Not Reported in Cal.Rptr.2d, 2002 WL 440407 (Cal.App. 2 Dist.)
Nonpublished/Noncitable (Cal. Rules of Court, Rules 8.1105 and 8.1110, 8.1115)
(Cite as: 2002 WL 440407 (Cal.App. 2 Dist.))

Court of Appeal, Second District, Division 7, California.
VSS SALES, INC., Plaintiff and Appellant,
v.
UNI-SEAL VALVE COMPANY et al., Defendants and Respondents.

No. B144966.
(Los Angeles County Super. Ct. No. TC 015064).
March 21, 2002.

Buyer of valves sued seller, and its parent, claiming product was defective. The Superior Court, Los Angeles County, Michael B. Rutberg, J., entered judgment for buyer against seller and for parent against buyer. Buyer appealed adverse judgment. The Court of Appeal, Lillie, J., held that seller was alter ego of parent, allowing for piercing of corporate veil and judgment against parent.

Reversed with directions.

Perluss, J., dissented and filed opinion.

West Headnotes

Corporations and Business Organizations 101 1059

101 Corporations and Business Organizations
101II Disregarding Corporate Entity; Piercing Corporate Veil
101k1057 Particular Occasions for Determining Corporate Entity
101k1059 k. Contracts in general. Most Cited Cases
(Formerly 101k1.6(2))

Seller of defective valves was alter ego of its parent, allowing buyer to pierce corporate veil and obtain judgment against parent; seller never issued stock, and had no capitalization, existing only on infusions from parent when necessary, had common director with parent, and failed to observe many corporate formalities

APPEAL from a judgment of the Superior Court of Los Angeles County, Michael B. Rutberg, Judge. Reversed with directions.Finer, Kim & Stearns, Harry J. Kim and Robert B. Parsons for Plaintiff and Appellant.

Kenneth W. Kind for Defendants and Respondents.

LILLIE, P.J.

***1** VSS Sales, Inc. (VSS) appeals judgment entered in favor of Lortz & Son, Inc. (Lortz & Son) in VSS's action for breach of contract and breach of warranty against Lortz & Son and its division, Uni-Seal Valve Company (Uni-Seal). After a bench trial, the trial court entered judgment for VSS on its claim against Uni-Seal, but entered judgment in favor of Lortz & Son on the grounds that Uni-Seal was not the alter ego of Lortz & Son. The sole issue on appeal is whether the trial court erred in failing to pierce the corporate veil based on evidence establishing that Uni-Seal was never capitalized, failed to observe corporate formalities, and the businesses of Lortz & Son and Uni-Seal were conducted as the same entity.

FACTUAL BACKGROUND AND PROCEDURAL HISTORY

VSS obtained a contract to refurbish air compressors for Nevada Power at the Reid Gardner facility, which provides power to Clark County, Nevada. VSS commenced work on the project in approximately February 1996. Soon thereafter, VSS discovered the valves VSS purchased from Uni-Seal for use in the project were defective and had to be replaced after several weeks. As a result, VSS

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lost Nevada Power as a customer and incurred out-of-pocket costs of over $80,000 to rectify the problem.

On August 22, 1997, VSS commenced the instant action against Uni-Seal and its parent, Lortz & Son, for breach of contract and breach of express and implied warranties. VSS sought damages for its out-of-pocket costs as well as consequential damages. A bench trial commenced November 16, 1999. On the alter ego theory, the following evidence was established at trial:

Charles Lortz (Lortz) testified that he is the president of Lortz & Son. In August 1993, Lortz & Son acquired the assets, stock inventory, and office furniture of Uni-Seal, a going concern, from Wilbur-Ellis. The sales price was $25,000 in cash and a note for the balance due of $225,000. At the time of the purchase, Wilbur-Ellis warranted that Uni-Seal had been incorporated on January 26, 1993, had no assets or liabilities, had not appointed its board of directors nor elected officers, and had otherwise conducted no business. Lortz testified Uni-Seal had no paid-in capital, and no stock has been issued in Uni-Seal.[FN1] Uni-Seal had inventory and other assets, including equipment and valve patterns. After the purchase, there were two directors of Uni-Seal, Lortz and Nancy Klawitter.

> FN1. Lortz variously testified that he owned the stock of Uni-Seal, that Lortz & Son owned the stock of Uni-Seal, and that he was unsure who owned Uni-Seal's stock. The stock book of Uni-Seal has not been located.

Lortz testified he had to put money in Uni-Seal in order to keep it operational. Although Uni-Seal did not need infusions of cash every month from Lortz & Son, Lortz & Son would put money into Uni-Seal when it was “strapped” for cash. At one point, Lortz & Son had to advance $500,000 to Uni-Seal in order for Uni-Seal to cover its payroll. Lortz testified that separate bank accounts were maintained for Lortz & Son and Uni-Seal, and records were maintained on all advances Lortz & Son made to Uni-Seal. Lortz & Son and Uni-Seal had different general managers. Lortz understood that the “capitalization” of Uni-Seal could refer to its inventory and assets.

***2** Ricky Williams (Williams) testified that from 1993 through 1996, he was the accountant for Lortz & Son. Over a period of approximately three years, Lortz & Son transferred approximately $380,000 to Uni-Seal to keep it in operation. To his knowledge, this money was not repaid. In addition, Lortz & Son made a loan of $30,000 to Uni-Seal to keep Uni-Seal going. For accounting purposes, Williams treated Uni-Seal and Lortz & Son as separate corporations. Lortz & Son and Uni-Seal filed a consolidated tax return, which permitted Lortz & Son to take advantage of losses Uni-Seal incurred. Williams understood the relationship between Uni-Seal and Lortz & Son to be that of parent and subsidiary. He understood that when Lortz & Son purchased Uni-Seal from Wilber Ellis, Lortz & Son purchased a corporation, not just its assets; for tax purposes, Lortz & Son's purchase of Uni-Seal was treated as if Lortz & Son had bought the corporate entity of Uni-Seal, not just the assets of Uni-Seal. Williams never saw any minutes or bylaws for Uni-Seal, although he attended board and shareholders meetings and observed that minutes were taken.

Thomas Vaughn, the president and CEO of VSS, testified he did not know of the relationship between Lortz & Son and Uni-Seal until after VSS experienced difficulties with the Uni-Seal valves. He did not “rely upon” Lortz & Son's relationship with Uni-Seal when the contract to purchase the valves was made.

In October 1996, Lortz & Son sold the assets of Uni-Seal to Phillip B. Rummell, dba Productioneered Products Co. for $120,000, plus 10 percent of the total gross sales generated by the use of the assets and name “Uni-Seal Valve.” The sale did not include Uni-Seal's corporate records. Uni-Seal was rendered insolvent upon Lortz & Son's sale of Uni-Seal's assets in 1996. All the creditors of Uni-Seal

were paid except for Lortz & Son.

After the bench trial, the court found for VSS, awarding it $62,142.03 in out-of-pocket expenses incurred to rectify the problems with the Uni-Seal valves. On the alter ego issue, the court, in its minute order, found that VSS had failed to establish that any fraud would be perpetrated or that any injustice would result if the separateness of the Uni-Seal corporate form were recognized. Specifically, the court pointed to the fact that no cash, inventory, equipment or other property of Uni-Seal was transferred to Lortz & Son; Uni-Seal repaid its loan to Lortz & Son; the proceeds of the bulk sale were used to repay creditors of Uni-Seal, and were not used to "line the pockets" of Lortz & Son; and the bulk sale took place many months after the contract with VSS. The court found that rather than "raiding" the assets of Uni-Seal, Lortz & Son poured $300,000 of its own money into Uni-Seal to keep it afloat and did not use any of the bulk sales proceeds for its own benefit. Furthermore, VSS "did not rely upon any participation of Lortz & Son when it entered into its business relationship" with Uni-Seal, "nor did any of the claimed corporate violations alleged by [VSS] have any impact upon the relationship between" VSS and Uni-Seal.

***3** The court issued a statement of decision which reiterated the findings of its minute orders, and in which it further stated that there was a "separateness of identity" between Uni-Seal and Lortz & Son such that they were not one and the same company. The court found Lortz & Son had acquired only the assets constituting the business operations of Uni-Seal, and that Uni-Seal never issued any stock to Lortz & Son.

DISCUSSION

VSS contends the trial court erred because the facts establish Lortz & Son disregarded the corporate form and separateness of Uni-Seal. No stock was issued; Uni-Seal had no bylaws, no minutes, no stock certificates, no stock register, and no corporate documentation. Therefore, no parent-subsidiary relationship existed between Lortz & Son and Uni-Seal, and they must be treated as one and the same. Furthermore, the commingling of funds and other assets of Lortz & Son and Uni-Seal was undocumented, and Lortz & Son, rather than Uni-Seal, agreeing to indemnify Rummell in connection with the 1996 sale of Uni-Seal's assets, show that no separateness of the two corporations existed. Based upon these facts, VSS contends it would be grossly unjust for Lortz & Son to use the corporate shell of Uni-Seal to avoid liability for the defective parts.

Two requirements must be met before the corporate form will be disregarded pursuant to the alter ego doctrine. First, there must be such a unity of interest between the two corporate entities that the separate personalities of such corporations no longer exist; and second, it would promote injustice to continue to recognize the separateness of the two corporations. (*Tomaselli v. Transamerica Ins. Co.* (1994) 25 Cal.App.4th 1269, 1285, 31 Cal.Rptr.2d 433.) Both requirements of the doctrine must be met, as it "does not guard every unsatisfied creditor of a corporation but instead affords protection where some conduct amounting to bad faith makes it inequitable for the corporate owner to hide behind the corporate form." (*Sonora Diamond Corp. v. Superior Court* (2000) 83 Cal.App.4th 523, 539, 99 Cal.Rptr.2d 824.) The doctrine applies equally to individuals and to corporations-the "alter ego" may be a person or a parent or sister corporation. (*Las Palmas Associates v. Las Palmas Center Associates* (1991) 235 Cal.App.3d 1220, 1249, 1 Cal.Rptr.2d 301 (*Las Palmas Associates*).)

In determining whether to apply the doctrine, the inquiry is fact-intensive. "There is no litmus test to determine when the corporate veil will be pierced; rather the result will depend upon the circumstances of each particular case." (*Mesler v. Bragg Management Co.* (1985) 39 Cal.3d 290, 299, 216 Cal.Rptr. 443, 702 P.2d 601; *H.A.S. Loan Service, Inc. v. McColgan* (1943) 21 Cal.2d 518, 523, 133 P.2d 391.) Furthermore, because the inquiry is fact-intensive, we will not overturn the ruling of the trial court if it is supported by substantial evidence.

(*Jack Farenbaugh & Son v. Belmont Construction, Inc.* (1987) 194 Cal.App.3d 1023, 1032, 240 Cal.Rptr. 78.) A judgment against a corporation and its alter ego is enforceable against each separately. (*Mesler v. Bragg Management Co., supra,* 39 Cal.3d at p. 301, 216 Cal.Rptr. 443, 702 P.2d 601.)

***4** Numerous factors are considered in determining whether the separateness of the corporate form exists, and include: inadequate capitalization, commingling of funds and other assets, disregard of corporate formalities (minutes, stock issuance, election of officers, segregation of corporate records), identical equitable ownership in the two entities, or identical directors and officers. (*Brooklyn Navy Yard Cogeneration Partners v. Superior Court* (1997) 60 Cal.App.4th 248, 257-258, 70 Cal.Rptr.2d 419.) However, "sound public policy dictates that imposition of alter ego liability be approached with caution." (*Las Palmas Associates, supra,* 235 Cal.App.3d at p. 1249, 1 Cal.Rptr.2d 301.) Therefore, mere disregard of the corporate form is insufficient to impose alter ego liability. The third party creditor must show that "some conduct amounting to bad faith makes it inequitable for the corporate owner to hide behind the corporation form." (*Sonora Diamond Corp. v. Superior Court supra,* 83 Cal.App.3d at p. 539, 147 Cal.Rptr. 376.)

In particular, the failure to issue stock in the corporation is grounds for piercing the corporate veil, although it is not conclusive in establishing that the corporate form was the mere alter ego of the defendant. (*Marr v. Postal Union Life Ins. Co.* (1940) 40 Cal.App.2d 673, 679, 105 P.2d 649; see also *Automotriz etc. de California v. Resnick* (1957) 47 Cal.2d 792, 796, 306 P.2d 1.) Lack of capitalization is indicative that the corporation is being used as a mere shell. (*Ibid.*) "The attempt to do corporate business without providing any sufficient basis of financial responsibility to creditors is an abuse of the separate entity ... shareholders should in good faith put at the risk of the business unencumbered capital reasonably adequate for its prospective liabilities." (*Id.* at p. 797.) *Automotriz* concluded that "[i]f the capital is illusory or trifling compared with the business to be done and the risks of loss, this is a ground for denying the separate entity privilege." (*Ibid.*)

In *Automotriz,* the shell corporation never issued stock, no bank account was opened for the corporation, although one was opened under a dba, the funds for the purchase of inventory were provided by the individual officers of the corporation, not the corporation, the corporation never held title to the inventory, and sales proceeds were deposited into the dba account for reimbursement to the officers. (*Automotriz etc. de California v. Resnick, supra,* 47 Cal.2d at p. 795, 306 P.2d 1.) In upholding alter ego liability, the court pointed to the failure to issue stock as well as the manner in which the business was run as an extension of the individual directors. (*Id.* at p. 798, 306 P.2d 1.)

In *Las Palmas,* the buyers of a shopping center claimed the seller corporation executed lease guarantees with no intent to honor them, and sought to hold another corporation liable as the alter ego of guaranteeing corporation. The two corporations had common directors; the shell corporation had divested itself of its assets, leaving it undercapitalized, and the corporations shared employees, as the guaranteeing corporation had discharged its employees and become "a shell" with the other corporation's employees transacting its business. (*Las Palmas Associates, supra,* 235 Cal.App.3d at pp. 1232-1234, 1 Cal.Rptr.2d 301.) The court found these facts justified a finding the two corporations were "combined into a single enterprise to defraud" third parties. (*Id.* at p. 1251, 1 Cal.Rptr.2d 301; see also *Pan Pacific Sash & Door Co. v. Greendale Park, Inc.* (1958) 166 Cal.App.2d 652, 658-659, 333 P.2d 802.) Similarly, in *Pan Pacific,* the corporations (Greendale Park, Inc. and Ralmor, Inc.) had the same stockholders, directors, officers, and occupied the same premises and had common employees. Both corporations were undercapitalized; as the need arose, the corporations made loans to each other. These facts justified alter ego liability,

as it would promote injustice and be inequitable for one corporation to avoid an obligation incurred as much for its benefit as for the other corporation. (*Id.* at p. 659, 333 P.2d 802.)

***5** Conversely, where a corporation was undercapitalized but the two corporations maintained separate books and records, separate bank accounts, were incorporated at different times, did not share all of the same directors or officers, retained separate counsel, issued stock, had their own employees and kept separate payrolls, maintained corporate formalities, such as minutes and meetings, and did not commingle funds, the facts supported a finding of no alter ego liability. (*Associated Vendors Inc. v. Oakland Meat Co.* (1962) 210 Cal.App.2d 825, 841, 26 Cal.Rptr. 806.)

Lastly, we point out that corporate veil analysis differs where liability is to be founded on contract, rather than tort, and a stronger showing is required because contract claimants have voluntarily dealt with the corporation. Presumably, in a consensual transaction, the third party has had the opportunity to ascertain the corporation's creditworthiness and to obtain guarantees, security agreements, liens, or other means of protecting itself. Therefore, unless there is evidence of commingling, misrepresentation, or diversion of corporate assets, alter ego liability will not be imposed. (*Cascade Energy & Metals Corp. v. Banks* (10th Cir.1990) 896 F.2d 1557, 1577.)

We find the trial court's conclusion is not supported by substantial evidence. The facts in the instant case are more analogous to *Automotriz* and *Las Palmas Associates.* The record demonstrates that although Uni-Seal was never capitalized and no stock was issued, Uni-Seal had its own bank accounts, manager, assets and inventory, and held its board of directors and shareholder meetings. However, these latter facts do not save any fiction of its separateness. Uni-Seal *never* issued stock; had *no* capitalization, and therefore required repeated infusions of capital from Lortz & Son in order to function. Furthermore, it had a common director with Lortz & Son; failed to observe numerous corporate formalities; and it was a mere shell of a corporate form when Lortz & Son purchased it in 1993. Lortz & Son propped Uni-Seal up and kept it going. These latter facts indicate that Uni-Seal never had an existence independent of Lortz & Son sufficient to justify our continued adherence to the separateness of its corporate form.

Furthermore, the circumstances of the sale of Uni-Seal's assets, in the absence of any capitalization of the corporation, and its subsequent insolvent state, would work an inequitable and unjust result on VSS. Uni-Seal was a mere shell through which Lortz & Son speculated on the success of Uni-Seal's potential business and obtained tax benefits; when Uni-Seal failed, Lortz & Son sold Uni-Seal's assets and took its losses. Thus, while it is laudable that Uni-Seal paid some creditors, it did not pay all of its creditors; the fact that Lortz & Son did not profit by its operation of Uni-Seal has no bearing on our analysis. Finally, our conclusion is not affected by VSS's status as a contract claimant, as Lortz & Son's conduct in keeping Uni-Seal going through massive infusions of cash created a faade of a viable going concern when in fact Uni-Seal was but a pretense.

DISPOSITION

***6** The judgment is reversed with directions to enter judgment for VSS against Lortz & Son in the sum of $62,142.03. Appellant is awarded costs on appeal.

I concur: JOHNSON, J.
PERLUSS, J.

I respectfully dissent.

Under the alter ego doctrine, when the corporate form is used to perpetrate a fraud or accomplish a wrongful or inequitable purpose, courts treat the corporation's acts as those of the person or entity actually controlling the corporation. (*Sonora Diamond Corp. v. Superior Court* (2000) 83 Cal.App.4th 523, 538, 99 Cal.Rptr.2d 824.) “The issue is not so much whether the corporate entity

should be disregarded for all purposes or whether its very purpose was to defraud the innocent party, as it is whether in the particular case presented, justice and equity can best be accomplished and fraud and unfairness defeated by disregarding the distinct entity of the corporate form." (*Communist Party v. 522 Valencia, Inc.* (1995) 35 Cal.App.4th 980, 993, 41 Cal.Rptr.2d 618.)

As the majority explains, in California two conditions must be met before the alter ego doctrine may be properly invoked. First, there must be such a unity of interest and ownership between the corporation and the individual or organization controlling it that their separate personalities no longer exist. Second, there must be an inequitable result if the acts in question are treated as those of the corporation alone. (*Sonora Diamond Corp. v. Superior Court, supra*, 83 Cal.App.4th at p. 538, 99 Cal.Rptr.2d 824; *Associated Vendors, Inc. v. Oakland Meat Co.* (1962) 210 Cal.App.2d 825, 837, 26 Cal.Rptr. 806.)

Unquestionably, Uni-Seal Valve Company and Lortz & Son Mfg. Company were guilty of grossly inadequate record keeping and a wholesale failure to observe required corporate formalities. Undoubtedly there was a "unity of interest" between the two entities.[FN1] Nonetheless, I believe substantial evidence supports the trial court's conclusion that the record "fail[ed] to disclose that any fraud or injustice would be perpetrated by recognizing the separateness of defendant Uni-Seal from the defendant Lortz & Son Mfg. Co." In particular, substantial evidence supports the findings that (1) Uni-Seal was already insolvent in October 1996 when the Uni-Seal assets were sold; (2) Lortz & Son did not use any of the October 1996 sale proceeds for its own benefit; and (3) VSS Sales did not rely upon any participation by Lortz & Son when it entered into its contractual relationship with Uni-Seal, and none of the many corporate violations identified at trial had any impact on the relationship between VSS Sales and Uni-Seal.

FN1. At oral argument counsel for VSS Sales suggested that, even as a formal matter, Uni-Seal Valve Company was not a validly existing, separate corporate entity and that it was entitled to a judgment against Lortz & Son Mfg. Company without satisfying both prongs of the traditional alter ego doctrine. (Cf. *Carr v. Barnabey's Hotel Corp.* (1994) 23 Cal.App.4th 14, 22-23, 28 Cal.Rptr.2d 127.) The trial court, however, expressly found Uni-Seal and Lortz & Son were separate entities. Substantial evidence (testimony from Charles Lortz and from the companies' former accountant) supports that finding.

The only "injustice" claimed by VSS Sales is its inability to collect on its judgment against Uni-Seal. The alter ego doctrine, however, does not protect every unsatisfied creditor: "The alter ego doctrine does not guard every unsatisfied creditor of a corporation but instead affords protection where some conduct amounting to bad faith makes it inequitable for the corporate owner to hide behind the corporate form. Difficulty in enforcing a judgment or collecting a debt does not satisfy this standard." (*Sonora Diamond Corp. v. Superior Court, supra*, 83 Cal.App.4th at p. 539, 99 Cal.Rptr.2d 824.)

***7** I would affirm the judgment of the trial court.

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