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Case Comments F. Corporations Perpetual Real Estate V. Michaelson Properties

tance to the Commissioner's drug testing order.[202] Despite this convolution, the trial court judged that the plaintiffs were discharged simply for their refusal to undergo testing, not because of their suspected drug use. Although the Third Circuit stopped short of overturning this finding, it was skeptical of the trial court's conclusion.[203] The broad drug use allegations undeniably obscured the purported focus on a single case of employee disobedience, regardless of whether the court explicitly acknowledged this fact. *Tucker*, in fact, can be read to fit neatly within *Linton*'s exception for pretextual charges.

Where, as in *Linton*, the generic allegations are "no more than harmless surplusage," *Loudermill* and *Tucker* should not be read to require a detailed accounting of these unrelated and really irrelevant charges. *Linton* simply defines some common sense boundaries to curb the due process explosion triggered by *Goldberg v. Kelly*[204] and its progeny.[205] *Linton* confirms that *Loudermill* due process requires nothing more of a state employer than clearly explained grievances justifying an employee's termination and the opportunity for response to those charges.[206]

F. Corporations

Perpetual Real Estate v. Michaelson Properties

974 F.2d 545 (4th Cir. 1992)

One of the advantages of doing business as a corporation is that it provides limited liability for shareholders. Courts recognize the corporation

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202. *See* Fraternal Order of Police Lodge No. 5 v. Tucker, 868 F.2d 74, 80 (3d Cir. 1989) (discussing relationship between drug use allegations and urinalysis order).

203. *See id.* (questioning whether Commissioner would have discharged plaintiffs for resistance to testing even if he were otherwise satisfied that they were not guilty of on-duty drug use).

204. 397 U.S. 254 (1970) (recognizing welfare as property right and requiring formal hearing before government's termination of welfare benefits).

205. *See generally* Perry v. Sinderman, 408 U.S. 593 (1972) (recognizing professor's de facto tenure as giving rise to claim of entitlement protected by Due Process Clause); Goss v. Lopez, 419 U.S. 565 (1975) (finding property interest in public education and requiring presuspension hearing for students); Gray Panthers v. Schweiker, 652 F.2d 146 (D.C. Cir. 1980) (holding informal procedures insufficient to deny medicare claims of any amount). *But see generally* Ingraham v. Wright, 430 U.S. 651 (1977) (holding that lack of hearing preceding school administrator's application of corporal punishment does not violate Fourteenth Amendment); Mathews v. Eldridge, 424 U.S. 319 (1976) (holding that government need not offer formal adjudicatory hearing before terminating social security benefits); Bishop v. Wood, 426 U.S. 341 (1976) (recognizing that state employee terminable at will has no property interest protected by Fourteenth Amendment).

206. Linton v. Frederick County Bd. of County Comm'rs, 964 F.2d 1436, 1441 (4th Cir. 1992); *see also* Cleveland Bd. of Educ. v. Loudermill, 470 U.S. 532, 546 (1985) (holding that due process for public employees is satisfied by notice of charges, explanation of evidence, and opportunity to respond).

as an entity separate and distinct from its officers and shareholders, describing the distinction as a "veil" between the corporation and the shareholders.[207] Because of this veil, shareholders of a corporation are not personally liable for the corporation's debts; their exposure to loss is limited to their initial capital investment.[208] Limited liability serves the important goal of stimulating business investment.[209]

Courts have been willing to depart from the principle of the corporation as a separate entity only under certain circumstances.[210] Generally, they will "pierce the corporate veil" and hold the owners liable if recognition of the corporate form would produce injustice or inequitable consequences.[211] Courts will exercise this power cautiously and reluctantly as an extraordinary exception to the general rule of limited liability.[212] The burden of proof rests on the party seeking to pierce the corporate veil.[213]

The United States Court of Appeals for the Fourth Circuit has held that a court may disregard the corporate form when its recognition would present an "element of injustice or fundamental unfairness."[214] The Fourth Circuit has established a number of factors to evaluate in deciding whether to pierce the corporate veil in its jurisdiction. They include undercapitalization, failure to observe corporate formalities, nonpayment of dividends, insolvency of the debtor corporation, siphoning of funds from the corporation by the dominant shareholder, nonfunctioning of officers and directors, absence of corporate records, and the use of the corporation as a facade for the operations of the dominant shareholder.[215] A decision to disregard the corporate entity may not rest on the existence of a single factor but must involve a number of such factors.[216] While substantial individual ownership of a corporation is a factor in deciding whether to disregard the corporate entity, standing alone it is insufficient.[217] Proof of

207. *See* DeWitt Truck Brokers v. W. Ray Flemming Fruit Co., 540 F.2d 681, 683 (4th Cir. 1976) (discussing idea of corporation as separate entity).

208. *See* Cancun Adventure Tours v. Underwater Designer Co., 862 F.2d 1044, 1047 (4th Cir. 1988) (explaining doctrine of limited shareholder liability).

209. *See* Johnson v. Flower Indus., 814 F.2d 978, 980 (4th Cir. 1987) (noting underlying purpose of limited liability).

210. *See DeWitt Truck Brokers*, 540 F.2d at 683 (explaining rationale for piercing corporate veil).

211. *See id.* (citing Krivo Indus. Supply Co. v. National Distilling & Chem. Corp., 483 F.2d 1098, 1106 (5th Cir. 1973)).

212. *Id.*; *see also* Cheatle v. Rudd's Swimming Pool Supply, 360 S.E.2d 828, 831 (Va. 1987) (explaining Virginia standard for piercing corporate veil); Beale v. Kappa Alpha Order, 64 S.E.2d 789, 797 (Va. 1951) (same).

213. DeWitt Truck Brokers v. W. Ray Flemming Fruit Co., 540 F.2d 681, 683 (4th Cir. 1976); *Cheatle*, 360 S.E.2d at 831.

214. *DeWitt Truck Brokers*, 540 F.2d at 687.

215. *See id.* at 685-87; United States Fire Ins. Co. v. Allied Towing Corp., 966 F.2d 820, 828 (4th Cir. 1992); Keffer v. H.K. Porter Co., 872 F.2d 60, 65 (4th Cir. 1989).

216. *DeWitt Truck Brokers*, 540 F.2d at 687.

217. Cancun Adventure Tours v. Underwater Designer Co., 862 F.2d 1044, 1047 (4th Cir. 1988).

fraud is not a necessary prerequisite for piercing the corporate veil in the Fourth Circuit.[218] Additionally, because the decision to pierce the corporate veil is very fact dependent, the Fourth Circuit has held that it will regard the district court's decision as presumptively correct and will overturn it on appeal only if clearly erroneous.[219]

Virginia state courts use a less elaborate, but more stringent, test for piercing the corporate veil. To pierce the corporate veil in Virginia, the plaintiff must show that the corporation was: 1) the alter ego, alias, stooge, or dummy of the individual owners; and 2) was used by the owners to disguise wrongs, obscure fraud, or conceal crime.[220] Like the Fourth Circuit, Virginia courts may also be more willing to pierce the corporate veil in the case of a closely held corporation.[221] Unlike the Fourth Circuit, however, to become personally liable the owners must have used their control to try to defraud or wrong a third party or conceal a crime; fundamental unfairness is not enough.[222] As in the Fourth Circuit, a reviewing court will regard the trial court's decision as presumptively correct and will not overturn it on appeal unless clearly erroneous.[223]

The Fourth Circuit examined the subtle but important distinction between the federal and Virginia tests for piercing the corporate veil in *Perpetual Real Estate v. Michaelson Properties*.[224] In a diversity action applying Virginia law, the plaintiff, Perpetual Real Estate Services, Inc. (PRES), sought to pierce the corporate veil of its former business partner, Michaelson Properties, Inc. (MPI), and hold Aaron Michaelson, MPI's sole shareholder, personally liable for a breach of warranty claim against the partnership.

Michaelson was the president and sole shareholder of MPI, a corporation he formed with an initial capitalization of $1,000 to enter into joint

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218. *See, e.g.*, Verreries De L'Hermitage, S.A. v. Hickory Furniture Co., 704 F.2d 140, 141 (4th Cir. 1983) (holding that complainant seeking to pierce corporate veil need not prove fraud or wrongdoing); Cunningham v. Rendezvous, Inc., 699 F.2d 676, 680 (4th Cir. 1983) (stating that court may pierce corporate veil in appropriate circumstances even in absence of fraud or wrongdoing); Federal Deposit Ins. Corp. v. Sea Pines Co., 692 F.2d 973, 976 (4th Cir. 1982) (stating that injustice or fundamental unfairness can exist in absence of fraud or wrongdoing); DeWitt Truck Brokers v. W. Ray Flemming Fruit Co., 540 F.2d 681, 684 (4th Cir. 1976) (stating general rule that fraud is not necessary predicate for piercing corporate veil).

219. *Keffer*, 872 F.2d at 64-65.

220. *See* Cheatle v. Rudd's Swimming Pool Supply, 360 S.E.2d 828, 831 (Va. 1987); Lewis Trucking Corp. v. Commonwealth, 147 S.E.2d 747, 753 (Va. 1966); Beale v. Kappa Alpha Order, 64 S.E.2d 789, 798 (Va. 1951).

221. *Compare DeWitt Truck Brokers*, 540 F.2d at 685 (stating that courts have shown no hesitancy in disregarding corporate form when substantial individual corporate ownership is combined with other factors) *with Lewis Trucking*, 147 S.E.2d at 753-54 (quoting treatise on Michigan law for proposition that courts are more liberal in piercing corporate veil with one-man corporation).

222. *See* Garrett v. Ancarrow Marine, Inc., 180 S.E.2d 668, 670 (Va. 1971) (refusing to disregard corporate entity absent fraud); Washington & Old Dominion Users Ass'n v. Washington & Old Dominion R.R., 155 S.E.2d 322, 326 (Va. 1967) (same).

223. *Cheatle*, 360 S.E.2d at 831.

224. 974 F.2d 545 (4th Cir. 1992).

real estate ventures. MPI entered into two joint ventures with PRES to convert apartment buildings in Maryland and Virginia into condominiums. They formed the second partnership, Arlington Apartment Associates (AAA), in November 1983. Under the AAA partnership agreement, PRES and MPI each contributed $50,000 in capital and agreed to share the partnership liabilities equally. To finance the project, the partnership borrowed $24 million from Perpetual Savings Bank, PRES' parent corporation, after Michaelson and his wife personally guaranteed $750,000 of the loan. PRES later loaned MPI $1.05 million to complete the project after securing a second personal guarantee from the Michaelsons.

During 1985 and 1986 the AAA partnership made three distributions of the profits from sales of the condominium units to MPI and PRES. These distributions were made only after the partners had determined there were sufficient partnership assets to meet expenses. MPI subsequently distributed its share of the profits, totalling approximately $456,000, to Michaelson as its sole shareholder. In 1987, more than a year after the last of the distributions, several condominium purchasers sued AAA for breach of warranty claims totaling $5.5 million. AAA settled out of court for $950,000, with PRES paying the full amount on behalf of the partnership. MPI made no contribution to the settlement because it had already distributed its profits to Michaelson.

PRES subsequently filed a diversity action against MPI and Michaelson, seeking indemnity from MPI for the settlement and personal liability from Michaelson for MPI's settlement debt. The United States District Court for the Eastern District of Virginia entered summary judgment on the indemnity claim against MPI and denied Michaelson's motion for a directed verdict on the veil piercing claim. The jury found Michaelson personally liable for MPI's share of the settlement debt. Michaelson moved for a judgment notwithstanding the verdict, claiming the court had incorrectly instructed the jury on the applicable Virginia law for piercing the corporate veil.[225] The district court denied the motion, deciding that the instructions, which required the jury to find that Michaelson used MPI to perpetrate an "injustice or fundamental unfairness" on PRES before imposing personal liability, were the essential equivalent of the Virginia requirement that the shareholder must use the corporate form to "disguise a wrong" before the court pierces the corporate veil.[226]

On appeal, the Fourth Circuit reversed. The *Michaelson* court determined the district court had incorrectly interpreted the Virginia standard when it reviewed the jury instructions. In reviewing the applicable Virginia case law, the court noted that the test articulated by the Supreme Court of Virginia in *Cheatle v. Rudd's Swimming Pool Supply*[227] requires evi-

225. Perpetual Real Estate Serv. v. Michaelson Properties, 775 F. Supp. 893, 894 (E.D. Va. 1991).

226. *Id.* at 896 n.3.

227. 360 S.E.2d 828 (Va. 1987).

dence that some person dominated or controlled the corporation and also used it to disguise wrongs, obscure fraud, or conceal crime before the court will disregard the corporate form.[228] Domination or control alone is not enough. It characterized the decision in *Cheatle* to uphold the corporate entity as an example of the stringency of the Virginia standard. The *Michaelson* court contrasted this strict standard from the case law to what it characterized as the "soggy" jury instructions used in the district court. Those instructions, which allowed the jury to pierce the corporate veil if it found an "injustice or fundamental unfairness," were not a correct statement of the Virginia law that requires proof of some legal wrong. The *Michaelson* court was careful to distinguish its application of the "injustice or fundamental unfairness" standard in *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*,[229] a case cited by PRES, noting that case did not involve Virginia law.[230]

The *Michaelson* court determined that there was insufficient evidence under the Virginia standard to justify remanding the case for a new trial. The district court had focused on the first part of the *Cheatle* test involving control of the corporation and had ignored the second half, which requires use of the corporate form to disguise a wrong, obscure fraud, or conceal crime. In reviewing the business relationship between PRES and MPI for evidence of fraud or crime, the *Michaelson* court noted that PRES had full knowledge of Michaelson's sole ownership of and limited capital investment in MPI. The court found it entirely foreseeable that MPI would distribute its share of the partnership profits to its sole shareholder and noted that this distribution took place well before the condominium buyers filed the breach of warranty claims against the partnership.

The *Michaelson* court also placed great importance on PRES' selective use of personal guarantees in its business dealings with Michaelson. In contrast to the loan agreements with PRES and its parent corporation, the AAA joint venture agreement between PRES and MPI included no personal guarantees by Michaelson. Because PRES had willingly entered the agreement with full knowledge of MPI's structure and capitalization, the court viewed the agreement as a valid contract. It noted that courts are more reluctant to pierce the corporate veil in contract cases, usually requiring proof of misrepresentation to the creditor. Because PRES had failed to prove that Michaelson had misrepresented MPI's structure or financial condition, there was no justification for disregarding the partnership agreement and eliminating Michaelson's contracted for limited liability.

The Fourth Circuit's opinion in *Perpetual Real Estate v. Michaelson Properties* has several important lessons. First, while the Fourth Circuit

228. *See* Cheatle v. Rudd's Swimming Pool Supply, 360 S.E.2d 828, 831 (Va. 1987) (articulating two part Virginia test for piercing corporate veil).

229. 540 F.2d 681 (4th Cir. 1976).

230. *See* DeWitt Truck Brokers v. W. Ray Flemming Fruit Co., 540 F.2d 681, 683 (applying South Carolina law in diversity action involving corporate veil piercing claim).

is willing to pierce the corporate veil, it will do so sparingly and only after the district court has expressly applied the factors from *DeWitt Truck Brokers v. W. Ray Flemming Fruit Co.* Second, the Fourth Circuit appears to be less deferential to district court decisions in this area than the "clearly erroneous" standard would suggest. Finally, in diversity actions, the Fourth Circuit will take great care in applying the applicable state law rather than its own veil-piercing jurisprudence. *Perpetual Real Estate* should resolve any possible confusion about which standard to apply from the Fourth Circuit's decision in *National Carloading Corp. v. Astro Van Lines.*[231] A plaintiff seeking to pierce the corporate veil in a diversity action involving Virginia law will have to prove more than just an "injustice or fundamental unfairness" to satisfy the Fourth Circuit. The party will need to satisy the *Cheatle* test by showing that the corporation was a device or sham used to disguise wrongs, obscure fraud, or conceal crime.

Bauer v. Sweeny

964 F.2d 305 (4th Cir. 1992)

It is, well settled that causes of action against directors, officers, and employees for mismanagement of a bank belong to the bank rather than the bank's shareholders.[232] Should the bank refuse to institute these causes of action, one or more of the shareholders may bring a derivative action.[233] When a bank fails, however, the causes of action against the bank's management vest with the bank's receiver and may be conveyed or sold as any other asset. It is when a bank's causes of action are sold that the propriety of a shareholder derivative suit comes into question.[234]

In *Federal Deposit Insurance Corp. v. American Bank Trust Shares, Inc.*,[235] the United States Court of Appeals for the Fourth Circuit consid-

231. 593 F.2d 559, 563 (4th Cir. 1979) (citing to Kentucky, Kansas, and Nebraska case law in diversity action applying Virginia law and involving judgment against transferee corporation); *see* St. Paul Fire & Marine Ins. Co. v. Pepsico, Inc., 884 F.2d 688, 705 (2nd Cir. 1989) (distinguishing Fourth Circuit's decision in *National Carloading Corp.*).

232. Federal Deposit Ins. Corp. v. American Bank Trust Shares, Inc., 412 F. Supp. 302, 306 (D.S.C. 1976), *vacated and remanded on other grounds*, 558 F.2d 711 (4th Cir. 1977), *remanded*, 460 F. Supp. 549 (D.S.C. 1978), *aff'd*, 629 F.2d 951 (4th Cir. 1980); *see also* Mid-State Fertilizer v. Exchange Nat'l Bank, 877 F.2d 1333, 1336 (7th Cir. 1989) (recognizing that shareholders do not have standing to assert claims on behalf of corporation); Gaff v. Federal Deposit Ins. Corp., 814 F.2d 311, 315 (6th Cir. 1987) (holding that shareholder does not have personal right of action for wrongs to corporation); United States v. Palmer 578 F.2d 144, 145-46 (5th Cir. 1978) (holding that only corporation can bring action for injury to corporation).

233. *See* FED R. CIV. P. 23.1 (allowing shareholder derivative actions when corporation or association has "failed to enforce right which may properly be asserted by it").

234. *Compare* Tucker v. New Orleans Laundries, 145 So. 2d 365, 369 (La. Ct. App. 1962) (holding that corporation's sale of cause of action precludes shareholder derivative action) *with* Landy v. Federal Deposit Ins. Corp., 486 F.2d 139, 148 (3rd Cir. 1973) (holding that placing bank into receivership does not preclude shareholder derivative action).

235. 558 F.2d 711 (4th Cir. 1977) (affirming that sale of cause of action precludes shareholder derivative suit when purchaser has brought action).

ered a case where the Federal Deposit Insurance Corporation (FDIC), in its corporate capacity, purchased from the FDIC, as receiver, causes of action against officers and directors of the bank. The *American Bank* court affirmed that this purchase for value precluded a shareholder derivative action while the FDIC was pursuing the same claims and held that the FDIC had the sole right to pursue them. By contrast, the Fourth Circuit held in *Womble v. Dixon*[236] that where the Federal Savings and Loan Insurance Corporation (FSLIC), as receiver, transferred the rights to the causes of action of a failed savings and loan to the FSLIC in its corporate capacity, shareholders could maintain a derivative action when the FSLIC neglected to assert certain of those causes of action. The distinguishing and controlling factor in these cases was the FSLIC's failure to bring its claims in *Womble* and the FDIC's active pursuit of its claims in *American Bank*. The opinions in *Womble* and *American Bank*, therefore, avoided a discussion specifically concerning the impact of the sale or conveyance of a bank's causes of action on the ability of shareholders to bring a derivative action. Consequently, the Fourth Circuit had not determined the importance of this issue when it reviewed the case of *Bauer v. Sweeny*[237].

In *Bauer*, the plaintiffs were shareholders of Seabank Federal Savings Bank (Seabank). In December of 1989, the Office of Thrift Supervision closed Seabank and appointed the Resolution Trust Company as receiver of the bank (RTC-Receiver). RTC-Receiver then sold all of Seabank's claims against its officers to the Resolution Trust Company in its corporate capacity (RTC-Corporate). Because RTC-Corporate apparently had not pursued any of these potential claims, the plaintiffs attempted to bring a derivative action against the various officers and directors of Seabank.

The United States District Court for the District of South Carolina, on the authority of *American Bank*, dismissed the plaintiffs' action for failure to state a claim. The court found that RTC-Corporate purchased, and exclusively owned, the claims the plaintiffs sought to bring in their derivative action. The court held, therefore, that the shareholders lacked standing to pursue their derivative claims because the sole right to institute the claims belonged to RTC-Corporate. Plaintiffs appealed to the Fourth Circuit where the decision of the district court was affirmed.

In affirming the district court's decision, the Fourth Circuit echoed the lower court's reliance on *American Bank*. However, in so relying on *American Bank*, both the *Bauer* court and the district court were forced to confront the seemingly contradictory language of the district court in *Womble*, affirmed by the Fourth Circuit, which stated that "[a] derivative action is not precluded simply because a bank, or a savings and loan

236. 752 F.2d 80 (4th Cir. 1984) (holding that shareholder derivative suit may be proper where FSLIC neglected to bring cause of action).

237. 964 F.2d 305 (4th Cir. 1992) (addressing impact of sale of cause of action on shareholder derivative suit).

association is placed in receivership."[238] The district court held that this language applies only to situations where a bank still owns the causes of action the shareholders seek to assert in a derivative action. Thus, the district court, and the Fourth Circuit on appeal, read *Womble* as presenting a situation where the FSLIC-Receiver transferred, but did not sell for value, the savings and loan's causes of action to FSLIC-Corporate.

The *Bauer* court's characterization of *Womble* as a transfer of the causes of action allowed it to distinguish *Womble* from the present case where the receiver sold the causes of action. Moreover, the *Bauer* court noted that in *Womble* the question of whether the sale of a cause of action precludes a derivative action was not even at issue. In *Womble*, the defendants had challenged the shareholders' standing on the grounds that they failed to demonstrate the FSLIC's refusal to assert certain claims it properly could have asserted.

Having satisfactorily distinguished *Womble*, the *Bauer* court concluded that, as in *American Bank*, RTC-Corporate validly purchased the rights to Seabank's claims. This purchase meant that Seabank's shareholders lacked standing to bring a derivative action. In so holding, the court reasoned that a derivative action by the bank's shareholders presupposes that the bank itself has a cause of action. When Seabank ceased to have any interest in the causes of action because RTC-Receiver sold those rights, the sale extinguished the shareholders' derivative action as well. The rationale for this holding is that Seabank and its shareholders had already received the benefits of these causes of action as consideration for the sale. The *Bauer* court found it reasonable, therefore, that the sale of Seabank's claims should preclude a derivative action by Seabank's shareholders.

Chief Judge Ervin filed a dissenting opinion which called into question the analysis of the majority. The dissent argued that the majority placed too little weight on the fact that in *American Bank* the FDIC was pursuing all potential claims against the bank's officers. According to the dissent, *American Bank* stands only for the narrow proposition that shareholders cannot bring a derivative action when a purchaser of that action is pursuing the same claim. The dissent concluded that because RTC-Corporate had not pursued its purchased claims the shareholders could bring their derivative action.

Chief Judge Ervin strengthened his conclusion that the shareholders had standing with three additional arguments. First, the dissent argued that the situation in *Bauer* is governed by the law of assignment. According to principles of assignment, Seabank, through its receiver, may sell only what it owns to RTC-Corporate. Had Seabank retained its causes of action but refused or failed to pursue them, courts would permit the shareholders

238. Womble v. Dixon, 585 F. Supp. 728, 731 (E.D. Va. 1983), *aff'd in part*, 752 F.2d 80 (4th Cir. 1984).

to bring a derivative action. Likewise, the dissent concluded, the rights that RTC-Corporate had purchased were subject to the same limitation allowing the shareholders to bring a derivative action should RTC-Corporate fail to assert those rights.

The second argument advanced by Chief Judge Ervin concerned the terms of the sale of Seabank's claims. Under these terms, Seabank was to receive the excess over a certain figure of any recovery resulting from a successful claim against the bank's officers. The dissent argued that this provision was a significant part of the bargain, and, unless the claims are brought, Seabank and its shareholders will not realize the value of this provision of the sale.

Finally, the dissent noted that the decision to sell the bank's causes of action was within the discretion of the bank's management. Furthermore, the management of a bank usually is the target of a shareholder derivative action. The dissent found a conflict of interest in allowing a bank's management to avoid derivative actions, and therefore their own liability, by selling the bank's causes of action to a third party. The dissent argued that this power effectively would defeat the purpose of the shareholder derivative action. For these reasons, the dissent concluded that the circuit court should reverse the decision of the district court.

The Fourth Circuit's opinion in *Bauer* is significant in that it resolves a question that *American Bank* and *Womble* left unanswered. From *American Bank*, it is clear that a shareholder derivative suit is precluded when the holder of the claims both purchased those claims for value and is presently pursuing those claims.[239] Alternatively, *Womble* suggests that if the holder of the causes of action did not purchase them for value and is not actively pursuing those rights, a shareholder may properly institute a derivative action.[240] While *American Bank* and *Womble* effectively define certain conditions that block derivative actions, neither court spoke directly to the situation, as in *Bauer*, where a third party purchases the bank's causes of action for value, but never pursues those rights. In deciding *Bauer*, the Fourth Circuit made clear that the purchase of claims for value is controlling. Once a corporation, or its receiver sells its causes of action, the shareholders may not bring a derivative suit. The usual question in a derivative suit, whether the corporation has failed or refused to bring the action on its own,[241] is irrelevant once the bank sells its causes of action for value.

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239. *See* Federal Deposit Ins. Corp. v. American Bank Shares, Inc., 558 F.2d 711, 714 (4th Cir. 1977) (holding that district court did not err in determining that FDIC-Corporate had sole right to pursue action against bank's officers).

240. *See* Womble v. Dixon, 752 F.2d 80, 82 (4th Cir. 1984) (holding that refusal of FSLIC to bring claims may permit shareholder derivative suit).

241. *See* FED R. CIV. P. 23.1 (permitting derivative actions by shareholders only when corporation has failed to pursue claim).

United States Fire Insurance Co. v. Allied Towing Corp.

966 F.2d 820 (4th Cir. 1992)

The corporate veil provides only limited protection against liability for the corporation's wrongs. A variety of conditions have led courts to pierce the corporate veil. Some of these conditions include failure to observe corporate formalities, to maintain corporate records, to pay dividends, or to provide a corporation with sufficient capital.[242] Courts consistently have refused, however, to pierce the veil between two corporations merely because the businesses have the same officers or directors.[243] The United States Court of Appeals for the Fourth Circuit reached this same conclusion in *United States Fire Insurance Co. v. Allied Towing Corp.*[244]

Allied Towing was an admiralty case arising out of a collision involving a tugboat, barge, and Navy ship. On March 24, 1989, the Mount Baker, a Navy ammunition ship, struck the TMI-96, an unmanned barge owned by Transerve Marine, Inc. (Transerve). The Starcrescent, a tugboat that Allied Towing Corp. (Allied) owned, was towing the TMI-96. Both the barge and the Navy ship suffered damages in the collision.

Transerve and the barge's insurer, United States Fire Insurance Co. (U.S. Fire), filed suit against Allied and the Navy. The United States District Court for the Eastern District of Virginia found both Allied and the Navy at fault and apportioned liability equally between them. The district court awarded U.S. Fire and Transerve damages, but the court refused to award the plaintiffs prejudgment interest. U.S. Fire and Transerve appealed, seeking prejudgment interest. Allied and the Navy cross-appealed, questioning the district court's liability apportionment, findings of fault, and damages award.

On appeal, the Fourth Circuit left intact the district court's apportionment of liability and findings of fault. However, the Fourth Circuit

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242. *See* Keffer v. H.K. Porter Co., 872 F.2d 60, 65 (4th Cir. 1989) (listing conditions or actions that may support piercing corporate veil, including grossly undercapitalizing corporation, failing to observe corporate formalities, siphoning funds from corporation, failing to pay dividends, and lacking corporate records); *see also* United States v. Jon-T Chems., Inc., 768 F.2d 686, 691 (5th Cir. 1985) (stating that limitation on owner liability for corporation's wrongs may not apply if owner established corporation for fraudulent purpose, used corporation to commit illegal act, or drained corporation's assets), *cert. denied*, 475 U.S. 1041 (1986); *cf.* United States v. Kayser-Roth Corp., 910 F.2d 24, 27 (1st Cir. 1990) (finding that parent corporation, which asserted total control over subsidiary's activities, could be liable for subsidiary's violations of federal environmental laws), *cert. denied*, 111 S. Ct. 957 (1991).

243. *See, e.g.*, Lowell Staats Mining Co. v. Pioneer Uruvan, Inc., 878 F.2d 1259, 1263 (10th Cir. 1989) (stating that identity of corporate officers and directors does not justify piercing corporate veil); *Jon-T Chems., Inc.*, 768 F.2d at 691 (concluding that 100 percent ownership and identity of corporate officers and directors are, even together, insufficient basis for piercing corporate veil); C.M. Corp. v. Oberer Dev. Co., 631 F.2d 536, 539 (7th Cir. 1980) (stating that stock control and common officers and directors are generally prerequisite to piercing corporate veil, but that those factors are not sufficient by themselves).

244. 966 F.2d 820 (4th Cir. 1992).

was not satisfied with the district court's explanation of the damages award. Consequently, the Fourth Circuit vacated the district court's damages findings and remanded the case for a more detailed explanation of the basis for the award.

The Fourth Circuit next considered the district court's denial of prejudgment interest. Citing *Reeled Tubing, Inc. v. M/V Chad G*,[245] the court stated that awarding prejudgment interest in maritime cases is the rule rather than the exception. In practice, the Fourth Circuit noted, such an award is virtually automatic. However, the court recognized that a district court has authority to deny prejudgment interest if "peculiar circumstances" would render such an award inequitable.[246] Examples of such circumstances include an unwarranted delay in bringing a lawsuit, a damages award substantially less than that sought, a genuine dispute regarding liability, complex legal and factual issues, and a bad faith claim.

The Fourth Circuit determined that the case before it did not present peculiar circumstances. The district court had declined to award prejudgment interest because it determined that Transerve was partially responsible for the collision. Specifically, the district court imputed partial fault to Transerve because its officers and directors, acting as Allied's officers and directors, decided not to repair a winch on the Starcrescent until the tug and tow reached Virginia. The failure to make such repairs meant the barge's tow line was longer than advisable, and this apparently contributed to the collision.

The Fourth Circuit agreed with the district court that Transerve and Allied had effectively identical ownership, boards, and management. Making such similarities the basis for finding Transerve at fault, however, required piercing Transerve's corporate veil. Consequently, the central question before the Fourth Circuit was whether piercing Transerve's veil was appropriate.

The court first noted that certain situations—including failure to observe corporate formalities, to maintain corporate records, or to capitalize a corporation sufficiently—can support piercing the corporate veil. But merely sharing officers and directors, the Fourth Circuit found, is not one of those situations. The Fourth Circuit cited *Crown Central Petroleum Corp. v. Cosmopolitan Shipping Co.*,[247] in which the United States Court of Appeals for the Second Circuit stated that sister corporations are presumably separate despite their common ownership. The Fourth Circuit also relied on *Zaist v. Olson*,[248] in which the Supreme Court of Connecticut recognized that there is nothing inherently "insidious" about interlocking directorates or identity of officers. Finally, the Fourth Circuit also cited *Washington & Old Dominion Users Ass'n v.*

245. 794 F.2d 1026, 1028 (5th Cir. 1986).

246. Orduna S.A. v. Zen-Noh Grain Corp., 913 F.2d 1149, 1157 (5th Cir. 1990).

247. 602 F.2d 474, 476 (2d Cir. 1979).

248. 227 A.2d 552, 558 (Conn. 1967).

Washington & Old Dominion Railroad,[249] in which the Virginia Supreme Court held that an intrastate railroad and its parent company were separate entities, even though the companies shared some officers and directors.[250]

The Fourth Circuit's refusal to pierce Transerve's corporate veil eliminated the district court's sole reason for denying Transerve prejudgment interest. Without piercing Transerve's corporate veil, the district court could not find Transerve at fault for Allied's decision not to repair the Starcrescent's winch. Without that finding of fault, there was no reason to deny Transerve's motion for prejudgment interest. Consequently, the Fourth Circuit vacated the district court's ruling on that motion.

The Fourth Circuit's refusal to pierce the corporate veil merely because Transerve and Allied shared officers and directors is in accord with cases from other jurisdictions. For example, in *McKinney v. Gannett Co.*,[251] the United States Court of Appeals for the Tenth Circuit, applying New Mexico law, noted that courts generally will recognize the separate status of a parent corporation and its subsidiary, even if the parent owns all shares in the subsidiary and the corporations share officers and directors.[252] Similarly, in *Lowell Staats Mining Co. v. Pioneer Uruvan, Inc.*,[253] the Tenth Circuit, this time applying Colorado law, stated that identity of corporate officers and directors does not justify piercing the corporate veil.[254]

Likewise, in *United States v. Jon-T Chemicals, Inc.*,[255] the United States Court of Appeals for the Fifth Circuit, applying Texas law, concluded that one hundred percent ownership of one corporation by another and identity of corporate officers and directors are, even together, an insufficient basis for piercing the corporate veil.[256] Finally, in *C.M. Corp. v. Oberer Development Co.*,[257] the United States Court of Appeals for the Seventh Circuit stated that stock control and common officers and directors are generally prerequisite to piercing the corporate veil, but that those factors are not sufficient by themselves.[258]

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249. 155 S.E.2d 322, 325-26 (Va. 1967).

250. The companies maintained separate corporate books and accounting records. Washington & Old Dominion Users Ass'n v. Washington & Old Dominion R.R., 155 S.E.2d 322, 325 (Va. 1967). Separate labor agreements covered each company's employees. *Id.* The railroad systems were not physically connected, and each railroad maintained its own published tariffs. *Id.* Furthermore, although the companies shared some officers and directors, the same persons did not hold precisely the same positions in both railroads. *Id.*

251. 817 F.2d 659 (10th Cir. 1987).

252. McKinney v. Gannett Co., 817 F.2d 659, 665-66 (10th Cir. 1987).

253. 878 F.2d 1259 (10th Cir. 1989).

254. Lowell Staats Mining Co. v. Pioneer Uruvan, Inc., 878 F.2d 1259, 1263 (10th Cir. 1989).

255. 768 F.2d 686 (5th Cir. 1985), *cert. denied*, 475 U.S. 1041 (1986).

256. United States v. Jon-T Chems., Inc., 768 F.2d 686, 691 (5th Cir. 1985), *cert. denied*, 475 U.S. 1041 (1986).

257. 631 F.2d 536 (7th Cir. 1980).

258. C.M. Corp. v. Oberer Dev. Co., 631 F.2d 536, 539 (7th Cir. 1980).