2006 (co-authored with Katherine A. Kinser)

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LexisNexis Texas Annotated Family Code, Annotations for Chapter Four – "Premarital and Marital Property Agreements," 2006 – 2008 (co-authored with Katherine A. Kinser)

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American Journal of Family Law, Valuing Professional Practices & Licenses: A Guide for the Matrimonial Practitioner, 2005 - 2008 Supplement, "Celebrity Divorce – Representing Big Hitters" (co-authored with Katherine A. Kinser)

Family Law News (Official Publication of the State Bar of California Family Law Section), Issue 4 2005, Vol. 27, No. 4, "The PASS Payment: Negotiating the Professional Athlete's Child Support Obligations" (co-authored with Matthew G. Grimmer and Katherine A. Kinser)

Texas Academy of Family Law Specialists 20th Annual Trial Institute – 2006 – Trial Demonstration Participant

Texas Advanced Paralegal Seminar, "Family Violence ; FAQ RE PO's: The ABC's of Protective Orders," September 20, 2006

Texas Entertainment and Sports Law Journal, Spring 2006, Vol. 15, No. 1, "The PASS Payment: Negotiating the Professional Athlete's Child Support Obligations" (co-authored with Matthew G. Grimmer and Katherine A. Kinser)

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REIMBURSEMENTS REVISITED: SEPARATE PROPERTY COMPANIES; *JENSON* CLAIMS; ALTER EGOS; REVERSE PIERCING; AND REPRESENTING THE SPOUSE WHO DOES NOT RUN THE COMPANY

I. INTRODUCTION

As family law practitioners, we all desire the same outcome for our clients- a fair and just division of the marital property. In order to attain this somewhat arduous goal, family law practitioners must know and understand the fundamentals of the law as it relates to reimbursements. This article addresses the current status of the law and claims the practitioner can make against separate property companies including: (1) *Jenson* claims; (2) alter egos; and (3) reverse piercing. Additionally, this article discusses several tips the family law practitioner may implement when representing the spouse who does not run the company.

II. THE CURRENT STATUS OF THE LAW- ECONOMIC CONTRIBUTION:

Currently, the Texas Family Code identifies six possible claims for economic contribution as:

> the dollar amount of: (1) the reduction of the principal amount of a debt secured by a lien on property owned before marriage, to the extent the debt existed at the time of marriage; (2) the reduction of the principal amount of a debt secured by a lien on property received by a spouse by gift, devise, or descent during a marriage, to the extent the debt existed at the time the property was received; (3) the reduction of the principal amount of that part of a debt, including a home equity loan: incurred during a marriage; secured by a lien on property; and incurred for the acquisition of, or for capital improvements to, property; (4) the reduction of the principal amount of that part of a debt: incurred during marriage; secured by a lien on property owned by a spouse for which the creditor agreed to look for repayment solely to the separate marital estate of the spouse on whose property the lien attached and was incurred for the acquisition of, or for capital improvements to, property; (5) the refinancing of the principal amount described by Subdivision 1-4 above, to the extent the refinancing reduces that principal amount in a manner described above; and (6) capital improvements to property other than by incurring debt. Tex. Fam. Code § 3.402.

The following language is the formula set forth in the Texas Family Code for calculating claims of economic contribution:

> The amount of the claim under this section is equal to the product of:(1) the equity in the benefited property on the date of dissolution of the marriage, the death of a spouse, or disposition of the property; multiplied by (2) a fraction of which: (A) the numerator is the economic contribution to the property owned by the benefited marital estate by the contributing marital estate; and (B) the denominator is an amount equal to the sum of: (I) the economic contribution to the property owned by the benefited marital estate by the contributing marital estate; and (ii) the contribution by the benefited estate to the equity in the property owned by the benefited estate. Tex. Fam. Code § 3.403.(b)(1)(2).

The economic contribution equation listed above came into existence during a progressive movement away from reimbursements and towards economic contributions. Many family law practitioners believed, at the time, that reimbursements were simply failing to properly and fully compensate the contributing marital estates. The economic contribution statutes were designed to cure this deficiency. In application, however, the economic contribution statutes were considered by some as problematic, difficult, and inflexible.

In the last few years rumors began to emerge about the repeal of the economic contribution statutes. Such rumors were enough to evoke the appropriate wink, nod, and smile from long time colleagues during Family Law Continuing Legal Education courses and major farewell parties in the evenings. In 2009, one of the biggest changes emerging from the 81st legislative session is the long awaited repeal of the economic contribution statutes. Thanks to the members of the Texas Family Law Foundation, Senator Chris Harris (R-Arlington) and Representative Stephen Frost (D-New Boston), the 81st Texas Legislature is moments away from passing the repeal into law.

As of the date of this article, the Texas Senate has concurred with the House of Representative on the proposed amendments to Senate Bill No. 866. For more up to date information, please refer to the following link: http://www.capitol.state.tx.us.

June 1, 2009 was the last day of the Texas legislative session. Sunday, June 21, 2009 is the last day the governor can sign or veto legislation passed during the legislative session. At this point, Senate Bill No. 866 only lacks the governor's signature; we all remain confident that the governor will soon approve and sign the bill into law.

The upcoming legislation will replace the rigid formulas set forth by the economic contribution statutes and with a general principles of reimbursement- including and offsets. The division of the marital estate shall be based upon the court's discretion for a just and right division of the estate. At first glance, the bill seems to suggest that the new legislation will afford the family law practitioner with more flexibility when it come to reimbursement claims.

Joan F. Jenkins is the current President of the Texas Family Law Foundation. Ms. Jenkins has played an instrumental role in the passage of Senate Bill No. 866. Ms. Jenkins will be giving a speech during this course on "Legislative Updates." For further information on the repeal of the economic contribution statutes, please refer to Joan F. Jenkin's article in Chapter 2 of your course materials. Also, attached to this article as Appendix No. 1 is a copy of Senate Bill No. 866 as amended by the House of Representatives.

III. CLAIMS AGAINST SEPARATE PROPERTY COMPANIES

Under the "inception of title" rule, the practitioner can easily decipher if a spouse's company will be deemed as separate property. The difficult task comes in form of making a claim against separate property companies. The following discussion will give one the tools to effectively make claims against the separate property companies using the reimbursement theories espoused by "*Jensen*" claims, alter egos, and reverse piercing- all of which we shall be addressed individually below.

A. *JENSEN* CLAIMS

A judicially crafted effort to create a "do right" rule is found in *Jensen v. Jensen*, 665 S.W.2d 107 (Tex. 1984). The issue presented to the Supreme Court was how to treat corporate stock owned by a spouse before marriage, but which had in creased in value during marriage due, at least in part, to the time and effort of either or both spouses. The facts recited in the opinion showed that Mr. Jensen had acquired 48,455 shares (about 48% of the outstanding shares) of RLJ Printing Company, Inc. for $1.56 per share prior to marriage. During the marriage Mr. Jensen was the key man in the operation of RLJ. At the time of the divorce, the per share value of the stock was $13.48 according to husband's expert, and $25.77 according to wife's expert.

The Court observed that the community property states have adopted variations of either "reimbursement" or "community ownership" theories in fact patterns such as these. The common thread to these approaches is the concept that the community should receive whatever remuneration is paid to a spouse for his or her time and effort, since the time and effort belong to the community. However, the "community ownership" theory attributes the increase in value of the stock to the community. On the other hand, the "reimbursement" theory recognizes the separate ownership of the stock, but compensates the community for the reasonable value of the time and effort of the spouse or spouses attributable to the increase in value. The rule announced by the Court is:

> "...the community will be reimbursed for the value of time and effort expended by either or both spouses to enhance the separate estate of either, other than that reasonably necessary to manage and preserve the separate estate, less the remuneration received for that time and effort in the form of salary, bonus, dividends and other fringe benefits, those items being community property when received." *Id.* at 109.

The Court also imposed the burden of proof upon the spouse seeking the reimbursement.

1. A Limited Measure of Equity

It has been twenty-five years since the announcement of the *Jensen* rule and its application continues to limit the equitable recovery to the community. It is not measured by the increase in value of the separate estate. Instead, it is the *value* of the time and effort expended by the spouses to enhance the value, less the value of the time and effort reasonably necessary to manage and preserve the separate estate; and less the remuneration actually received. These requirements can and do create difficulties in proof. In practical application, these fact patterns are often claims for under compensation. Thus creating the necessity of credible evidence of what the compensation *should* have been. Additionally, the rule is clear that the *time and effort expended* must have *enhanced* the value of the separate property. If the enhancement is due to economic or market forces, then there is no basis for reimbursement.

2. Examples of Difficulties

Although there is no general theme to these cases, a few recitations may help to demonstrate the difficulties with the *Jensen* doctrine.

In *Rogers v. Rogers*, 754 S.W.2d 236 (Tex. App.– Houston [1st Dist.] 1988, no writ) the husband was successful in convincing the trial court to award him a judgement of $17,500 for reimbursement for his community time and effort used to enhance the wife's separate property real estate. The judgment was reversed and remanded as the Houston Court determined that there had been no evidence of the value of the husband's time and effort.

In *Gutierrez v. Gutierrez*, 791 S.W.2d 659 (Tex. App.– San Antonio 1990, no writ), there were several claims for reimbursement relating to husband's separate property, only one of which involved a true *Jensen* claim. In that instance, wife claimed that she had assisted with the husband's cattle herd by cooking for the ranch hands, feeding the cattle and assisting in the round up of cattle. The Court found that there was no proof to support the claim because her efforts did no more than was reasonably required to maintain the herd. Additionally, there was no evidence as to the value of her uncompensated time.

In *Wilkerson v. Wilkerson*, 992 S.W.2d 719 (Tex. App.– Austin 1999, no pet.), the trial court's imposition of a lien on husband's separate property to secure the claimed reimbursement was reversed and remanded. The Austin Court considered the fact that the community had expended funds and labor to improve the real estate. However, there was no showing of the extent of the community labor or the value of that labor.

In *Zeptner v. Zeptner*, 111 S.W.3d 727 (Tex. App.– Fort Worth 2003, no pet.) the trial court awarded an $80,000 reimbursement claim relating to husband's separate property sole proprietorship. This award was reversed on appeal because wife did not provide evidence to establish the value of husband's services or how much income the community had received from the business. Wife thus did not establish the value of the reimbursement claim for time, toil and efforts expended to enhance the business.

Fazakerly v. Fazakerly, 996 S.W.2d 260 (Tex. App.– Eastland 1999 pet. denied) was a claim by the deceased husband's estate for reimbursement for the increase in value of wife's separate property corporations. The jury determined that the community estate was not entitled to the reimbursement. On appeal, one of the issues presented was the sufficiency of the evidence. The court reasoned that the evidence demonstrated that the enhancement of the value of the business was due not only to the time, toil and efforts of the parties, but to economic and market conditions at the time. Therefore, there was sufficient evidence for the jury's findings.

3. Successful Use of Jensen

Jones v. Jones, 699 S.W.2d 583 (Tex. App.– Texarkana 1985, no writ) is an example of winning the battle, but not the war. The opinion offers limited facts, but does recite that the evidence was sufficient to support the trial court's award of reimbursement for an under compensation claim. The trial court found that $15,000 per year (for an unstated period of years beginning in 1977 to date of divorce) would reasonably compensate the community. Instead of awarding the judgment to the claiming spouse, the court made a disproportionate division of property. The case was reversed and remanded for reasons unrelated to the *Jensen* claim.

Another example of hollow victory is found in *Pearce v. Pearce*, 824 S.W.2d 195 (Tex. App.– El Paso 1991, writ denied). Husband and wife entered into the equivalent of a post-marital agreement (Trust Indenture), in which they agreed that the income or increase in the separate property of husband shall remain his property. Upon husband's death, wife sued the estate for a finding that the agreement was not enforceable and for reimbursement to the community based on the "time, toil, talent and effort" expended by husband to enhance the value of his separate estate. The agreement was held to be enforceable, but the jury awarded wife the sum of $1,825,639 in reimbursement. The trial court granted a "take nothing" judgement in favor of the estate. The El Paso Court held that the agreement did not bar recovery for reimbursement. It only referred to "property". Reimbursement is not a property right, but is an equitable claim that arises upon dissolution of the marriage. The expert testimony offered at trial showed that the husband's separate estate was clearly enhanced by virtue of his time and effort and the value of that time and effort was worth a maximum of $1,277,000. The jury award in excess of that amount was not supported by the evidence. It would have required husband's separate estate to pay more in reimbursement than his estate was benefitted.

4. Application of Family Code §3.408

When first enacted in 1999, there was some discussion as to whether or not §3.401, then the Equitable Interest statute, would serve to usurp the *Jensen* rationale. That query has been partially answered by the 77th Legislature with its 2001 amendment to Tex. Fam. Code

§3.408, which states that a claim for economic contribution does not abrogate another claim for reimbursement in factual circumstance not covered by Subchaper E. Tex. Fam. Code §3.408 (b)(2) provides:

> "A claim for reimbursement includes:(2) inadequate compensation for the time, toil, talent and effort of a spouse by a business entity under the control and direction of that spouse."

The provisions of Tex. Fam. Code §3.408(b)(2) are troubling because reference is made to inadequate compensation for time, toil and effort, without reference to the enhancement in value to the targeted business, nor the other measurements indicated in *Jensen*. That is, *Jensen* held that:

> "the community will be reimbursed for the value of time and effort expended by either or both spouses to enhance the separate estate of either, other than that reasonably necessary to manage and preserve the separate estate, less the remuneration received for that time and effort in the form of salary, bonus, dividends and other fringe benefits, those items being community property when received." *Id.* at 109.

In other words, Tex. Fam. Code §3.408 (b)(2) does not incorporate all of the *Jensen* factors and seems to create another form of reimbursement for inadequate compensation. It is doubtful that it eliminates *Jensen* claims because it provides that a claim for reimbursement "includes." The Code Construction Act gives some guidance. Tex. Gov't Code §311.005 provides that:

> "The following definitions apply unless the statute or context in which the word or phrase is used requires a different definition:
> (13) "Includes" and "including" are terms of enlargement and not of limitation or exclusive enumeration, and use of the terms does not create a presumption that components not expressed are excluded."

Therefore, it is the author's opinion that, other than fact patterns falling within economic contribution, the two items listed in Tex. Fam. Code §3.408(b)(2) are not exclusive. For the same reasons described above with reference to the Code Construction Act, it is this author's opinion that the *Jensen* measure is still alive. Further, under any theory of common law reimbursement, the mere fact of "inadequate compensation" without an accompanying enhancement in value would not support a claim for reimbursement.

B. ALTER EGO

There has perhaps never been a doctrine whose application has vexed jurists, attorneys, litigants, and business persons like disregarding the corporate structure. It is often inextricably intertwined with the minds of the persons attempting to apply it to any particular set of facts. It is thus susceptible to result-oriented decisions. The doctrine was originally conceived as a creditor's remedy to preclude a debtor's avoidance of just and lawful debts.

In the family law context, the Courts have had to "reverse pierce" the corporation. In the normal state of affairs, the doctrine is applied as an equitable remedy to enforce an obligation of the corporate entity by piercing through the limited liability of the corporate entity and holding an individual shareholder accountable. However, in the marital dissolution context, the converse is true. The attacking party is seeking to pierce past the individual shareholder to reach the funds and/or assets of the corporation. For this reason, Courts, especially in the context of family law cases, have held that it is a condition precedent to "piercing the corporate veil" th at 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. U.S.*, 910 F.d. 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 v. Branscum*, 721 S.W.2d 270 (Tex. 1986). However, from a practical perspective, there appears to be no reported decision in which a corporate entity has been disregarded in the family law 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 many 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).

1. *Castleberry v. Branscum*: An Attempt to Bring Order to a Chaotic Doctrine

In the most recognized case 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.

Castleberry originated from a suit on a promissory note by one business partner against two other partners in their individual and corporate capacities. 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 ownership interest in the corporation. Following the incorporation by the three business partners, one 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 bus iness. 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. 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 by Byboth and Branscum and reinitiated for the benefit of Custom Carriers.

The Supreme Court held that the foregoing facts were sufficient to support a finding that the corporate form was used as a sham to perpetrate a 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. 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.

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 that 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. 2d. 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." *Castleberry*, 721 S.W. 2d. 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. *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 applying the "alter ego" doctrine: (1) the degree to which corporate formalities have been followed; (2) the degree to which corporate and individual property have been kept separately; (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. *Id.* 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 often criticized, the opinion does render one of the clearest statements of the meaning of the term "unfair device." The term "unfair device," unlike the term "alter ego," embodies only 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," one could argue that there 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.

2. Amendments to Texas Business & Commerce Code

In response to the *Castleberry* opinion, the Legislature embarked upon a series of amendments to the Texas Business Corporation Act. The pertinent provisions are found at Tex. Bus. Corp.Act. Art 2.21A(2) and (3) (Vernon Supp. 2003) which provides that a *shareholder shall be under no obligation to the corporation or to its obligees with respect to:*

> (2) any *contractual obligation of the corporation or any matter relating to or arising from the obligation* on the basis that the [shareholder] is or was the alter ego of the corporation, or on the basis of actual fraud or constructive fraud, a sham to perpetrate a fraud, or other similar theory, unless the obligee demonstrates that the [shareholder] caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud, or other similar theory, on the obligee primarily for the direct personal benefit of the [shareholder]; or
> (3) any obligation of the corporation on the basis of the failure of the corporation to observe any corporate formality, including without limitation: (a) the failure to comply with any requirement of this Act or of the articles of incorporation or bylaws of the corporation; or (b) the failure to observe any requirement prescribed by this Act or by the articles of incorporation or bylaws for acts to be taken by the corporation, its board of directors, or its shareholders. (Emphasis added).

The phrase "contractual obligation" was discussed in *Menetti v.Chavers*, 974 S.W.2d 168 (Tex. App.– San Antonio 1998, no writ) in connection with respect to a construction contract between plaintiff and the target corporation and its shareholders. The Court observed that the statute makes it clear that, absent a finding of actual fraud, the shareholder cannot be liable for a corporate contractual obligation. Where the plaintiff's claim is based in tort may not be so clear. The Court noted that:

> Prior to the 1993 amendment, commentators and courts agreed that all claims that were not contractual were governed by *Castleberry*, which required only a showing of constructive fraud in order to pierce the corporate veil. (Citations omitted). Traditionally, Texas cases have attempted to treat contract claims and tort claims differently in determining whether to pierce the corporate veil *See Lucas v. Texas Indus., Inc.*, 696 S.W.2d 372, 375 (Tex. 1984) (pointing out differences between tort and contract alter ego cases). The 1989 amendments to article 2.21 apparently tried to keep this distinction alive.
> One commentator has suggested that this distinction has existed because in contract cases, the parties have voluntarily come together to conduct business, but in tort cases there is no such voluntariness. (Citation omitted)....The commentary following the 1996 [sic] amendments suggests that the actual fraud requirement should be applied, by analogy, to tort claims, especially those arising from contractual obligations. *Menetti*, 974 S.W.2d at 173-174.

This distinction was addressed briefly in a footnote in *Texas-Ohio Gas, Inc. v. Mecom* 28 S.W.3d 129 (Tex. App.– Texarkana 2000, no writ) where the court cited *Menetti* for the proposition that Article 2.21 limits liability for contractual obligations and for torts arising from such contractual obligations. As a matter of the plain reading of the statute, the Texas-Ohio footnote seems to more accurately interpret the meaning of Article 2.21A(2). That is, it clearly refers to a contractual obligation or any matter relating to or arising from the obligation. Of course these fine distinctions may not apply to the concept of "reverse" piercing as the doctrine is used in the family law setting. That is, "reverse" piercing does not seek to hold the shareholder liable for an obligation. Rather, it seeks to "unzip" the corporate shield and bring those assets into the community for equitable division.

3. Alter Ego in the Family Law Setting

In efforts to assist the reader, the family law opinions related to alter ego are offered in chronological order. As mentioned above, the doctrine is often applied in fact specific settings. Therefore, where appropriate, detailed facts recited in the opinions are offered here.

a. *Dillingham v. Dillingham*

In *Dillingham*, the question to be decided was 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.

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.2d. 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 should be noted that *First Nat'l* held that "alter ego" 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 con tinued to be treated as a separate entity. Therefore, the second prong of the "alter ego" test was ignored.

b. *Bell v. Bell*

The next mention of "alter ego" in the family law 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. 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. This opinion offers little in advancing and understanding of the doctrine's proper application in the family law context.

c. *Uranga v. Uranga*

In *Uranga*, 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. 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.

d. *Goetz v. Goetz*

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

e. *Humphrey v. Humphrey*

In *Humphrey*, the Court considered, inter alia, whether the trial court erred in refusing to instruct the jury on the "alter ego" doctrine. 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 or to any third party." Id. (emphasis added). In the absence of evidence of the foregoing, the court noted that there cannot be a finding of "alter ego."

f. *Duke v. Duke*

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) Appellant used corporate funds to make four m onthly 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."

g. *Brooks v. Brooks*

Next in the chronological discussion of authorities addressing the "alter ego" doctrine in the family law context is *Brooks v. Brooks*.

At the time of the parties' marriage, each possessed a significant separate estate. 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. Mr. Brooks was operating the corporation prior to the date of the marriage and he was the sole owner. 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 this 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." *Brooks*, 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 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. 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 year marriage.

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. 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. 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. 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.

h. *Spruill v. Spruill*

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." At the time of marriage, Mr. Spruill owned 48% of the Larry Spruill Company, Inc. After the marriage, the husband acquired the remaining shares of outstanding stock by expending community funds to purchase them. 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 percent interest in four other corporations that were involved in the mobile home business. 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. The Court noted: *"the husband even paid for the food and other necessities of life from a corporate account."* (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 companies. 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. 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 Alost the house, the furniture, all of the mobile home inventory, all monies, the motor vehicles, and every other conceivable community asset."

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. 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. 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. 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." *Id.* at 96.

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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.

i. *Martin v. Martin*

The next appellate decision to entertain any discussion of the "alter ego" doctrine was one of the few wherein the Court had the opportunity to squarely address the issue of the proper application of the doctrine in the family law context. In *Martin*, the Court of Appeals 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 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 can be categorized as another in a number 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.

j. *Zisblatt v. Zisblatt*

In *Zisblatt*, the Court 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. Hence, the Court found that Mr. Zisblatt was evading an existing legal obligation to his spouse and therefore disregarded the corporate form.

In beginning its analysis of resolving the issue of whether the lower court erred in holding that Dispo [the corporation alleged to be husband's separate property] was not the "alter ego" of Mr. Zisblatt, the Court, began by stating the "unfair device" doctrine. Thus, the Court wrote "the corporate fiction may be disregarded:

> "(1) where it is used as a means for 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." *Id.* 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). 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." at p. 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); *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. 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 separate and apart from that of Jack", *Id.* 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.*

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. 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."

k. *Robbins v. Robbins*

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). 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 that was attempting to alter the character of her 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." at p.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. Further, the Court noted that mere unity of financial interest is equally insufficient in itself to justify the invocation of the remedy. 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 party seeking to disregard the corporate form before a Court will do so.

l. *Thomas v. Thomas*

The next pertinent reference to the "alter ego" doctrine in the domestic relations context came in *Thomas v. Thomas*. Although the Court did not substantively address the doctrine, the case is instructive 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).

Another section of the Court's opinion is worthy of mention. 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. This result follows from the generally recognized principal that Aa 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.

m. *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.

In 1967, Southwest Livestock was formed by Neil, Darrell, and Joe Earl Hargrove. 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. Joe's spouse Nadine Hargrove passed away and her interest in the corporation passed to the children of Joe and Nadine. Joe then married Jonnye Glee Hargrove. At the time the couple was married, Joe owned twenty-five percent of Southwest, twenty five percent was owned by Joe and Na dine's children, and the remaining fifty percent was owned by Darrell. Following his marriage to Jonnye, Joe purchased an additional sixteen percent of stock in Southwest Livestock from the estate of Nadine. Thus, his interest in Southwest Livestock was then forty-one percent. The remaining nine percent is in trust for the children born of the marriage of Joe and Nadine.

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.

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. 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. These expenditures were accounted for as travel and entertainment expenses, freight and buying commissions, corporate expenses, and corporate veterinary supplies, respectively. Any profits derived from the vitamin venture were kept solely by Jonnye.

Prior to filing for divorce, Jonnye wrote herself two 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.

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. 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. 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." *Id.* 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 uni ty 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.

n. *Parker v. Parker*

In another pronouncement on the application of "alter ego" in the family law context, 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 footnotes citing to *Zisblatt* for the circumstances that justify an application of the doctrine. 897 S.W.2d 918, 934, n.11, n. 12.

o. *Lifshutz v. Lifshutz*

In this case, the appellate court reversed the trial court's attempt to pierce both a partnership and several corporate entities. Husband was a one-third owner of three corporate entities and one partnership. His two brothers each owned, in equal shares, the other two-thirds of these entities. Husband was, at varying times during the marriage, employed as the president, CEO or managing partner of these companies. His interest in the entities was his separate property, either having been owned prior to marriage or received by gift during the marriage. In the suit for divorce, wife sued the companies, seeking to pierce the corporate veil and reach their assets for distribution as part of the

community estate. The companies filed a cross-action against husband and wife, alleging that husband had breached his fiduciary duty to them by usurping corporate opportunities and used corporate funds to benefit him and his wife. They also sought to recover damages for corporate funds used by husband for his family expenses and further sought a constructive trust on assets acquired by the wife and the husband as a result of the breach of fiduciary duty owed to them. The trial court found that husband had breached his fiduciary duty to the entities, but denied their claims for damages and constructive trust. It also found that the entities were the alter ego of husband. Based on the finding of alter ego, the trial court pierced the corporate veil to the extent of husband's one-third interest, thus increasing the community estate. The San Antonio Court's opinion recites the standard definition of the doctrine of alter ego in the traditional business context, i.e., to allow the trial court to pierce the veil so as to hold individual shareholders liable for corporate debt. It further observed that alter ego has two elements: (1) such unity between corporation and individual that the separateness of the corporation has ceased and (2) a finding that holding only the corporation liable would result in an injustice. In addition, it set out standards for a finding of alter ego sufficient to justify piercing in the divorce context:

> "At the least...requires the trial court to find: (1) unity between the separate property corporation and the spouse such that the separateness of the corporation has ceased to exist, and (2) the spouse's improper use of the corporation damaged the co mmunity estate beyond that which might be remedied by a claim for reimbursement." *Id.* at 517.

It noted that the trial court had held that wife need not show intent or fraud, only that an inequitable result will occur if piercing is not applied. The Court specifically held that this statement is over-broad and misleading. The inequity that justifies "reverse piercing" in a divorce case must stem from an improper transfer of community assets to the corporation. The Court also observed that the evidence showed that husband's conduct as it related to the entities actually enhanced the community at the expense of the corporations and that there was no evidence that there was any community property transferred to them.

The trial court denied the entities' claims against the spouses, although it did find that the husband had breached his fiduciary duty to them. The appellate court determined that remand was required to determine liability and damages on the causes of action brought by the entities.

The trial court's effort to pierce the partnership was also reversed, the Court noting that a trial court may not award specific partnership assets to the non-partner spouse in the event of a divorce, citing Texas Revised Partnership Act, Tex. Rev. Civ. Stat. Ann., art 6132b-5.01, -5.03, -5.04 and *McKnight v. McKnight*, 543 S.W.2d 863 (Tex. 1976).

p. *Young v. Young*

Husband had formed DAX Enterprises, Inc. prior to the marriage. He was the sole employee. The opinion does not recite whether or not he was the sole shareholder. However it does recite that he was in charge of the day-to-day finances of DAX. He kept his income in the DAX account. He used the account to pay personal expenses, including daycare expenses for his child from a prior marri age, car payments and payments on a home he owned "individually." In reviewing whether or not his misuse of the corporation damaged the community, consistent with the *Lifshutz* opinion, the court considered that he had received over $216,000 in benefits from the corporation in the form of income, loans and personal checks. Further, near the time of the marriage, the parties agreed to purchase a home. Husband told wife it would be in both of their names. Instead, it was purchased in the corporate name. Without reciting further details, the opinion also advises that he placed many community assets in the corporate name; he was paid a relatively small salary in relation to the income of the corporation and he put his earned income back into DAX. It was held that the evidence in this case showed that he had misused the corporation to the extent it damaged the community estate and that it was the alter ego of husband.

C. The Unique Nature of "Reverse Piercing"

As mentioned at the beginning of this section, the application of the equitable doctrine of piercing the corporate veil in the family law context is a "reverse" piercing. That is, instead of seeking to satisfy a corporate obligation against the shareholder, the party attempts to pierce through the shareholder to reach the

assets of the corporation. With this unique application of the doctrine come at least two possible requirements.

1. Requirement of a Finding of Alter Ego

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 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 "reverse" pierce the corporate veil.

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 reverse piercing is an appropriate remedy in the State of Texas. See *Castleberry v. Branscum*, supra. 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 reverse piercing" to those cases in which there is an affirmative finding of "alter ego" and, with the Lifshutz opinion, where community assets have been transferred to the corporation.

This assertion is supported in the case of *Zahra Spiritual Trust v. U.S.*, 910 F.d. 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 *Dillingham* and *Zisblatt* and concluded that in the State of Texas, Aa 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.d. 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)).

2. Is There a Requirement of Finding of a Majority Interest in a Corporate Entity?

As one can readily discern from a review of each of the above cases, there is no situation in which the corporate form has been successfully 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 (with the exception of the Lifshutz facts) 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.

3. Evidence of Damage to the Community

As held in *Lifshutz*, supra, there will be no piercing unless the evidence shows the improper use of the corporate entity damaged the community estate beyond that which might be remedied by a claim for reimbursement and the improper transfer of community assets to the corporation. The mere existence of alter ego status will not support a reverse piercing effort.

IV. REPRESENTING THE SPOUSE WHO DOESN'T RUN THE BUSINESS

When representing the spouse who does not run the business, a lawyer's first line of business is to find and gather as much information as possible about the business. Here are several questions to start with and consider when drafting a request for production of documents:

1) What is the company worth?;
2) What interest does the involved spouse have in the business?;
3) What is the business spouse's ability to make decisions within the business (e.g., distributions/refusal to distribute, transfer of assets, payment of debt, purchase of new technology)?;
4) How is the business organized- Is a corporation, L.L.P., L.L.C., or a partnership?
5) How much does the involved spouse earn annually?; and
6) Does the involved spouse receive bonuses or fringe benefits?

When representing the spouse who does not run the business, a family lawyer's primary concern is that the business spouse will attempt to starve out the other spouse. A request can be made of the court to put everyone on a budget and to equalize the payment of fees for attorneys and other professionals.

The next thing the family law practitioner can do to help the spouse who does not run the business is to hire a financial expert. A financial expert can review the business document produced, testify about the value of the business, and run reports on what average person in the same type of business would earn. Remember to consider the difficulties presented in *Jensen* when considering what evidence will be sufficient to make your case.