MAKING SENSE OF NEVADA'S ALTER EGO DOCTRINE

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In 1957, the Nevada Supreme Court established the "alter ego" analysis still used by Nevada courts today (now codified by statute) to determine whether or not to pierce through a corporate veil to find a shareholder, officer, director or affiliated corporation liable for the acts of a corporate defendant. *Frank McCleary Cattle Co. v. Sewell*, 73 Nev. 279, 282, 317 P.2d 957, 959 (1957), *reversed on other grounds* in *Callie v. Bowling*, 123 Nev. 181, 160 P.3d 878 (2007). As set forth in the statutory version at NRS 78.747(2):

A stockholder, director or officer acts as the alter ego of a corporation if:

a. The corporation is influenced and governed by the stockholder, director or officer;
b. There is such unity of interest and ownership that the corporation and the stockholder, director or officer are inseparable from each other; and
c. Adherence to the corporate fiction of a separate entity would sanction fraud or promote a manifest injustice.[1]

Among the lessons of the many Nevada Supreme Court cases that have followed *McCleary Cattle Co.* is the particular importance to the court of the third factor listed above – avoiding fraud or manifest injustice.

Many of the court's decisions and respected commentators have observed that, while there may be a number of facts in a particular case tending to favor a finding of alter ego under the first two of the factors of NRS 78.747(2), unless there are also facts tying those factors to a fraud or injustice upon the plaintiff, the court is not likely to pierce the corporate veil for the plaintiff's benefit. It should not be surprising that in a state that prides itself on a protective corporate environment, the court has repeatedly emphasized that the "corporate cloak is not lightly thrown aside;" however, the court will disregard that "cloak" if "adherence to the fiction of a separate entity ... [would] sanction a fraud or promote injustice." *Baer v. Walker*, 85 Nev. 219, 452 P.2d 916 (1969); *North Arlington Medical Bldg., Inc. v. Sanchez*, 86 Nev. 515, 520, 471 P.2d, 240, 243 (1970).

Factors 1 and 2: Substantial Influence and Unity of Interest and Ownership

Several Nevada Supreme Court cases have been quick to find that the first two alter ego factors are met, particularly in small, closely held corporations involving a single or small group of stockholders, directors or officers. *See e.g.*, *Caple v. Raynel Campers, Inc.*, 90 Nev. 341, 343, 526 P.2d 334, 336 (1974, *abrogated on other grounds in Ace Truck and Equip. Rentals v. Kahn*, 103 Nev. 503, 746 P.2d 132). Indeed, most of the cases decided since *McCleary Cattle Co.* have involved small, closely held corporations.

In such cases, the requisite influence over the corporation between small groups of shareholders and other actors is typical, though, importantly, the court has noted some exceptions. For example, in *Lipshie v. Tracy Inv. Co.*, 93 Nev. 370, 377, 566 P.2d 819, 823 (1977) the court held that the mere fact of a parent owning all of the stock of a subsidiary corporation, with identical officers, without more, was insufficient to show the requisite influence in governance to meet the first factor. Rather, the court has held that it must be shown that the subsidiary corporation "is so organized and controlled, and its affairs are so conducted that it is in fact a mere instrumentality or adjunct of another corporation." *Bonanza Hotel Gift Shop, Inc. v. Bonanza No. 2*, 95 Nev. 463, 466, 596 P.2d 227, 229 (1979). *See also*, *Wyatt v. Bowers*, 109 Nev. 593, 596-597, 747 P.2d 881, 883 (1987); *Truck Ins. v. Palmer J. Swanson, Inc.*, 124 Nev. 629, 636, 189 P.3d 656, 660-661 (2008).

With regard to the question of whether there is such a unity of interest and ownership that the corporation, and the person sought to be held liable, are virtually inseparable, the court has enunciated a number of familiar factors, including by way of common examples:

1. Comingling of funds;
2. Undercapitalization;
3. Unauthorized diversion of funds;
4. Failure to observe corporate formalities;
5. The existence (or non-existence) of separate bank accounts;
6. Whether sister corporations had independent headquarters;
7. Whether separate corporations had separate business responsibilities and operations; and
8. Whether dividends were paid to shareholders.

See e.g., Polaris Indus. Corp. v. Kaplan, 103 Nev. 598, 601, 747 P.2d 884, 887 (1987); *Mosa v. Wilson-Bates Furniture Co.*, 94 Nev. 521, 522, 583 P.2d 453, 454 (1978); *Bonanza Hotel Gift Shop, Inc. v. Bonanza No. 2*, 95 Nev. 463, 467, 596 P.2d 227, 230 (1979); *Rowland v. Lepire*, 99 Nev. 308, 317-318, 662 P.2d 1332, 1338 (1983); *Truck Ins. Exchange v. Palmer J. Swanson, Inc*., 124 Nev. 629, 636, 189 P.3d 656, 661 (2008).

While the court will often find the presence of at least some of the foregoing factors favoring the application of alter ego liability, the court has also held that there is no "litmus test" for determining whether the corporate veil should be disregarded; rather, the result depends upon the circumstances of each case. *Polaris Indus. Corp. v. Kaplan*, 103 Nev. 598, 601, 747 P.2d 884, 887 (1987) (Citations omitted). The real question, then, is how the court generally decides when the existence of some of the factors described above favor the imposition of alter ego liability.

Factor 3: Avoiding Fraud or Injustice

As pointed out in *In re James Giampietro*, 317, B.R. 841, 853 (Bankr. D. Nev. 2004), Bankruptcy Judge Bruce A. Markell, while conducting an extensive review of Nevada's case law in this area, and relying in part upon a decision from 20 years prior by U.S. District Court Judge Lloyd D. George (then serving as a bankruptcy judge), observed that the prevention of fraud or manifest injustice is the most meaningful of the NRS 78.747 factors. It is not enough simply that some of the factors favoring alter ego liability exist. More importantly, based on the court's prior holdings in this area, there must be a *causal connection* between those factors and the plaintiff's injury. Quoting George's earlier analysis in *In re Twin Lakes Village, Inc.*, 2 B.R. 532, 542 (Bankr. D. Nev. 1980), Judge Markell noted "the element of reliance, or more particularly, on 'reasonable reliance' by the complaining creditor upon debtor conduct which would indicate either the absence of a corporate form or the assumption of liability by a person or entity controlling an openly visible corporation," has been the primary focus of Nevada courts. This conclusion, requiring a causal connection between the alter ego factors and actual harm to the plaintiff has been discussed in various Nevada Supreme Court cases.

In *North Arlington Medical Building, Inc., v Sanchez Construction Co.*, 86 Nev. 515, 471 P.2d, 240 (1970), where a corporate president, who had completely influenced and managed the corporation failed to follow corporate formalities and left the corporation undercapitalized, the court nevertheless held that the plaintiff "failed to show any causal connection" between the way the corporation was capitalized and its subsequent inability to pay the obligation owed. As a result, the court found that there was no evidence showing how those factors "sanctioned a fraud or promoted an injustice" toward the plaintiff. This holding suggests that in order to utilize undercapitalization as grounds for piercing the veil, it will likely need to be shown to have existed at the time the debts were incurred. *See also*, *Paul Steelman, Ltd. v. Omni Realty Partners*, 110 Nev. 1223, 884 P.2d 549 (1994).

Similarly, in *Lipshie v. Tracy Inv. Co.*, 93 Nev. 370, 377, 566 P.2d 819, 823 (1977), while finding that a parent and subsidiary corporation had identical officers and shareholders, and that the corporation was undercapitalized at the time of trial, the court observed that "it is not reasonable to conclude that the [parent corporation] undercapitalized [the subsidiary corporation] in order to frustrate the payment of its obligation" to plaintiff. While other factors supported a finding of alter ego liability, there was no causal connection between those factors and the injury suffered by plaintiff, such that the third factor was not met.

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Conversely, in a case finding the requisite causal connection, *Mosa v. Wilson-Bates Furniture Co.*, 94 Nev. 521, 522, 583 P.2d, 453(1978), the court found that it was appropriate to pierce the corporate veil where the shareholder had given "personal assurances at various times that he … would personally pay the outstanding debts of [the corporation]," and that such assurances were given "to induce forbearance by [plaintiff] in asserting its claim against the corporation for debts due and owing."

Conclusion

It is vital for corporations to rigorously observe formalities and to take action that will avoid the applicability of alter ego liability. Nevertheless, in the litigation context, where an effort is made to actually pierce the corporate veil, it appears that the Nevada Supreme Court's primary focus is on whether there is any *causal connection* between an exertion of undue influence over an entity by a dominant shareholder, or the failure to observe corporate formalities, or keep the corporation sufficiently capitalized, etc., and the ultimate harm caused to the plaintiff. ■

1 An important question is whether the methods for piercing a corporate veil apply equally to piercing *Nevada limited liability companies.* In *In re James Giampietro*, 317 B.R. 841, 846 (D. Nev. 2004) the bankruptcy court asserted it is "highly likely" the Nevada courts would extend the alter ego doctrine to members of limited liability companies. This view appears to have been, at least to some extent, confirmed by *Scott J. Webb v. Schull, et al.*, 128 Nev. Adv. Op. 8, at page 11, (March 2012) in which the Nevada Supreme Court analyzed the alter ego arguments at issue therein under the standard set forth in NRS 78.747, even though that case involved a limited liability company. It should however be noted that, at footnote 3 to the *Schull* decision, the court indicated it was doing so based on the assumption of both parties that the statute would apply, and was not necessarily specifically ruling on that question, as it would need to do if the issue were disputed.

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