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LEGAL UPDATES

A Lesson From Tiger King: Corporate Separateness

Many of us have recently learned about Joseph Maldonado-Passage (aka Joe Exotic) through the Netflix documentary "Tiger King, Murder, Mayhem and Madness." While the documentary has provided much entertainment during COVID-19, it can also teach us a few lessons on what not to do, legally speaking.

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by Rayna Sparkes

Many of us have recently learned about Joseph Maldonado-Passage (aka Joe Exotic) through the Netflix documentary "Tiger King, Murder, Mayhem and Madness." While the documentary has provided much entertainment during COVID-19, it can also teach us a few lessons on what not to do, legally speaking. From a legal perspective, in addition to the trademark infringement issues Joe Exotic has encountered, he has also experienced firsthand the adverse consequences of setting up multiple entities without maintaining sufficient corporate separateness and effecting fraudulent transfers to these entities.

In a recent court judgment for $953,000 plus interest rendered against him as a result of the trademark infringement case, Joe was held liable to Big Cat Rescue. However, in attempting to evade that liability, he created multiple entities. The court ultimately found all successor entities to be liable for the judgment. While Joe's actions evidence his fraudulent intent in setting up multiple entities and transferring cash and assets to these entities, even companies without such fraudulent intentions can suffer unintended legal liability due to of an absence of sufficient corporate protections in a business structure with multiple entities.

It is not uncommon for a business to suffer adverse consequences where they intend to shield itself from liabilities and protect its assets by creating a multi-entity structure, but nevertheless fail because their efforts were insufficient in creating separateness among the entities. Many courts have addressed this issue over the years. Through the theory of "alter ego", a corporation's limited liability protection may be eliminated, thereby "piercing the veil" of those entities and effectively treating multiple entities as mere divisions of the other with the resulting treatment of them as one entity for all of the liabilities and obligations of each of the related entities.

How Do You Create Corporate Separateness in a Multi Entity Structure?

In California, a court will determine whether a corporation and its parent constitute a single enterprise, the effect of which would result in the entire enterprise being liable for the acts and omissions of each component entity, if both (1) the degree of unity of interest and (2) ownership among all the entities makes the separate corporate structure merged such that, in practice, the entities are in effect a single enterprise.

If the court makes such a determination, equity dictates that all component entities should be treated as one enterprise. In its examination of the facts, the court will, among other things, look to see if the parent controls the subsidiary to such a degree that the subsidiary is a mere instrumentality or agent of the parent. In addition, it will look at various factors in order to determine whether there is true separation between the component entities.

List of Indicators That Increase Risk of Piercing the Veil

The following is a list of indicators, the presence of which will increase the potential risk of a piercing of the corporate veil:

- Commingling funds and other assets
- Confusion of corporate records of the separate entities
- Equitable owners who dominate and control the entities
- Existence of identical directors and officers of the entities
- Use of the same office or business location
- Employment of the same employees or legal counsel
- Complete absence of corporate assets or undercapitalization of the controlled entities
- Use of an entity as a mere shell, instrumentality or conduit for a single venture of the business of the other entity
- Disregard of legal formalities and failure to maintain arm's length relationships among related entities
- Use of the corporate entity to procure labor, services or merchandise for another entity

Ensuring Separateness Among Entities

In order to ensure sufficient separateness among entities, a business should be sure to provide for the following:

- Sufficient capitalization to fund expected losses, particularly at formation.
- The ability of each entity to pay its debts as they become due and that current assets exceed current liabilities.
- Each entity should minimize common control over other entities (i.e. have different or varied boards of directors, if or as much as possible, and managers) and avoid parental determination of decisions that should be made by the subsidiary.
- Comply with basic corporate formalities: hold regular board meetings, document and elect officers and directors on an annual basis, avoid majority overlap of board members among parent and its subsidiaries, and documentation of corporate decision-making process as necessary or appropriate.
- Shared corporate assets can be maintained at the parent company or another affiliate so long as the subsidiary compensates the parent or affiliate for their use through a reasonably drafted written intercompany agreements on market terms.

Creating multi structure entities with sufficient separateness is a strategic and fact intensive analysis and will need to be done with the assistance and guidance of your attorneys and accountants or advisors.