Legal Backgrounder

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TEXAS HIGH COURT REJECTS SINGLE BUSINESS ENTERPRISE THEORY

by

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For more than twenty years, intermediate appellate courts in Texas, as well as federal courts applying Texas law, have recognized the "single business enterprise" theory as a basis for disregarding the corporate form in order to impose liability on one corporation for another corporation's debt or wrongdoing. In a much-anticipated ruling, the Texas Supreme Court recently rejected this theory. Texas is the only state in which the highest court has clearly discarded this particular theory of corporate disregard, while courts in a number of other states continue to routinely apply the theory, and courts in yet other states may be moving toward its use.

In *SSP Partners v. Gladstrong Investments (USA) Corp.*, the court unanimously held that "corporations cannot be held liable for each other's obligations merely because they are part of a single business enterprise."[1] To understand what this opinion means for the future of corporate disregard under Texas law, it is useful to briefly review the history of "piercing the corporate veil."

History of Limited Shareholder Liability and Development of Veil Piercing Theories. The idea of corporations as entities separate from their owners arose within Roman law and was adopted into English law and then into United States law.[2] For much of the history of corporations, there was no veil to be pierced – owners or shareholders were liable for the debts and obligations of the corporation. In the mid-19th century, state legislatures in the U.S. began to limit shareholder liability as a way to encourage capital investment and democratize business ownership.[3] Thereafter, courts began to fashion legal principles to disregard the corporate form in some circumstances as to hold the shareholders liable for a corporation's obligations. In the most traditional and classic form, a natural person who was, *e.g.*, sole shareholder, sole director and president would be found to have treated the corporation as an extension of himself and would be held liable in order to reach money he had siphoned off from the corporation. Many people think of "piercing the corporate veil" and "alter ego" as synonymous, and some court opinions make the terms coincide. However, more careful analysis reveals that "alter ego" is only one of several theories under which courts in Texas and elsewhere have disregarded corporate form, even prior to the arrival of the "single business enterprise" theory.[4]

Until about 100 years ago, a U.S. corporation could not hold shares in another corporation without express statutory authorization (rarely given except to railroads and telegraph companies). The changes in state corporate law permitting corporations to freely acquire and form subsidiaries transformed American corporate structure.[5] The courts then began to recognize the possibility of piercing the veil in new ways, *e.g.*, between an operating company and its holding company or between "sibling subsidiaries." Beginning in the 1930s, the legal system began to recognize the existence of corporate groups and use enterprise principles in place of traditional entity law; this was particularly true within statutes regulating banking, securities, employer-sponsored pensions, export controls and foreign trade.[6] Those statutes, as well as statutes dealing with subjects such as labor

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relations, employment and casino gambling, at times treat a corporate group as an integrated enterprise. Influenced by all of these developments, courts crafted the "single business enterprise" theory.

Piercing the Veil under Texas Law. In 1986, the Texas Supreme Court in *Castleberry v. Branscum* stated that the corporate form could be disregarded when:

(1) the fiction is used as a means of perpetrating fraud;
(2) a corporation is organized and operated as a mere tool or business conduit of another corporation;
(3) the corporate fiction is resorted to as a means of evading an existing legal obligation;
(4) the corporate fiction is employed to achieve or perpetrate monopoly;
(5) the corporate fiction is used to circumvent a statute; or
(6) the corporate fiction is relied upon as a protection of crime or to justify wrong.[7]

Texas lawyers and legislators regarded this opinion as significantly expanding the opportunity for veil piercing and the Texas legislature shortly enacted a statute, Tex. Bus. Corp. Act art. 2.21, in an attempt to rein in the courts and pin down the basis for piercing of corporate veils. Art. 2.21 requires a finding of actual fraud to hold shareholders and affiliates liable for claims against a corporation when the claims are based on a contract or relate to or arise from a contract. Nevertheless, courts have continued to utilize a variety of theories, particularly when adjudicating tort claims, and the "single business enterprise" theory grew in popularity.[8]

The "Single Business Enterprise" Theory in Texas. The single business enterprise theory grew out of court opinions rendered in the mid-1980s. It was applied when multiple entities had integrated their resources to achieve a common purpose and allowed a court to treat them as one entity. The theory's attractiveness is demonstrated in the many court opinions adopting it as well as the criticisms leveled against it.[9]

In 1996, the El Paso Court of Appeals approved of a submission under which the jury had found two companies to be a single business enterprise, based on the jury's consideration of whether the two companies had common employees, common recordkeeping, centralized accounting, payment of wages by one corporation to another corporation's employees, common business name, services rendered by the employees of one corporation on behalf of the other, undocumented transfers of funds between corporations, unclear allocation of profits and losses between corporations, same officers, same shareholders, and same telephone number.[10] The several dozen other published cases recognizing the single business enterprise theory set out similar lists of factors, noting, as did the jury instruction, that no one factor is determinative and that not all factors need be found.

In 2007, the Houston First District Court of Appeals affirmed the finding of a single business enterprise composed of the company that built the plaintiffs' home and the individual owner of that corporation as well as two other corporations that he owned, based on a list of factors similar to that in the preceding paragraph.[11] The appeals court recognized that the viability of the single business enterprise theory in Texas was unclear, given the supreme court's declining to decide whether the theory was a "necessary addition to Texas law," but nevertheless joined the other appeals courts applying the theory. [12]

***The Facts and the Opinion in* SSP Partners**. The lawsuit arose from a house fire in which one child died and others were injured, but the issues on this appeal related only to defendants seeking indemnity from others. Blaming the fire on an allegedly defective butane lighter, the parents sued the retailer and the importer of the lighter.[13] Plaintiffs settled with the retailer and the importer for $1.6 million each. The retailer sought indemnity from the importer, and the trial court granted a summary judgment to the importer, finding that the importer was not a manufacturer as defined in the Texas statute that requires manufacturers to indemnify retailers and finding that common-law indemnity was not available on the record before the court. The Corpus Christi Court of Appeals reversed in part and remanded for further development of the record, finding some evidence that the importer was an apparent manufacturer which could trigger common-law indemnity.[14] The retailer argued that importer Gladstrong USA was in a single business enterprise with its parent Gladstrong Hong Kong (the exporter, and more clearly the manufacturer), an argument rejected by the appeals court on the ground that one entity cannot be found to be part of a single business enterprise if the other entities are not parties to the case.[15]

The supreme court agreed with the appeals court that the summary judgment on common-law indemnity must be reversed and the case remanded, but on different reasoning, stating that the retailer would be entitled to indemnity only upon proof that the importer was responsible for the defective condition of the lighter.[16] The court rejected the retailer's argument that the importer should be considered a statutory manufacturer by reason of operating as a single business enterprise with its parent, and took the opportunity to point out the error of those courts that had recognized the single business enterprise theory.[17] The court observed that an early case had misinterpreted the precedents it cited and that no court had "found sound jurisprudential footing for the theory."[18] Each basis to disregard the corporate form as sanctioned in *Castleberry* entailed the use of that form "as part of a basically unfair device to achieve an inequitable result," while the practices of "sharing names, offices, accounting, employees, services, and finances" are not *per se* unjust or abusive.[19] The court distinguished between the two considerations involved in disregarding the corporate form: (1) the relationship between the two entities (for which the commonly used list of single business enterprise factors may be useful) and (2) whether the use of limited liability was illegitimate (on which the factors are "almost entirely irrelevant").[20] In sum, the court stated that imposing liability on corporations for each other's obligations without a finding of the kind of abuse enumerated in *Castleberry* would "seriously compromise what we have called a 'bedrock principle of corporate law' that [limiting liability is] a legitimate purpose for forming a corporation…."[21]

The court noted that, on remand, "SSP will be free to assert a valid theory for requiring Gladstrong USA to meet any indemnity obligation Gladstrong Hong Kong may have."[22] The court did not expressly hold that art. 2.21 would govern any such attempt but did say that the single business enterprise theory is "fundamentally inconsistent" with the legislature's approach in art. 2.21.[23]

SSP's motion for rehearing was filed on December 11, 2008.[24] The opinion has not been released for publication and is subject to revision or withdrawal, but it seems unlikely that the court will change its mind about the single business enterprise theory.

Recognition of the "Single Business Enterprise" Theory by Other States. Other than Texas, the state most active in developing the concept of "single business enterprise" has been Louisiana. States that have at least recognized the theory under that name or another, as a means to impose liability or to find personal jurisdiction, include Arkansas, California, Indiana, Massachusetts, Mississippi, New Jersey, New York, North Carolina, Virginia, and Washington.[25] The "instrumentality" or "identity" doctrine in Connecticut is a similar theory for collapsing affiliated corporations.[26] In a 2003 opinion, a Michigan court of appeals rejected the theory, in an unpublished opinion that has no precedential value.[27] A well known treatise states that one case in Colorado has hinted at the possibility of adopting the theory and that "the road on which [states that have adopted it] are moving could soon have many fellow travelers." [28]

Conclusion. Although the retailer did not do so in *SSP Partners*, in many of the Texas cases seeking a finding of single business enterprise, plaintiffs have also pleaded other grounds to impose liability beyond the primary actor, such as alter ego, joint venture, joint enterprise, partnership, agency, conspiracy, and the various bases enumerated in *Castleberry*. Lawyers drafting such pleadings for Texas courts now have one less theory to rely on. The single business enterprise theory permits courts to collapse corporate structures based on practices that are not in themselves improper. As today's complex corporate structures engage in the global economy, the Texas Supreme Court was right to reject this theory and curtail the case law that was complicating the ability to predict when corporations might be subject to exceptions to the rule of corporate identity.

ENDNOTES

[1] 52 Tex. Sup. Ct. J. 95, 2008 WL 4891733 at *1 (Tex. Nov. 14, 2008).

[2] Phillip I. Blumberg, *The Increasing Recognition of Enterprise Principles in Determining Parent and Subsidiary Corporation Liabilities*, 28 CONN. L. REV. 295, 297 (1995-96).

[3] Stephen B. Presser, *The Bogalusa Explosion, "Single Business Enterprise," "Alter Ego," and Other Errors: Academics, Economics, Democracy, and Shareholder Limited Liability: Back Towards a Unitary "Abuse" Theory of Piercing the Corporate Veil*, 100 NW. U. L. REV. 405, 408-09 (2006).

[4] *See, e.g.*, Blumberg, *supra* note 2, at 300-01 and text at note 7 *infra*.

[5] Blumberg, *supra* note 2, at 298.

[6] *Id.* at 298, 303.

[7] 721 S.W.2d 270, 272 (Tex. 1986).

[8] *See* Marilyn Montano, Comment, *The Single Business Enterprise Theory in Texas: A Singularly Bad Idea*?, 55 BAYLOR L. REV. 1163, 1167-71 (2003) for a detailed discussion of art. 2.21 and the amendments thereto. Ms. Montano characterized Texas as the only state with a statute directly addressing corporate veil-piercing.

[9] *See, e.g.*, Montano, *supra* note 8; Glenn D. West and Benton B. Bodamer, *Corporations*, 59 S.M.U. L. REV. 1143, 1144 (2006) (the single business enterprise theory is "disturbing" and the worst of the array of creative theories devised by courts).

[10] *Beneficial Personnel Services of Texas, Inc. v. Rey*, 927 S.W. 2d 157, 116 (Tex. App-El Paso 1996), *vacated per settlement*, 938 S.W. 2d 717 (Tex. 1997).

[11] *Country Village Homes, Inc. v. Patterson*, 236 S.W.3d 423 (Tex. App.--Houston [1st Dist.] 2007, pet. dism'd by agreement).

[12] *Id*. at 427 (quoting *S. Union Co. v. City of Edinburg*, 129 S.W.3d 74, 87 (Tex. 2003)).

[13] The discussion of the procedural history above is somewhat truncated. The retailer SSP had filed a third-party action for indemnity against its supplier Metro and settled that claim for $800,000. 2007 WL 4891733 at *1. Metro also sought indemnity from Gladstrong USA. The supreme court opinion refers to SSP and Metro collectively as SSP since their interests were aligned. *Id*. SSP and Metro had sued Tianjin Sico Lighters, Co., Ltd., the alleged manufacturer of a component of the lighter; claims against Tianjin were severed. *SSP Partners v. Gladstrong Investments (USA) Corp*., 169 S.W.3d 27, 31 (Tex. App.-Corpus Christi 2005), *aff'd*, 2007 WL 4891733 (Tex. 2008).

[14] 169 S.W.3d at 41.

[15] SSP and Metro had sought, but failed to secure, leave of court to bring Gladstrong Hong Kong into the suit. 169 S.W.3d at 31 and n.4. The appeals court recited evidence similar to that on which other courts have found single business enterprise, including: one individual was president of both family-run companies and he controlled the decisions of both; the officers of both were the same; the parent entirely capitalized the subsidiary; the companies did business only with each other; revenues of the subsidiary passed directly to the parent and allocation of profits was unclear. *Id*. at 36-37.

[16] 2007 WL 4891733 at *11.

[17] *Id*. at *6-10.

[18] *Id*. at *8.

[19] *Id*.

[20] *Id.* at *9.

[21] *Id.* (citation omitted).

[22] *Id*. at *10.

[23] *Id.*

[24] *See* Mary Alice Robbins, *Texas Supreme Court Rejects Single-Business Enterprise Theory*, TEXAS LAWYER, Nov. 24, 2008, at 1, 20, quoting SSP's attorney and others concerned that the decision will make it more difficult for Texas businessmen to obtain indemnity from U.S. affiliates of foreign corporations that distribute products manufactured overseas.

[25] STEPHEN B. PRESSER, PIERCING THE CORPORATE VEIL §1:9, at 21 (Thompson West Supp. 2008).

[26] *Id.* §1:9, at 21-22.

[27] *Id.* §1:9, at 23 n.14.

[28] *Id*. §2:6 at 68 n.1, §1:9 at 21.