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Peter Sherman

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**THE EFFECT OF THE CORPORATE
STRUCTURE ON LIABILITY: *IBF
CORPORATION v. ALPERN AND
NATIONAL PARALEGAL
INSTITUTE, INC. v. BERNSTEIN***

In 1985, the District of Columbia Court of Appeals heard two appeals concerning the issue of corporate liability. In one case, a creditor sought to have the personal debt of a corporate officer satisfied by garnishing the assets of the corporation.¹ In the second case, a creditor of a corporation whose charter had been revoked and later reinstated, attempted to have the reinstatement applied retroactively in order to maintain his action to recover a debt owed to him by the corporation.² In both cases, the court was called on to decide whether to allow a company to use its corporate structure as a shield to escape paying its outstanding obligations or the obligations of its employees.

I. *IBF CORPORATION v. ALPERN*

The corporate entity is viewed as distinct and independent from its individual investors³ and thus provides a shield protecting these shareholders from liability for the debts of the corporation. Occasionally, however, in the interest of equity and justice, courts ignore this independence or pierce the corporate veil to hold the individual shareholders liable for the debts of the corporation.⁴ The most common situation for piercing the corporate veil involves a creditor who is attempting to set aside the corporate entity in

1. *IBF Corp. v. Alpern*, 487 A.2d 593 (D.C. 1985).

2. *National Paralegal Inst., Inc. v. Bernstein*, 498 A.2d 560 (D.C. 1985).

3. *Valley Fin., Inc. v. United States*, 629 F.2d 162, 171 (D.C. Cir. 1980). "The concept of distinct corporate entity has long served useful business purposes, encouraging risk-taking by individual investors as well as overall convenience of financial administration." *Id.* The court in *Valley Finance* went on to state that "ordinarily, such considerations justify treating the corporation as a separate entity, independent of its owner." *Id.* See also *Harris v. Wagshal*, 343 A.2d 283, 287 (D.C. 1975) (where the court maintained: "The general rule, of course, is that a corporation is regarded as an entity separate and distinct from its shareholders").

4. *Quinn v. Butz*, 510 F.2d 743 (D.C. Cir. 1975). Although a corporation is ordinarily to be viewed as a distinct entity, "the corporate entity must be disregarded in the interest of public convenience, fairness and equity." *Id.* at 757. See also *Harris*, 343 A.2d at 287 ("Where, however, the corporate form is a mere sham and is used by those in control to work injustice, it will be disregarded.").

order to reach the assets of the individual shareholders. However, in *IBF Corporation v. Alpern*,⁵ the creditor was trying to go beyond the individual to reach the assets of the corporation. In trying to garnish the assets of the corporation to pay a debt owed by an individual, the creditor was attempting to pierce the corporate veil "in reverse."⁶ To justify piercing the corporate veil in reverse within the District of Columbia, the creditor must show that the debtor was an employee of the corporation but received no salary, had rendered services to the corporation, and was entitled to receive benefits from the corporation for those services.⁷ In addition, a creditor attempting to have a debt satisfied by attaching the assets of a third party has the burden of proving the third party is liable to the debtor.⁸

In *Alpern*, the issue was whether a creditor could garnish the funds of a family corporation in order to satisfy a debt owed to him by one of the corporation's officers who incurred the debt for his own benefit.⁹ In this case, the appellee, Alpern, was an attorney who had provided legal services, valued at \$14,000, to Bernard Frishman, the husband of the owner of IBF Corporation.¹⁰ When Frishman failed to pay for the services provided, Alpern sued to recover the debt owed to him. Alpern received a default judgment against Frishman for the full amount owed to him.¹¹ After failing to have the default judgment satisfied, Alpern sought a court order to have the debt paid by garnishing IBF funds¹² because Frishman was an officer of the

5. 487 A.2d 593 (D.C. 1985).

6. *IBF*, 487 A.2d at 596; *see also* *Valley Fin., Inc. v. United States*, 629 F.2d 162 (1980) (court reached same conclusion concerning a federal tax lien created by taxpayer who was the sole owner of the corporation).

7. 487 A.2d at 595-96. D.C. CODE ANN. § 16-579 (1981 & Supp. 1985) states:

Where the judgment debtor claims or is proved to be rendering services to or employed by a relative or other person or by a corporation owned or controlled by a relative or other person, without salary or compensation, or at a salary or compensation so inadequate as to satisfy the court that the salary or compensation is merely colorable and designed to defraud or impede the creditors of the debtor, the court may direct the employer-garnishee to make payments on account of the judgment, in installments based upon a reasonable value of the services rendered by the judgment debtor under his employment or upon the debtor's then earning ability.

Id.

8. 487 A.2d at 596. "In an attachment action the test of the liability of the garnishee is whether he has funds, property or credits in his hands, the property of the debtor, for which the debtor would have the right to sue." *Walsh v. Lewis Swimming Pool Constr. Co.*, 261 A.2d 475, 476 (1970). In *Alpern*, the fact that Frishman provided services for IBF and was entitled to compensation satisfied the requirement that IBF was liable to Frishman from which Alpern could recover the amount owed to him. 487 A.2d at 596.

9. 487 A.2d at 595.

10. *Id.* The sum was the amount in legal fees owed by Frishman to Alpern since April, 1970.

11. *Id.* Alpern received a judgment against Bernard Frishman on March 3, 1973.

12. *Id.*

corporation.¹³

Garnishment of a corporation's funds to satisfy the debts of an employee or a person who has rendered services to that corporation is governed by District of Columbia Code (D.C. Code) section 16-579.¹⁴ This provision authorizes an action to satisfy the debt of a person who has rendered services to the corporation and in return has received either inadequate or no compensation for those services.¹⁵ Prior to enactment of the current law pertaining to the garnishment of wages in the District of Columbia, a judgment creditor was permitted to attach the entire wages of the debtor in order to satisfy a debt.¹⁶ However in 1959, Congress enacted legislation, which is the basis for the law in the District of Columbia today, that limits the amount a judgment creditor is entitled to receive to an amount which is reasonable.¹⁷ Furthermore, the amount a corporation can be required to pay in such a case must be "based on a reasonable value of the services rendered by the judgment debtor under his employment or upon the debtor's then earning ability."¹⁸

Before granting the appellee's motion to garnish IBF's funds, the court had to resolve two issues: first, whether Bernard Frishman had rendered services to IBF;¹⁹ and second, if he was employed by IBF, the value of the services rendered.²⁰ In making the first determination, the court found that, although Mrs. Frishman had denied that Mr. Frishman was an officer of IBF, there was evidence produced showing that Mr. Frishman held himself out as being president of IBF and had taken action in that capacity.²¹ Therefore, the court held that the facts in the record were sufficient to satisfy

13. *Id.* Frishman had signed a lease for the premises of IBF in his capacity as president of the corporation. *Id.* at 595 n.1. Mrs. Frishman stated in interrogatories that her husband was the President of IBF, but received no salary. *Id.*

14. *Id.* at 596. *See also supra* note 7.

15. *See supra* note 7.

16. 487 A.2d at 596. H.R. REP. NO. 263, 86th Cong., 1st Sess. 2 (1959); S. REP. NO. 459, 86th Cong., 1st Sess. 2 (1959).

17. Pub. L. No. 86-130, 73 Stat. 275 (1959). The legislative history indicates that the bill was enacted to create a more workable law governing garnishment in the District of Columbia. S. REP. NO. 459, *supra* note 16. The main emphasis was to allow only an affordable amount to be withheld from the employee, based on his or her monthly earnings. *Id.* at 2-3.

18. *See supra* note 7.

19. *Alpern*, 487 A.2d at 597.

20. *Id.*

21. *Id.* Frishman's relationship to IBF appears to fit within the definition of the apparent authority doctrine of agency. Under this doctrine an agent may or may not have actual authority to act on behalf of the principal. However, the actions of the principal leads the third party to believe in good faith that the agent is acting on behalf of the principal and with the principal's acquiescence. In this case, Frishman had entered into contracts on behalf of IBF and the corporation's compliance with those contracts is evidence of Frishman's apparent authority to act as an agent of IBF. *Id.* at 595 & nn.1-2.

the requirement that the debtor, Bernard Frishman, had provided services to IBF Corporation as required under section 16-579.²²

Once it was proved that Bernard Frishman did hold a position with IBF, the court turned to the second determination concerning the value of the service rendered by Frishman to the corporation. According to section 16-579 of the D.C. Code, the court could order the corporation to make payments to satisfy the debt of its employee.²³ Because there was no employment contract between IBF and Mr. Frishman,²⁴ under section 16-579 the court could order such payments based on the "reasonable value of the services rendered by the judgment debtor" based "upon the debtor's then earning ability."²⁵

In this case, the court considered the tangible compensation Frishman received from IBF, as well as the income Frishman received from his own architectural business as a measurement of the value of Frishman's employment with IBF.²⁶ After making the determination as to the value of the services provided by Mr. Frishman to IBF, based on his earning ability, the lower court ordered IBF to pay to the appellee monthly installments of \$1,500 until the debt was satisfied.²⁷

22. *Id.* at 597. The court of appeals held that the evidence showing that Frishman was IBF president; held himself out as an IBF employee by virtue of his business card; regularly used IBF office space for which he paid no rent but deducted the rental payments as a business expense on his personal income tax returns; received his mail at IBF's office; and relied on the IBF answering service, was sufficient to support the finding that Frishman had rendered services to IBF and that the motions judge was correct in invoking § 16-579. *Id.*

23. *See supra* note 7. Under the provisions of the D.C. Code, the court can "direct the employer-garnishee to make payments on account of the judgment, in installments, based upon a reasonable value of the services rendered by the judgment debtor." D.C. CODE ANN. § 16-579 (1981).

24. *Alpern*, 487 A.2d at 595. Since there wasn't an employment contract in force between the corporation and the officer-debtor, the court had to calculate the value of the services rendered by the officer to the corporation, and make a determination as to how much of the corporation's funds could be garnished in order to repay the debt owed by the corporate officer. *Id.* at 597-98.

25. D.C. CODE ANN. § 16-579 (1981). *See supra* note 7. In determining the value of the services rendered, the court has the discretion to use one of three different methods of measuring the value of such services. The measurement that the court prefers to use is the "market value" that treats the services as a commodity upon which a price can be levied. The second method uses the actual value of the services to the employer. A third measurement is based on the amount of compensation actually received by the employee. At the minimum, the third measurement provides a "floor value" for the services rendered. In *Alpern*, the lower court combined the first and third methods to arrive at a figure for Mr. Frishman. 487 A.2d at 597-98.

26. 487 A.2d at 597-98. The compensation that Frishman actually received from IBF were the rental payments made for his office in Silver Spring, Maryland. The court used these payments as a floor for calculating the reasonable value of Frishman's services to IBF. *Id.*

27. *Id.* at 597. The \$1,500 monthly payment was calculated by averaging Frishman's

Although it affirmed the lower court's finding that Frishman had provided services to IBF, the court of appeals had to decide whether the trial court was correct in using Frishman's gross annual receipts from his architectural business in calculating the value of the services he provided to IBF.²⁸ The court of appeals interpreted section 16-579 of the D.C. Code narrowly and stated that the "statute itself does not command use of a 'net' rather than 'gross' value."²⁹ The court of appeals concluded that the trial court did not err in using the gross income of the judgment debtor and upheld the trial court's decision ordering monthly payments to be made by IBF to the appellee.³⁰ By upholding these payments, the court of appeals allowed the appellee to reach the assets of the corporation by piercing the corporate veil in reverse. The court held that D.C. Code section 16-579 was adopted to permit such action, so as to prevent a debtor who has a relationship with the corporation from defrauding or impeding his or her creditor.³¹

While the decision in this case differs from the traditional concept of piercing the corporate veil, it is not necessarily a break from past precedent. In previous District of Columbia Court of Appeals decisions,³² piercing the corporate veil was based on such considerations as equity and justice.³³ Because piercing the corporate veil is a doctrine of equity,³⁴ the key considerations in whether the corporate shield should be disregarded will vary in each case.³⁵ Before deciding whether to pierce the corporate veil the court will consider such factors as: (1) the fraudulent use of a corporation, i.e., using

earnings from his architectural business (\$24,000 in 1979 and \$11,000 for 1980), then dividing it by 12, thus coming to the figure of \$1,500 a month.

28. *Id.* at 598. This became an issue because Frishman's architectural business actually showed a loss of \$2,410 in 1979 and \$10,853 in 1980. *Id.*

29. *Id.* The court also reasoned that the judgment against Frishman predated his architectural expenses that would have offset any IBF/Frishman income he was now receiving. *Id.*

30. *Id.* at 599.

31. *Id.* at 597. Because there is a lack of legislative history specifically pertaining to § 16-579, the purpose and reach of the statute is based on the court's interpretation.

32. *Vuitch v. Furr*, 482 A.2d 811 (D.C. App. 1984). This case involved a medical malpractice suit against several corporations. The jury found intermingling of the identities and property of the two corporations. Moreover, the disregard of some of the corporate formalities by the shareholders was evidence that the corporations did not have separate identities and that they merely served as the shareholders' alter egos. This evidence provided sufficient grounds for the jury to pierce the corporate veil of these medical corporations. *Id.* at 817; *Harris v. Wagshal*, 343 A.2d 283 (D.C. App. 1975). Defendants were found to have established an inadequately capitalized corporation to insulate the debts of the defendants from their creditors. These factors, combined with the lack of adherence to corporate formalities and the commingling of corporate and personal funds, were sufficient to pierce the corporate veil in order to reach the assets of the corporation. *Id.* at 287-88.

33. *Harris*, 343 A.2d at 288.

34. *Vuitch*, 482 A.2d at 815-16.

35. *Id.* at 816.

the corporation as a shield from the legitimate claims of creditors; (2) extensive commingling of personal and corporate funds; (3) substantial disregard of the formalities of the corporate form; and (4) inadequate capitalization.³⁶ The final decision to pierce the corporate veil will be based on the judgment of "who should bear the risk of loss and what degree of legitimacy exists for those claiming the limited liability protection of a corporation."³⁷ In *Alpern*, the court decided that under equitable principles the corporate shield could not be applied to fend off past obligations. In short, because of the appellant's relationship with IBF, the corporation should bear the burden of satisfying his monetary obligations.

II. NATIONAL PARALEGAL INSTITUTE V. BERNSTEIN

In another 1985 case decided by the District of Columbia Court of Appeals, *National Paralegal Institute, Inc. v. Bernstein*,³⁸ the court addressed the issue of whether the reinstatement of a corporation's charter would be applied retroactively in order to allow the creditor to maintain his claim on the unpaid debt owed by a corporation.³⁹ In *Bernstein*, a corporation had a default judgment entered against it for rents due to the appellee, Bernstein. Although National Paralegal Institute's (NPI) defense rested on its claim that the service of process to the corporation was insufficient,⁴⁰ the most important issue of the case was the effect of the revocation and later reinstatement of NPI's certificate and articles of incorporation on the debt owed Bernstein by the corporation.⁴¹

NPI, a nonprofit corporation, entered into a lease with Bernstein for the period of December, 1982 through November, 1985.⁴² Preceding the expiration of the lease, NPI vacated the premises.⁴³ After Bernstein failed to collect the unpaid rent from NPI, he filed suit against NPI. Prior to the filing of the suit, Bernstein discovered that NPI's certificate and articles of incorporation were revoked in September of 1978.⁴⁴ Because of this, when Bernstein filed suit, service was made on the Superintendent of Corporations in

36. *Id.*

37. *Id.*

38. 498 A.2d 560 (D.C. App. 1985).

39. *Id.* at 562.

40. *Id.* at 561.

41. *Id.* at 561-62.

42. *Id.* at 561.

43. *Id.* Appellee claimed that NPI occupied his premises until July 30, 1983 and NPI claimed that they vacated the premises on March 15, 1983.

44. *Id.* NPI's certificate and articles of incorporation had been revoked in 1978 because of its failure to file annual reports and failure to pay all its fees due in 1977 and 1978. *Id.*

compliance with D.C. Code section 29-511(b).⁴⁵ NPI failed to file an answer and in December of 1983 Bernstein obtained a default judgment against NPI. NPI sought to vacate the default judgment claiming insufficiency of process.⁴⁶ The trial court denied this motion and NPI appealed to the District of Columbia Court of Appeals.⁴⁷

Although neither party raised the issue in the lower court proceedings, the court of appeals considered the effect that the revocation of NPI's certificate and articles of incorporation had on the appellee's lawsuit.⁴⁸ The court concluded that when these corporate documents were revoked, NPI lost any right it had to conduct business under the corporate structure.⁴⁹ Therefore, when NPI entered into its present lease with Bernstein it did not exist as a corporation.⁵⁰

In February of 1985, the Superintendent of Corporations reinstated NPI's corporate charter.⁵¹ According to the court of appeals, the effect of the reinstatement of NPI's charter was to restore NPI as a corporation retroactively for the maintenance of this action and to deny NPI any protection from paying its debts because of its failure to meet the statutory requirements of maintaining corporate status in the District of Columbia.⁵²

After deciding the retroactivity issue, the court ruled on NPI's claim that the appellee failed to serve process adequately on the corporation. In the

45. *Id.* at 562. D.C. CODE ANN. § 29-511(b) (1981 & Supp. 1985) provides:

Whenever a corporation shall fail to appoint or maintain a registered agent in the District or whenever its registered agent cannot with reasonable diligence be found at the registered office, then the Mayor shall be an agent of such corporation upon whom any such process, notice, or demand may be served.

Id.

46. *Bernstein*, 498 A.2d at 561. William Fry, NPI's former executive director, moved to dismiss the complaint because he was never notified of the suit. *Id.* The court found that NPI never claimed that Fry was the registered agent of the corporation and was to receive notification of the suit. *Id.* at 562.

47. *Id.*

48. *Id.* at 561-62.

49. *Id.* D.C. CODE ANN. § 29-586 (1981 & Supp. 1985) includes language which states that when the articles are proclaimed void "all powers conferred upon such corporation are declared inoperative, and . . . all powers conferred thereunder shall be inoperative." 498 A.2d at 561-62.

50. 498 A.2d at 562.

51. *Id.*

52. *Id.* This is not the first case in which the court of appeals has ruled on the effect of the reinstatement of a corporation's charter. In *Accurate Constr. Co. v. Washington*, 378 A.2d 681 (D.C. 1977), the court of appeals held that reinstatement of a corporate charter is not retroactive so as to allow the corporation to maintain an action on its behalf. *Id.* at 685. In this case, the corporation continued to carry on business as usual even after its charter had been revoked. The court invalidated the corporation's undertakings during this period in which it operated without its charter. *Id.* In the words of the court, "[r]evocation is a disability imposed on a corporation as a penalty" and such a penalty cannot be erased at the "conven-

District of Columbia, the procedure for proper service of process is set out in rule 4(d)(3) of the Superior Court's Civil Rules.⁵³ This rule provides for service of process on an officer of the corporation or any agent who was appointed or authorized by law.⁵⁴ Because NPI had its corporate status revoked and could no longer serve as a corporate entity, it had no acting officers at the time of service of process.⁵⁵ In addition, the evidence indicated that there were no registered agents who could have been served by the appellee at the time of the suit.⁵⁶

Because of the status or lack of corporate status of NPI, the appellee was forced to serve process on the Superintendent of Corporations under section 29-511(b).⁵⁷ Under the circumstances of this case, the court of appeals upheld the lower court's decision that the method of service of process used by the appellee conformed with the statutory requirements of the District of Columbia and upheld the default judgment against NPI.⁵⁸

Bernstein indicates that the effect of revocation and subsequent reinstatement of a corporation's charter will depend on the facts of an individual case, but in no way will be used for the benefit of the corporation. While reinstatement of the corporate status will render a corporation incapable of

ience" of the corporation. *Id.* The final result was that the corporation was unable to recover a debt owed to it because of its failure to maintain its corporate structure.

In *Truitt v. Miller*, 407 A.2d 1073 (D.C. 1979), the District of Columbia Court of Appeals held that reinstatement of the corporate charter would be applied retroactively in order to maintain an action against a corporation. In its decision, the court of appeals held that a corporation is " 'estopped from using its own failure to file annual reports as a way to evade responsibility for the obligations it appeared to assume.' " *Id.* at 1081 (quoting *Accurate Constr. Co. v. Washington*, 378 A.2d at 685). In addition, the court stated that revocation of the charter and articles of incorporation was not intended "to relieve corporations of obligations which they undertake." *Id.* In *Bernstein*, the court of appeals followed the precedent established by the later case and held that NPI's reinstatement will be applied retroactively in order to allow the appellee to maintain his action. 498 A.2d at 562. The only significant difference in these cases are the fact patterns. In all three cases, the court of appeals has penalized a corporation that has failed to meet the statutory requirements of being a corporation. This will hold true whether the corporation is attempting to sue to recover a debt owed to it or is being sued by a creditor.

53. SUPER. CT. CIV. R. 4(d)(3) provides:

Upon a domestic or foreign corporation or upon a partnership or other unincorporated association which is subject to suit under a common name, by delivering a copy of the summons and complaint to an officer, a managing agent, or to any other agent authorized by appointment or by law to receive service of process and . . . the statute so requires, by also mailing a copy to the defendant.

Id.

54. *Id.*

55. 498 A.2d at 562.

56. *Id.*

57. *See supra* note 45.

58. 498 A.2d at 562.

pursuing an action on its own behalf, it will not shield a corporation from its obligations and will not prevent suits from being brought against a corporation. In cases where a creditor is bringing suit against a corporation, the District of Columbia Court of Appeals will apply the reinstatement of a corporation's charter retroactively in order to allow a creditor to maintain an action to recover money owed by the corporation.

III. *ALPERN* AND *BERNSTEIN*: JUDICIAL INTERPRETATIONS OF THE EFFECT OF THE CORPORATE STRUCTURE ON LIABILITY

The corporate structure is most noted for shielding a corporation's individual shareholders from liability. However, *Alpern* and *Bernstein* represent instances where the District of Columbia Court of Appeals will disregard that structure. While the fact patterns in *Alpern* and *Bernstein* differ, the results are similar in that they reinforce the rights of creditors to satisfy the debts owed to them in spite of the protection enjoyed by a corporation. In both cases, the court has refused to allow a corporation to use its corporate structure as a shield against paying either its debts or the debts of its employees. The court of appeals has based the rights of the creditors on judicial interpretation of the District of Columbia Code. In *Alpern* and *Bernstein*, as well as in previous decisions in the District of Columbia,⁵⁹ the court of appeals has held that where equity and justice demand it creditors will not be prevented from recovering outstanding obligations owed to them by an individual or entity attempting to hide behind the corporate shield. While these cases obviously provide additional safeguards and benefits to creditors in the District of Columbia, it must be noted that corporations in the District will still be afforded the same protections given to corporations in other jurisdictions as long as the corporate structure is employed for legitimate purposes.

Peter Sherman

59. See *supra* note 32.

