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Mesler v. Bragg Management Co.: A Dramatic Change in the Application of the Alter Ego Doctrine

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Mesler v. Bragg Management Co.: A Dramatic Change in the Application of the Alter Ego Doctrine

In *Mesler v. Bragg Management Company*,[1] the California Supreme Court held the release of a parent-owned subsidiary corporation did not release the parent corporation in an action to pierce the corporate veil through the alter ego doctrine.[2] *Mesler* significantly altered the long standing common entity theory of the alter ego doctrine,[3] in which subsidiary and alter ego parent corporations were considered one entity in actions to pierce the corporate veil of the alter ego parent.[4] The court in *Mesler* held an alter ego parent and subsidiary corporation were one entity for the purpose of allowing a plaintiff access to the assets of a parent corporation, but at the same time, the subsidiary and alter ego parent were separate entities for purposes of joint liability.[5] As a result of *Mesler*, the separate entity of a corporation may be pierced for one purpose, yet remain separate and distinct for another.[6] The *Mesler* court treated an alter ego parent and subsidiary corporation as joint tortfeasors,[7] and applied California Code of Civil Procedure section 877, under which a release of one joint tortfeasor will not release other joint tortfeasors.[8] Therefore, the release of the subsidiary did not release the parent.[9]

Part I of this note summarizes the facts of *Mesler* and reviews the opinion of the court.[10] Part II discusses the legal background of the alter ego doctrine of piercing the corporate veil.[11] Finally, part III of this note will discuss the legal ramifications of the *Mesler* opinion.[12]

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1. Mesler v. Bragg Management Co., 39 Cal. 3d 290, 702 P.2d 601, 216 Cal. Rptr. 443 (1985).
2. *Id.* at 305-06, 702 P.2d at 610, 216 Cal. Rptr. at 452.
3. *See infra* notes 105-09 and accompanying text.
4. *See infra* notes 105-09 and accompanying text.
5. *Mesler*, 39 Cal. 3d at 300-01, 702 P.2d at 606-07, 216 Cal. Rptr. at 448-49.
6. *Id.* at 300-01, 702 P.2d at 606-07, 216 Cal. Rptr. at 448-49; *see infra* notes 60-67 and accompanying text.
7. *Mesler*, 39 Cal. 3d at 303-06, 702 P.2d at 609-10, 216 Cal. Rptr. at 451-52.
8. CAL. CIV. PROC. CODE § 877; *see infra* notes 68-77 and accompanying text.
9. *Mesler*, 39 Cal. 3d at 303-06, 702 P.2d at 608-10, 216 Cal. Rptr. at 450-52.
10. *See infra* notes 13-97 and accompanying text.
11. *See infra* notes 98-130 and accompanying text.
12. *See infra* notes 131-38 and accompanying text.

I. THE CASE

A. *The Facts*

The plaintiff, Wesley Mesler, was an employee of Crescent Coke Handlers, Inc.[13] In 1979, plaintiff was operating a tractor previously owned by Bragg Crane Services, Inc.,[14] when he noticed a problem with the blade of the tractor. During inspection of the tractor, plaintiff slipped into the engine fan and lost one third of his arm.[15] The plaintiff named Crescent Coke Handlers, Inc., Bragg Crane Services, Inc., and several others as defendants in his suit to recover for personal injuries.[16] After two years of discovery, plaintiff learned that Crescent Coke Handlers, Inc. and Bragg Crane Services, Inc. were wholly owned subsidiaries of Bragg Management Company.[17] Upon this discovery, plaintiff amended his complaint to include Bragg Management as a named defendant.[18]

In a motion for summary judgment, Bragg Management claimed to have no connection with the workplace, the tractor, or the plaintiff.[19] The plaintiff, having failed to assert the alter ego doctrine in the pleadings,[20] subsequently sought leave of the court to amend his pleadings to include the alter ego theory of recovery against Bragg Management.[21] Plaintiff's request was denied and the motion for summary judgment by Bragg management was granted.[22] Plaintiff appealed the judgment. Prior to the hearing, Bragg Crane Services, Inc., a subsidiary of Bragg Management, settled with plaintiff in return for an agreement by plaintiff to release Bragg Crane Services from all liability.[23]

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13. *Mesler*, 39 Cal. 3d at 295, 702 P.2d at 602-03, 216 Cal. Rptr. at 444-45.
14. *Id.* at 295, 702 P.2d at 603, 216 Cal. Rptr. at 445.
15. *Id.* at 295, 702 P.2d at 602, 216 Cal. Rptr. at 444.
16. *Id.* at 295, 702 P.2d at 602-03, 216 Cal. Rptr. at 444-45. Named parties included: Crescent Coke Handlers, Inc., the plaintiff's employer; Mobil Oil Corporation, the owners of the premises on which the accident occurred; Great Lakes Carbon Corporation, owners of the coke pile plaintiff was working on at the time of the accident; Caterpillar Tractor Company, the manufacturer of the tractor; and unnamed Does. *Id.*
17. *Id.* at 295-96, 702 P.2d at 603, 216 Cal. Rptr. at 445.
18. *Id.*
19. *Id.*
20. Plaintiff had completed a great deal of discovery on the alter ego issue, but his pleadings did not contain any alter ego claim against Bragg Management. The only feasable way plaintiff could seek damages against Bragg Management would be to claim that Bragg Management and its subsidiary, Bragg Crane Services, Inc., were alter egos. *Id.*
21. *Mesler*, 39 Cal. 3d at 296, 702 P.2d at 603, 216 Cal. Rptr. at 445.
22. *Id.* at 296, 702 P.2d at 603-04, 216 Cal. Rptr. at 445-46.
23. The plaintiff dismissed the claim against Bragg Crane Services, Inc. with prejudice as part of the settlement agreement. *Id.*

B. The Opinion

The California Supreme Court first determined that because California has a liberal policy toward amendment of pleadings, the plaintiff should have been allowed to amend his complaint to include the alter ego claim against Bragg Management.[24] The court held that allowing the amendment to include the alter ego theory would not constitute undue surprise to the defendant since an extensive amount of discovery already had been conducted on the subject of alter ego piercing.[25] The court next considered whether the plaintiff's release of the subsidiary corporation, Bragg Crane, acted as a release of the parent corporation, Bragg Management.[26]

The court examined the history and policies underlying section 877 of the California Code of Civil Procedure.[27] At common law, if an injured party settled with one or more joint tortfeasors, the injured party was precluded from recovering from other joint tortfeasors.[28] The rationale behind this theory of limited recovery was that a plaintiff was entitled to recover only once for his injuries, and therefore, settlement with one joint tortfeasor would constitute full recovery.[29] The inequity of this rule is apparent in the situation of an injured plaintiff who settles with one of several joint tortfeasors for an amount below the value of the claim and is barred from further compensation. Under these circumstances, the plaintiff could not be made whole.[30]

In order to circumvent the common law release rule, the covenant not to sue was developed.[31] The covenant not to sue allowed a plaintiff to receive money from a defendant in return for a promise not

24. *Id.* at 296-97, 702 P.2d at 603-04, 216 Cal. Rptr. at 445-46. A court may grant leave to amend in the "furtherance of justice." CAL. CIV. PROC. CODE § 473. A conflict arising out of a request for leave to amend is most often resolved in favor of the amending party. 5 WITKIN, CALIFORNIA PROCEDURE, *Pleading*, § 1042 at 457-59 (3d ed. 1985).

25. *Mesler*, 39 Cal. 3d at 296-97, 702 P.2d at 603-04, 216 Cal. Rptr. at 445-46; *see also infra* notes 98-130 and accompanying text.

26. *Mesler*, 39 Cal. 3d at 296-97, 702 P.2d at 603-04, 216 Cal. Rptr. at 445-46.

27. *Id.* Section 877 allows a plaintiff to settle with one or more of several joint tortfeasors without impairing any future claim against nonsettling tortfeasors. *Id.*

28. *Id.* (citing Lamoreux v. San Diego Rye Co., 48 Cal. 2d 617, 624, 311 P.2d 1, 5 (1957) and Chetwood v. California National Bank, 113 Cal. 414, 426, 45 P. 704, 707 (1896)); *see also* Thaxter, *Joint Tortfeasors: Legislative Changes in the Rules Regarding Releases and Contribution*, 9 HASTINGS L.J. 180, 182 (1958) (discusses possible legal ramifications of the 1957 legislative package including § 877).

29. *Mesler*, 31 Cal. 3d at 297-98, 702 P.2d at 604-05, 216 Cal. Rptr. at 446-47.

30. *Id.* at 297-98, 702 P.2d at 604-05, 216 Cal. Rptr. at 446. At common law, courts would consider any type of satisfaction as the equivalent of a release. *Id. See also* Prosser, *Joint Torts and Several Liability*, 25 CALIF. L. REV. 413, 423 (1937).

31. *Mesler*, 31 Cal. 3d at 298, 702 P.2d at 605, 216 Cal. Rptr. at 447.

to bring legal action against the defendant. Since the covenant not to sue was a contract rather than a release, the common law release rule did not prevent a plaintiff from bringing subsequent actions against other tortfeasors.[32] The covenant not to sue, however, raised several problems regarding interpretation of settlement agreements.[33]

In 1957, the California Legislature adopted a package of legislative amendments to the Code of Civil Procedure entitled "Releases From and Contribution Among Joint Tortfeasors."[34] This package was designed to respond to the problems created by the common law release rule.[35] The code section pertinant to the *Mesler* decision was section 877.[36] Section 877 provides that when an aggrieved party releases one or more of several joint tortfeasors, or the parties institute a covenant not to sue, the release or covenant will not discharge any other tortfeasors from liability to the aggrieved party.[37] Section 877 applies when the release or covenant not to sue was made in good faith before a verdict or judgment was rendered.[38]

The *Mesler* court recognized that application of section 877 would allow the plaintiff to pursue an action against Bragg Management despite the settlement with Bragg Crane.[39] Bragg Management claimed that section 877 should not apply to claims brought under the alter ego doctrine.[40] Bragg Management asserted that since the alter ego

32. *Id.* (citing Kincheloe v. Retail Credit Co., 4 Cal. 2d 21, 23, 46 P.2d 971 (1935)). The covenants were not releases but promises not to institute a lawsuit against the covenantee. *Id.*

33. *Id.* (citing Pellet v. Sonotone Corp., 26 Cal. 2d 705, 711, 160 P.2d 783, 785-86 (1945)). The distinction between release agreements and covenants not to sue was entirely artificial. The primary distinction was that the latter would allow the covenantor to seek indemnity from other tortfeasors not parties to the agreement. *Id.*

34. *Mesler*, 39 Cal. 3d at 298-99, 702 P.2d at 605, 216 Cal. Rptr. at 447. The package of amendments included § 875 (providing for contribution among joint judgment debtors); § 876 (pro rata share determinations for judgment debtors); § 877 (abrogating the common law release rule); § 878 (providing the procedure a judgment debtor may follow to obtain contribution from a joint tortfeasor). CAL. CIV. PROC. CODE §§ 875-78. *See also* § 877.5 (dealing with sliding scale agreements); § 877.6 (establishing procedures to determine presence of good faith in settlement agreements in response to American Motorcycle Ass'n v. Superior Court, 20 Cal. 3d 578, 578 P.2d 899, 146 Cal. Rptr. 182 (1978)). CAL. CIV. PROC. CODE §§ 877.5, 877.6.

35. *Mesler*, 39 Cal. 3d at 298-99, 702 P.2d at 605, 216 Cal. Rptr. at 447.

36. *Id.* at 229, 702 P.2d at 605, 216 Cal. Rptr. at 447.

37. California Civil Procedure Code § 877 states:

> Where a release, dismissal with or without prejudice, or a covenant not to sue or not to enforce a judgment is given in good faith before verdict or judgment to one or more of a number of tortfeasors claimed to be liable for the same tort —(a) It shall not discharge any other such tortfeasor from liability unless its terms so provide, but it shall reduce the claims against the others in the amount stipulated by the release, the dismissal or the covenant, or in the amount of the consideration paid for it whichever is the greater; and (b) It shall discharge the tortfeasor to whom it is given from all liability for any contribution to any other tortfeasors.

CAL. CIV. PROC. CODE § 877.

38. CAL. CIV. PROC. CODE § 877.

39. *Mesler*, 39 Cal. 3d at 299, 702 P.2d at 605, 216 Cal. Rptr. at 447.

40. *Id.*

doctrine rested upon the theory that the two separate entities of the parent and the subsidiary corporations were actually one, settlement with one entity effectively amounted to settlement with the other.[41] Furthermore, Bragg Management maintained that section 877 applied only to joint tortfeasors, not to parent corporations held liable for acts of subsidiaries through application of the alter ego doctrine.[42]

Bragg Management cited the federal district court decision in *Fuls v. Shastina Properties, Inc.*[43] as controlling case law.[44] In *Fuls* plaintiff entered into a settlement agreement with a subsidiary corporation.[45] The subsidiary corporation allegedly committed fraud and violated sections of the Securities Exchange Act of 1934.[46] The plaintiff then sued the parent-owner of the subsidiary in an action for damages.[47] The *Fuls* court determined that the standard for piercing the corporate veil under the alter ego doctrine was that a parent-owner of a subsidiary corporation would be liable if the degree of unity of interest and ownership was so significant that the individuality of the subsidiary corporation and the parent-owner had ceased.[48] The *Fuls* court held that when the alter ego doctrine was applicable, the two corporations were treated as one for the purpose of determining liability.[49] Furthermore, the court reasoned that the release of one corporation released both because the two corporations are actually one entity.[50] The *Fuls* case was later reaffirmed by the Ninth Circuit in *M/V American Queen v. San Diego Marine Construction, Corp.*[51]

The *Mesler* court did not find the *Fuls* or subsequent cases affirming *Fuls* to be compelling.[52] The court faulted the *Fuls* court for failing to consider section 877 of the California Code of Civil Procedure and for misinterpreting the use of the alter ego doctrine by California courts.[53] After dispensing with federal decisions, the *Mesler* court

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41. *Id.*
42. *Id.*
43. 448 F. Supp. 983 (N.D. Cal. 9th Cir. 1978).
44. *Mesler*, 39 Cal. 3d at 299, 702 P.2d at 605-06, 216 Cal. Rptr. at 447.
45. *Fuls*, 448 F. Supp. at 988.
46. *Id.* at 986.
47. *Id.*
48. *Id.* at 989 (citing Hollywood Cleaners & Pressing Co. v. Hollywood Laundry Service, Inc., 217 Cal. 124, 129, 17 P.2d 709, 711 (1932) (applying the alter ego doctrine)).
49. *Fuls*, 448 F. Supp. at 989.
50. *Id. See infra* notes 119-27 and accompanying text.
51. M/V American Queen v. San Diego Marine Constr. Corp., 708 F.2d 1483 (9th Cir. 1983) (even if a parent corporation was the alter ego of a subsidiary, the parent would be released from liability through the plaintiff's settlement with the subsidiary); *see also infra* notes 117-25 and accompanying text.
52. *Mesler*, 39 Cal. 3d at 299-300, 702 P.2d at 606, 216 Cal. Rptr. at 448.
53. *Id.*

discussed the proper application of the alter ego doctrine in California.[54]

The court held that the alter ego doctrine applies when a defendant uses the separate entity of a corporation as a shield to derogate a plaintiff's rights and interests.[55] In these circumstances, a court may disregard the separate corporate entity and hold individual shareholders or owners liable for the acts of the corporation.[56] According to the court, no rigid test exists to determine when the corporate veil, or separate entity of the corporation, should be pierced.[57] In California, however, the common requirements for use of the alter ego doctrine are: (1) that such unity of interest and ownership exist that the personalities of the corporation and the owners are no longer separate, and (2) that, if the acts are treated as those of the corporation alone, an inequitable result will follow.[58] Once the factors required for piercing the corporate veil have been established, the owners of a corporation may be held personally liable for the acts of the corporation.[59]

The *Mesler* court found that once the criteria required to pierce the corporate veil were met, the separate corporate entity would be disregarded for purposes of indemnity against the owners of the corporation.[60] The corporate entity, however, will not be disregarded for all purposes.[61] A separate corporate entity existed for other purposes such as continuing business activities or determining joint liability.[62] The court reasoned that the requirement of avoiding inequitable results supports the contention that a corporate entity may be pierced for the purpose of reaching the assets of an alter ego parent corporation.[63] That same factor also dictates that the corporate entity re-

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54. *Id.* at 300, 702 P.2d at 606, 216 Cal. Rptr. at 448 (the court did not find *Fuls* or *M/V American Queen* binding); *see also infra* notes 126-30 and accompanying text.

55. *Mesler*, 39 Cal. 3d at 300, 702 P.2d at 606, 216 Cal. Rptr. at 448; *see also* 6 WITKIN, SUMMARY OF CALIFORNIA LAW, *Corporations*, § 5, at 4318 (8th ed. 1974).

56. *Mesler*, 39 Cal. 3d at 300, 702 P.2d at 606, 216 Cal. Rptr. at 448. The separate entity of a corporation is a privilege created by statute. Abuse of the privilege will allow a court to disregard the separate entity and hold the owners of the corporation liable. *Id.*

57. *Id. See also infra* notes 98-130 and accompanying text.

58. *Id.* (citing McLoughlin v. L. Bloom Sons Co., Inc., 206 Cal. App. 2d 848, 851, 24 Cal. Rptr. 311, 313 (1962) (equity was a primary requirement in piercing the corporate veil).

59. *Mesler*, 39 Cal. 3d at 300-01, 702 P.2d at 606, 216 Cal. Rptr. at 448.

60. *Id.* at 300, 702 P.2d at 606, 216 Cal. Rptr. at 448.

61. *Id.* at 300, 702 P.2d at 606-07, 216 Cal. Rptr. at 447-48; *see also* 6 WITKIN, SUMMARY OF CALIFORNIA LAW, *Corporations*, § 5, at 4318 (8th ed. 1974); Kohn v. Kohn, 95 Cal. App. 2d 708, 214 P.2d 71 (1950) (in a dissolution proceeding, a husband's alter ego corporation may be pierced for the purpose of awarding damages to a spouse; yet remain whole for other purposes).

62. *Mesler*, 39 Cal. 3d at 301, 702 P.2d at 607, 216 Cal. Rptr. at 449 (citing McLoughlin v. L. Bloom Sons Co., Inc., 206 Cal. App. 2d 848, 854, 24 Cal. Rptr. 311, 314 (1962)).

63. *Id.* at 301, 702 P.2d at 607, 216 Cal. Rptr. at 449.

main whole for other purposes.[64] The court held this situation analogous to "a hole being drilled in the wall of limited liability erected by the corporate form; for all purposes other than that for which the hole was drilled, the wall still stands."[65] Next, the court stated that a judgment obtained against a corporation and its alter ego was enforceable against both separately if section 877 of the California Code of Civil Procedure was applied to piercing situations.[66] If section 877 was not applicable, however, settlement with one tortfeasor would release both under the common law release rule.[67]

Bragg Management contended that section 877 applied only to joint tortfeasors and not a corporation held liable through the alter ego doctrine.[68] The court considered the language of section 877 and determined that the drafters of the section intended it to be interpreted broadly.[69] Furthermore, the court held that the broad lanquage used in section 877 included not only joint tortfeasors, but also concurrent and successive tortfeasors.[70]

Next, the court considered the application of section 877 to principal-agent relationships.[71] The court noted that in *Ritter v. Technicolor, Corp.*,[72] a Califiornia appellate court had applied section 877 to the principal-agent relationship, finding that a settlement with an agent does not release a principal from liability.[73] Since the legislature had not spoken against the decision in *Ritter*, the *Mesler* court presumed legislative acquiescence to the decision.[74]

The *Mesler* court also determined that a vicariously liable principal should be held liable not on the basis of fault, but because the interests of justice require that the enterprise be held financially respon-

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64. *Id.*
65. *Id.*
66. *Id.*
67. *Id.*
68. *Id.* at 301-02, 702 P.2d at 607, 216 Cal. Rptr. at 449.
69. *Id.* at 302, 702 P.2d at 607-08, 216 Cal. Rptr. at 449-50. The drafters of § 877 did not use restrictive wording in the statute. Instead of the narrow term "joint tortfeasors," the broad phrase "tortfeasors claimed to be liable for the same tort" was used. *Id. See also* 4 WITKIN, SUMMARY OF CALIFORNIA LAW, *Torts*, § 39, at 2338 (8th ed. 1974).
70. *Mesler*, 39 Cal. 3d at 302, 702 P.2d at 607-08, 216 Cal. Rptr. at 449-50 (citing City of Sacramento v. Gemsch Inv. Co., 115 Cal. App. 3d 869, 877, 171 Cal. Rptr. 764, 768-69 (1981) and (broad language of § 877 includes concurrent, successive, joint, or several tortfeasors); Ritter v. Technicolor Corp., 27 Cal. App. 3d 152, 153-54, 103 Cal. Rptr. 686, 687 (1972) (the legislature did not intend for § 877 to be restricted only to "true joint tortfeasors").
71. *Mesler*, 39 Cal. 3d at 302, 702 P.2d at 608, 216 Cal. Rptr. at 450.
72. Ritter v. Technicolor, Corp., 27 Cal. App. 3d 152, 103 Cal. Rptr. 686 (1972).
73. *Id.* at 154, 103 Cal. Rptr. at 687.
74. *Mesler*, 39 Cal. 3d at 303, 702 P.2d at 608-09, 216 Cal. Rptr. at 450-51. The California Legislature has not acted contrary to the decision in *Ritter*. Therefore they must have acquiesced to the application of § 877 to vicariously liable parties. *Id.* (citing Estate of McDill,

sible for the risks of conducting business.[75] The court analogized principal-agent relationships to alter ego parent and subsidiary corporations and found that the interests of justice supported imposition of liability in both cases.[76] In addition, the court considered case law of other states with contribution statutes similar to section 877.[77]

The *Mesler* court then looked at the policies underlying the application of section 877 to determine whether the provision should apply to alter ego corporations.[78] The three policies supporting application of section 877 to alter ego corporations are: First, maximizing the potential for an injured party to recover fully for injuries balanced against the fault of other parties; second, encouraging pretrial settlement of claims; and third, apportioning liability between multiple tortfeasors.[79] With respect to the first policy, the court felt that full recovery would not be achieved if a plaintiff's claim against an alter ego parent were dismissed after plaintiff had settled with a subsidiary.[80] Because many alter ego subsidiaries are undercapitalized, a settling plaintiff may often settle for an amount below the true value of the claim.[81] In addition, since many alter ego parent and subsidiary corporations are represented by the same counsel, the court found that alter ego corporations could escape contribution as joint

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14 Cal. 3d 831, 839, 537 P.2d 874, 878-79, 122 Cal. Rptr. 754, 758 (1975) (failure of the legislature to act on a judicial holding is presumed to be legislative acquiescence)).

75. *Mesler*, 39 Cal. 3d at 302, 702 P.2d at 608, 216 Cal. Rptr. at 450 (citing Hinman v. Westinghouse Elec. Co., 2 Cal. 3d 956, 959-60, 471 P.2d 988, 990, 88 Cal. Rptr. 188, 190 (1970) (losses caused by an employee are a required cost of an employer in doing business); and Rogers v. Kemper Constr. Co., 50 Cal. App. 3d 608, 618, 124 Cal. Rptr. 143, 148 (1972) (vicarious liability justified because an employer is better able to absorb and distribute the loss)).

76. *Mesler*, 39 Cal. 3d at 302, 702 P.2d at 608, 216 Cal. Rptr. at 450. The court found the same "interest of justice" that allows a plaintiff to seek indemnity against a principal after settlement with an agent should apply to a situation in which a plaintiff has settled with a subsidiary corporation and seeks additional indemnity from the alter ego parent of the subsidiary. *Id.* (citing Hinman v. Westinghouse Electric Co., 2 Cal. 3d 956, 971 P.2d 988, 88 Cal. Rptr. 188 (1970); Rogers v. Kemper Constr. Co., 50 Cal. App. 3d 608, 124 Cal. Rptr. 143 (1972)).

77. *Mesler*, 39 Cal. 3d at 303-04, 702 P.2d at 608, 216 Cal. Rptr. at 450; *see* Harris v. Aluminum Co. of Am., 550 F. Supp. 1024, 1030 (W.D. Va. 1982) (release of an agent does not preclude suit against a principal); Alaska Airlines, Inc. v. Sweet, 568 P.2d 916, 929-30 (Alaska 1977); Idaho v. Draper, 505 P.2d 1265, 1268-69 (Idaho 1973) (release of agent does not release principal); *but see* Craven v. Lawson, 534 S.W.2d 653, 656 (1976) (release of agent acts to release principal regardless of joint tortfeasor contribution statute similar to § 877).

78. *Mesler*, 39 Cal. 3d at 304, 702 P.2d at 609, 216 Cal. Rptr. at 451.

79. *Id.*

80. *Id.* at 304, 702 P.2d at 609, 216 Cal. Rptr. at 451. The intent behind the adoption of §§ 876 and 877 was to clarify the liability of tortfeasors and to benefit negligently injured plaintiffs. Without § 877, partial settlement with one defendant could hinder complete recovery. *Id.* (citing Mayhugh v. County of Orange, 141 Cal. App. 3d 763, 766-67, 190 Cal. Rptr. 537, 538-39 (1983) (under § 877, a good faith settlement with an employee does not release a jointly liable employer)).

81. *See Mesler*, 39 Cal. 3d at 304, 702 P.2d at 609, 216 Cal. Rptr. at 451.

tortfeasors by including both corporations in the settlement.[82] Thus, the imposition of joint tortfeasor status would give parent corporations greater incentive to participate in settlement agreements.[83] Finally, the court focused on the third policy of apportioning liability between multiple tortfeasors.[84] The court was concerned that an unsuspecting plaintiff may settle for a small sum from an undercapitalized subsidiary and be barred from full recovery against an alter ego parent.[85] The court stated that a parent corporation should not receive a special benefit from a settlement intended by a subsidiary and an injured party to be binding only between the injured party and the subsidiary.[86] The application of these policies confirmed the holding of the court that, in a tort action, the release of an alter ego subsidiary corporation does not release the alter ego parent corporation.[87] Hence, the summary judgment in favor of Bragg Management was reversed.[88]

C. The Dissent

The dissenting justices, Lucas and Grodin, disagreed with the reasoning of the majority.[89] The dissent initially was concerned with the reliance by the majority on principal-agent relationships,[90] stating that the individual identities attributed to a principal and an agent are not present in an action piercing the corporate veil of an alter ego parent corporation.[91] According to the dissent, once a parent-owner and a subsidiary corporation are shown to be in an alter ego relationship, the two corporations are no longer individuals but are treated as one entity.[92] Secondly, the dissent addressed the policy concern raised by the majority that a plaintiff might settle with an undercapitalized subsidiary and be barred from further recovery from an alter ego parent.[93] The dissent felt that this situation could be remedied by express reservation by plaintiffs of the right to seek recovery against other defendants.[94] Finally, the dissent considered the application by

82. *Id.* at 305, 702 P.2d at 609-10, 216 Cal. Rptr. at 451-52.
83. *Id.*
84. *Id.* at 305-06, 702 P.2d at 609-10, 216 Cal. Rptr. at 451-52.
85. *Id.* at 305-06, 702 P.2d at 610, 216 Cal. Rptr. at 452.
86. *Id.*
87. *Id.* at 306, 702 P.2d at 610, 216 Cal. Rptr. at 452.
88. *Id.*
89. *Id.* at 306, 702 P.2d at 610, 216 Cal. Rptr. at 452.
90. *Id.* at 306, 702 P.2d at 610-11, 216 Cal. Rptr. at 452-53.
91. *Mesler*, 39 Cal. 3d at 307, 702 P.2d at 607, 216 Cal. Rptr. at 453.
92. *Id.* at 307-09, 702 P.2d at 611-12, 216 Cal. Rptr. at 453-54; *see* 1 FLETCHER, CYCLOPEDIA CORPORATIONS, § 41.10, at 397-98 (perm. ed. 1983) (when a corporation is the alter ego of another corporation, the separate entity ends and the two are treated as one).
93. *Mesler*, at 309-10, 702 P.2d 612-13, 216 Cal. Rptr. at 454-55.
94. *Id.*

the majority of California Code of Civil Procedure section 877,[95] reasoning that alter ego corporations are not joint tortfeasors but are merely the aliases of a single tortfeasor.[96] Hence, the dissent stated that section 877 should not apply to situations like *Mesler* because an alter ego parent and subsidiary are one entity and not joint tortfeasors.[97]

II. Legal Background

California regards corporations as legal entities separate from their owners.[98] In the event of injury to a third party, recovery against a corporation usually is limited to the assets of the corporation.[99] Limited liability protects the owners of a corporation from personal liability.[100] Because the limited liability sometimes is subject to abuse, courts have fashioned an equitable doctrine commonly referred to as "piercing the corporate veil."[101] Piercing the corporate veil allows an injured party to look behind the "veil" of limited corporate liability and seek indemnity from the owners of the corporation.[102] When a subsidiary corporation is owned by a parent corporation, an injured party may pierce the corporate veil of the subsidiary to reach the assets of the parent corporation.[103] The primary method for piercing the veil of a parent-owned subsidiary is the alter ego doctrine.[104]

The alter ego doctrine provides that if the unity of interest between a corporation and its owners is so close that the owners and the cor-

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95. *Id.* at 311, 702 P.2d at 613, 216 Cal. Rptr. at 455.
96. *Id.*
97. *Id.*
98. *See* Merco Constr. Engineers v. Municipal Court, 21 Cal. 3d 724, 729-30, 581 P.2d 636, 639, 147 Cal. Rptr. 631, 634 (1978) (corporation is distinct from the shareholders); Cooperman v. California Unemployment Ins. Appeals Bd., 49 Cal. App. 3d 1, 7, 122 Cal. Rptr. 127, 131 (1975) (a corporation is a separate and distinct entity from its owners).
99. *See generally Merco Constr.*, 21 Cal. 3d 724, 729-30, 581 P.2d 636, 639, 147 Cal. Rptr. 631, 634 (1978) (recovery against a corporation is limited to corporate assets only); Cooperman v. California Unemployment Ins. Appeals Bd., 49 Cal. App. 3d 1, 7, 122 Cal. Rptr. 127, 131 (1985).
100. *See Metro Constr.*, 21 Cal. 3d 724, 729-30, 581 P.2d 636, 639, 147 Cal. Rptr. 631, 634 (1978).
101. *Mesler*, 39 Cal. 3d at 301, 702 P.2d at 607, 216 Cal. Rptr. at 449.
102. *See* Seymour v. Hull & Moreland Eng'g, 605 F.2d 1105, 1111 (9th Cir. 1979) (piercing allows a plaintiff access to the assets of corporate shareholders); Plumbers and Fitters Local 761 v. Matt J. Zaich Constr. Co., 418 F.2d 1054, 1058 (9th Cir. 1969) (no limited liability for shareholders once corporate veil is pierced).
103. *See* Edwin K. Williams & Co., Inc. v. Edwin K. Williams & Co.-East, 542 F.2d 1053, 1063-64 (9th Cir. 1976) (parent corporation subject to liability for the wrongdoings of its alter ego subsidiary).
104. *Id.*

poration are not separate, the two will be considered alter egos of each other.[105] Factors usually considered in piercing under the alter ego doctrine include compliance with corporate formalities,[106] adequate initial capitalization of the corporation,[107] proper use of corporate funds,[108] and finally, whether allowing the corporate entity to stand would perpetuate fraud or injustice.[109]

California courts consider these factors but usually state the test for alter ego piercing in a simple two-step form. In an action to pierce the corporate veil through the alter ego doctrine, the complaining party must show a unity of interest and ownership between the owner and the corporation. This unity must be so substantial that the separate identities of the corporation and the owners no longer exist and failure to pierce the corporate veil would lead to an inequitable result.[110] The alter ego doctrine of piercing was designed to prevent owners of corporations from harming third parties and taking advantage of the limited liability afforded corporations.[111] The policy of protecting innocent third parties from the wrongful acts of corporate owners through piercing the corporate veil is undisputed by most courts.[112] The result of a successful piercing action against an alter ego parent corporation and subsidiary, however, is the basis for a great deal of controversy.[113]

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105. *See* FLETCHER, CYCLOPEDIA OF CORPORATIONS § 41.10, at 397-98 (1983 perm. ed.) (unity of ownership and interest show that the separate personalities of the corporation and the individual no longer exist).

106. *See* Von Brimer v. Whirlpool Corp., 362 F. Supp. 1182, 1194 (9th Cir. 1973) (corporate formalities a factor in alter ego piercing); Minton v. Cavaney, 56 Cal. 2d 576, 579-80, 364 P.2d 473, 475, 15 Cal. Rptr. 641, 643 (1961) (commingling of assets and withdrawal of funds by the equitable owners may be factors in allowing the disregard of the corporate entity).

107. *See* Automotriz De California v. Resnick, 47 Cal. 2d 792, 796-97, 306 P.2d 1, 4 (1957) (initial inadequate capitalization of a corporation may be grounds to pierce the corporate veil); *see also* 6 WITKIN, SUMMARY OF CALIFORNIA LAW, *Corporations*, § 5, at 4322 (8th ed. 1974) (corporations must be organized with sufficient capitalization); Note, *Liability of a Corporation for Acts of Subsidiary or Affiliate*, 71 HARV. L. REV. 1122, 1125 (1958); Hamilton, *The Corporate Entity*, 49 TEX. L. REV. 979, 985 (1971) (adequate financal status at the outset of the corporate existence is essential to avoid disregard of the corporate entity).

108. *See* Horticultural Enterprises Corp. v. Allstate Ins. Co., 477 F. Supp. 161, 161 (9th Cir. 1979) (intermingling of corporate and personal funds grounds to disregard corporate entity); Minton v. Cavaney, 56 Cal. 2d 576, 579, 364 P.2d 473, 475, 15 Cal. Rptr. 641, 643 (1961) (withdrawal of corporate assets for personal use is improper).

109. *See* American Home Ins. Co. v. Travelers Indem. Co., 122 Cal. App. 3d 951, 966-67, 175 Cal. Rptr. 826, 834 (1981) (fraud or inequity remedied by allowing alter ego claims).

110. *See Fuls*, 448 F. Supp. at 989; *Mesler*, 39 Cal. 3d at 300, 702 P.2d at 606, 216 Cal. Rptr. at 448.

111. *See, e.g., Mesler*, 39 Cal. 3d at 300, 702 P.2d at 606, 216 Cal. Rptr. at 448.

112. *See id.*

113. *Compare Mesler*, 39 Cal. 3d at 305-06, 702 P.2d at 610, 216 Cal. Rptr. at 452 (release of a subsidiary corporation does not release alter ego parent corporation) *with Fuls*, 448 F. Supp. at 989 (release of subsidiary corporation releases alter ego parent corporation).

Prior to the *Mesler* decision, a successful piercing action against an alter ego parent of a subsidiary would result in the parent and subsidiary being treated as one entity.[114] This result is referred to as the common entity rule.[115] Prior to *Mesler*, the common entity rule would not have allowed a plaintiff who settled with a subsidiary to bring an action against the alter ego parent of the subsidiary.[116]

In 1983, the Ninth Circuit decided a case which involved a plaintiff's settlement with a subsidiary corporation owned by an alter ego parent corporation.[117] *M/V American Queen v. San Diego Marine Construction Co.* involved a factual situation very similar to *Mesler*.[118] In *M/V American Queen*, the plaintiff brought an action against a ship repair company, San Diego Marine Construction, and its parent company, Campbell Industries, for negligent repairs to the plaintiff's ship.[119] Plaintiff had signed an agreement with San Diego Marine promising to give notice within a certain time period if suit was to be filed against San Diego Marine.[120] The plaintiff brought an action after the notice period had elapsed.[121] At trial, the court decided that the agreement between the plaintiff and San Diego Marine was a valid release agreement and released San Diego Marine from all liability.[122] The court then considered the issue of whether the plaintiff could plead the alter ego doctrine for purposes of getting damages from Campbell Industries.[123] The court stated that consideration of the applicability of the alter ego doctrine was necessary because the release agreement with San Diego Marine would preclude the plaintiff from taking action against Campbell even if Campbell was the alter ego of San Diego Marine.[124] The court expressly reaffirmed the *Fuls* holding

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114. *See, e.g.*, M/V American Queen v. San Diego Marine Constr., 708 F.2d 1483, 1490 (9th Cir. 1983) (parent-owner and subsidiary considered as one entity when alter ego doctrine successfully pleaded); *see also* 1 FLETCHER, CYCLOPEDIA OF CORPORATIONS § 41.10, at 397-98 (1983 perm. ed.) (when a corporation is the alter ego of another corporation, the distinct corporate entity is disregarded and the two corporations treated as one); 6 WITKIN, SUMMARY OF CALIFORNIA LAW, *Corporations*, § 11, at 4323 (8th ed. 1974).

115. *See* BLUMBERG, THE LAW OF CORPORATE GROUPS, *Procedural Problems in the Law of Parent and Subsidiary Corporations*, § 1.02.1, at 9 (1982) (courts will usually construct a common identity for the parent and subsidiary corporations, treating them as one).

116. *See, e.g.*, M/V American Queen v. San Diego Marine Constr., 708 F.2d 1483, 1490 (settlement with subsidiary releases alter ego parent corporation).

117. *M/V American Queen*, 708 F.2d at 1483-84.

118. *Id.* at 1486-87.

119. *Id.*

120. *Id.*

121. *Id.* at 1487.

122. *Id.*

123. *Id.* at 1489-90.

124. *Id.* at 1490.

that an alter ego parent and a subsidiary are to be treated as one entity once the corporate veil is pierced.[125]

The federal cases were distinquished by the *Mesler* court.[126] The common entity rule, which prior to *Mesler* would have considered a subsidiary corporation and an alter ego parent as one entity, has been drastically affected by the *Mesler* holding.[127] After *Mesler*, alter ego parent and subsidiary corporations may be considered one entity for the purpose of allowing a plaintiff access to the assets of the parent corporation.[128] The parent and subsidiary, however, will be treated as joint tortfeasors for the purpose of contributing to any judgment awarded to the plaintiff.[129] The reasoning of the *Mesler* court will allow piercing of the corporate veil for a specific purpose without disrupting the separate corporate entities of a parent and subsidiary corporation for other purposes.[130]

III. Legal Ramifications

The *Mesler* decision will have a substantial effect upon the relationship between parent and subsidiary corporations.[131] *Mesler* has effectively overruled the common entity theory in California.[132] If a plaintiff can pierce an alter ego parent corporation successfully, the parent and subsidiary will be treated as joint tortfeasors, making both jointly and severally liable under section 877 of the California Code of Civil Procedure.[133] This exposure to potential liability will force parent corporations to either participate in negotiations between injured parties and subsidiaries or to avoid potential piercing by strictly conforming with corporate guidelines.[134] By overruling a longstanding doctrine that subsidiary and alter ego parent corporations are to be treated as one for purposes of liability, the *Mesler* court may erode

125. *Id.*
126. *Mesler*, 39 Cal. 3d at 299-301, 702 P.2d at 605-08, 216 Cal. Rptr. at 447-50; *see supra* notes 43-54 and accompanying text.
127. *Id.*
128. *Id.*
129. *Compare Mesler*, 39 Cal. 3d at 305-06, 702 P.2d at 610, 216 Cal. Rptr. at 452 (release of subsidiary corporation does not release an alter ego parent corporation) *with Fuls*, 448 F. Supp. at 989 (release of a subsidiary corporation also releases alter ego parent corporation).
130. *Mesler*, at 300-01, 702 P.2d at 606-07, 216 Cal. Rptr. at 448-49; *see also supra* notes 78-87 and accompanying text.
131. *See Mesler*, 39 Cal. 3d at 309-10, 702 P.2d at 613, 216 Cal. Rptr. 455 (Lucus, J., dissenting).
132. *See id.* at 310, 702 P.2d at 612, 216 Cal. Rptr. at 454 (Lucas, J., dissenting).
133. *See generally Mesler*, 39 Cal. 3d 290, 702 P.2d 601, 216 Cal. Rptr. 443.
134. *See Mesler*, at 309-10, 702 P.2d at 612-13, 216 Cal. Rptr. at 454-55 (Lucas, J., dissenting).

the concept of limited liability enjoyed by owners of corporations.[135]

CONCLUSION

During November, 1985, a California appellate court in *Pacific Union Conference of Seventh Day Adventists v. Brasher* held that section 877 of the California Code of Civil Procedure did not apply to principal-agent relationships.[136] The *Pacific Union* court held that the common law release rule would apply when an injured party settled and released an employee.[137] Therefore, the release of an employee would also release an employer.[138] Because *Pacific Union* was ordered not published, it remains to be seen whether future courts will follow the California Suprme Court's holding in *Mesler* or swing towards the holding in *Pacific Union.*

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135. *See id.* at 310, 702 P.2d at 613, 216 Cal. Rptr. at 455 (potential erosion of the limited liability of corporations).

136. Pacific Union Conference of Seventh-Day Adventists v. Brasher, 219 Cal. Rptr. 260, 266-67 (1985) (ordered not published).

137. *Id.* at 266-67 (section 877 does not abrogate the common law rule that the release of an employee releases the employer).

138. *Id.*