

Folger v. Cottle, No. E028821 (Cal.App. Dist.4 03/15/2002)

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COURT OF APPEAL, FOURTH DISTRICT DIVISION TWO STATE OF CALIFORNIA

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E028821

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2002.CA.0002463

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March 15, 2002

[5]

KATHLEEN L. FOLGER, INDIVIDUALLY AND AS ADMINISTRATOR, ETC.,
PLAINTIFF AND APPELLANT,

v.

MICK W. COTTLE ET AL., DEFENDANTS AND RESPONDENTS.

[6]

APPEAL from the Superior Court of Riverside County. Dallas Holmes, Judge. Affirmed.
(Super.Ct.No. RIC341744)

[7]

J. Edward Switzer, Jr.; and Bentley P. Jenkins for Plaintiff and Appellant. William L. Schanz Law Corporation and William L. Schanz for Defendants and Respondents.

[8]

The opinion of the court was delivered by: Ramirez, P. J.

[9]

NOT TO BE PUBLISHED

[10]

California Rules of Court, rule 977(a), prohibits courts and parties from citing or relying on opinions not certified for publication or ordered published, except as specified by rule 977(b). This opinion has not been certified for publication or ordered published for purposes of rule 977.

[11]

OPINION

[12]

Plaintiff Kathleen L. Folger (Folger), individually and as administrator of the estate of James Martin, appeals from a judgment entered in favor of defendants Mick W. Cottle (Cottle) and David Burrows (Burrows, collectively Defendants), after their motion for summary judgment was granted. Folger's husband, James Martin, a professional skydiver, was killed when his parachute became entangled on an inadequately seated grommet on its container and failed to deploy properly. Folger alleged that Fliteline Systems, Inc. (Fliteline) manufactured the allegedly defective container. She also alleged that Cottle and Burrows, the sole shareholders of Fliteline, should be liable to her for wrongful death under the theories of strict liability and the alter ego doctrine. She claims that the trial court erred when it determined that Fliteline was not shown to be the alter ego of Cottle and Burrows. We disagree and affirm the judgment.

[13]

Facts and Procedural History

[14]

On January 8, 2000, Folger's husband, James Martin, an experienced skydiver, was killed on impact with the ground when one of his parachute lines became snagged on a grommet on his Reflex parachute container and his reserve chute also failed to properly deploy. Sixteen days earlier, Fliteline had manufactured the Reflex parachute container that James Martin was wearing when he died. Folger claims that the Reflex container was defective.

[15]

With the assistance of legal counsel and a professional accountant, Burrows incorporated Fliteline in California on May 3, 1995, to design and manufacture parachuting equipment. The corporation has remained active and in good standing since that time. It has employed between eight and twelve people annually since its incorporation. On September 1, 1995, and October 13, 1995, respectively, Fliteline sought and obtained authorization to manufacture the Reflex container as a Federal Aviation Administration (FAA) approved product. *fn1 It began production of the first generation of the Reflex container in November 1995, and has subsequently manufactured over 2,000 units. Since 1996, Fliteline has sponsored skydiving professionals, teams and events, has been a member of industry and business organizations, and has attended and advertised at, by way of a manufacturer's exhibit, conventions. It has also undertaken considerable expense to promote and advertise its products.

[16]

Burrows is and has been Fliteline's president, secretary and chief financial officer since its incorporation. As such, he has been personally involved in and responsible for all of Fliteline's administrative support and financial transactions since its inception, including those involving himself and Cottle. He has never received any compensation from Fliteline. In 1995, Cottle began working full-time for Fliteline and was elected as a director and the vice president of engineering. He has held those positions ever since. At no time has his annual salary exceeded \$27,000. Fliteline has never had any directors or officers other than Burrows and Cottle.

[17]

Prior to incorporating Fliteline, Burrows had significant business experience, including managing 50 employees and a \$6 million budget. In 1994, Defendants began investigating the industry to determine who their competition would be, what they would need to do to establish a corporation to manufacture parachute harness and container systems, and what they would need to obtain FAA approval. Burrows then created rudimentary finance and marketing plans and projected that the company could be profitable in three to four years. During this time Defendants were also working on developing the "final" product that would be submitted for FAA testing. However, neither Burrows nor Cottle ever individually obtained any FAA approval to engage, or engaged, in manufacture, sale or distribution of Reflex systems. Those activities were carried out exclusively by Fliteline.

[18]

Folger filed her complaint on April 18, 2000, asserting causes of action for strict liability and negligence in her individual capacity and a cause of action for property damage as administrator of her late husband's estate. Defendants were named only in the causes of action for strict liability and property damage. Defendants answered the complaint and

thereafter, on August 31, 2000, moved for summary judgment or, in the alternative, summary adjudication of issues. After a hearing on October 17, 2000, the trial court granted Defendants' motion in its entirety. Judgment was entered for Defendants on November 14, 2000. This appeal followed.

[19]

Discussion

[20]

A. Standard of Review

[21]

The purpose of summary judgment "is to provide courts with a mechanism to cut through the parties' pleadings in order to determine whether, despite their allegations, trial is in fact necessary to resolve their dispute. [Citation.]" (*Aguilar v. Atlantic Richfield Co.* (2001) 25 Cal.4th 826, 844 (*Aguilar*)). Our de novo review is governed by Code of Civil Procedure section 437c, which provides in subdivision (c) that a motion for summary judgment may only be granted when, considering all of the evidence set forth in the papers and all inferences reasonably deducible therefrom, it has been demonstrated that there is no triable issue as to any material fact and the cause of action has no merit. The pleadings govern the issues to be addressed. (*City of Morgan Hill v. Brown* (1999) 71 Cal.App.4th 1114, 1121.) A defendant moving for summary judgment bears the burden of persuasion that there is no triable issue. Meeting this burden is accomplished by producing evidence that demonstrates that a cause of action has no merit because one or more of its elements cannot be established to the degree of proof that would be required at trial, or that there is a complete defense to it. Once that has been accomplished, the burden shifts to the plaintiff to show, by producing evidence of specific facts, that a triable issue of material fact exists as to the cause of action or the defense. (*Aguilar*, supra, 25 Cal.4th at pp. 849-851, 854-855.)

[22]

B. The Alter Ego Doctrine

[23]

In her causes of action for strict liability and property damage, Folger claimed that Defendants were liable both in their individual capacities and under the alter ego doctrine as the sole shareholders of Fliteline. However, on appeal, she has expressly abandoned all claims against Defendants in their individual capacities. She asserts only that Fliteline was merely a shell corporation acting as Defendants' alter ego and that they should therefore be liable for any judgment she might obtain against Fliteline.

[24]

"Ordinarily, a corporation is regarded as a legal entity separate and distinct from its stockholders, officers and directors. Under the alter ego doctrine, however, where a corporation is used by an individual or individuals, or by another corporation, to perpetrate fraud, circumvent a statute, or accomplish some other wrongful or inequitable purpose, a court may disregard the corporate entity and treat the corporation's acts as if they were done by the persons actually controlling the corporation. [Citations.] [¶] In general, the two requirements for applying the alter ego doctrine are that (1) there is such a unity of interest and ownership between the corporation and the individual or organization controlling it that their separate personalities no longer exist, and (2) failure to disregard the corporate entity would sanction a fraud or promote injustice. [Citations.]

The doctrine is applicable where some innocent party attacks the corporate form as an injury to that party's interests. The issue is not so much whether the corporate entity should be disregarded for all purposes or whether its very purpose was to defraud the innocent party, as it is whether in the particular case presented, justice and equity can best be accomplished and fraud and unfairness defeated by disregarding the distinct entity of the corporate form. [Citations.] [Citation.]" (Robbins v. Blecher (1997) 52 Cal.App.4th 886, 892.) While there is no litmus test to determine when alter ego liability will exist, it may be applied only in narrowly defined circumstances. (Mesler v. Bragg Management Co. (1985) 39 Cal.3d 290, 300-301.)

[25]

"`Among the factors to be considered in applying the doctrine are commingling of funds and other assets of the two entities, the holding out by one entity that it is liable for the debts of the other, identical equitable ownership in the two entities, use of the same offices and employees, and use of one as a mere shell or conduit for the affairs of the other.' [Citations.] Other factors which have been described in the case law include inadequate capitalization, disregard of corporate formalities, lack of segregation of corporate records, and identical directors and officers [where two corporations are involved]. [Citations.] No one characteristic governs, but the courts must look at all the circumstances to determine whether the doctrine should be applied. [Citation.] Alter ego is an extreme remedy, sparingly used. [Citation.]" (Sonora Diamond Corp. v. Superior Court (2000) 83 Cal.App.4th 523, 538-539.)

[26]

"The alter ego doctrine does not guard every unsatisfied creditor of a corporation but instead affords protection where some conduct amounting to bad faith makes it inequitable for the corporate owner to hide behind the corporate form. Difficulty in enforcing a judgment or collecting a debt does not satisfy this standard. [Citations.]" (Sonora Diamond Corp. v. Superior Court, supra, 83 Cal.App.4th at p. 539.) Cases have consistently required an element of bad faith or wrongful motive before applying the doctrine. (Ibid.; Webber v. Inland Empire Investments, Inc. (1999) 74 Cal.App.4th 884, 900 [alter ego doctrine applied where fraud and unfairness exist]; Rider v. County of San Diego (1992) 11 Cal.App.4th 1410, 1425 [good faith actions show no abuse or perversion that would render alter ego doctrine applicable]; Institute of Veterinary Pathology, Inc. v. California Health Laboratories, Inc. (1981) 116 Cal.App.3d 111, 119-120 [corporate parent must exercise manipulative control over subsidiary before alter ego doctrine can apply]; Associated Vendors, Inc. v. Oakland Meat Co. (1962) 210 Cal.App.2d 825, 842.)

[27]

In her complaint, Folger alleged that there was a unity of interest between Burrows, Cottle and Fliteline because Fliteline was inadequately capitalized. She claimed that failure to set aside the corporate form would work an injustice because Fliteline's inadequate capitalization caused it to have poor quality control, which in turn caused it to produce defective products against which it made no provisions to protect the public.

[28]

Defendants countered by producing evidence that demonstrated that none of the factors regarded as pertinent to a finding of alter ego liability existed in this case. That evidence includes the information contained in the factual statement above, as well as the following. Neither Burrows nor Cottle has ever commingled Fliteline's funds or assets

with or failed to segregate them from his own, nor has either used corporate funds other than for conducting Fliteline's business. Defendants have never used Fliteline's premises other than for the conduct of Fliteline's business. Fliteline has made no outside investments and has made no loans to anyone.

[29]

Fliteline was duly incorporated, with professional assistance, by filing articles of incorporation. Fliteline has held corporate meetings of the shareholders and board of directors on an annual basis and has kept minutes of those meetings. Burrows personally typed the corporate minutes within one or two weeks of formal shareholder meetings and had Cottle sign them. Corporate tax returns and financial statements have been prepared annually by a certified public accountant that Fliteline has employed since its inception. Fliteline has issued 100,000 shares of stock to Burrows and Cottle in exchange for capital contributions of \$1 per share, the stock's par value. Cottle obtained 10,000 of his shares in exchange for an assignment of the license for the Reflex system, valued at \$10,000. These transactions were recorded in Fliteline's stock ledger and other corporate agreements. Neither Burrows nor Cottle has ever tried to conceal his ownership of the corporation.

[30]

In 1995 Burrows assisted Fliteline in obtaining a Small Business Administration loan, for which he provided the required personal guarantee. He has also obtained two company credit cards and Fliteline's building lease on his personal guarantee. Neither he nor Cottle has otherwise held himself out as liable for Fliteline's debts. Burrows has also loaned Fliteline \$103,500, for the purpose of allowing the company to maintain growth and survive downturns, as evidenced by promissory notes and as reflected in the corporate records.

[31]

Defendants also pointed out that Folger's allegations cite undercapitalization as the only basis for finding a unity of interest between them and Fliteline. However, even if she could prove that Fliteline was undercapitalized, that fact alone is insufficient to invoke application of the alter ego doctrine. It is, at best, merely a factor to be considered with all of the other evidence. (*Associated Vendors, Inc. v. Oakland Meat Co.*, supra, 210 Cal.App.2d at pp. 840-842.)

[32]

As to the second prong of the alter ego doctrine, injustice arising from maintenance of the separate corporate form, Folger's complaint alleged merely that Fliteline had no assets and no product liability insurance with which to pay off injured claimants. As stated above, difficulty in enforcing a judgment or collecting a debt does not support application of the alter ego doctrine. Rather, some conduct amounting to bad faith must be demonstrated. (*Sonora Diamond Corp. v. Superior Court*, supra, 83 Cal.App.4th at p. 539; *Associated Vendors, Inc. v. Oakland Meat Co.*, supra, 210 Cal.App.2d at p. 842.)

[33]

Defendants testified that Fliteline made efforts to obtain product liability insurance but was repeatedly advised that such insurance could not reasonably be obtained because of the nature of the business, manufacturing parachute gear. Product liability insurance in the sport parachuting industry is extremely rare due to unavailability and/or prohibitive cost. A top manufacturer of containers such as the Reflex has operated without product

liability insurance for at least 10 years. Thus, Defendants claim that Folger cannot prove they acted in bad faith.

[34]

This evidence is sufficient to demonstrate that Folger's alter ego theory has no merit because neither element can be established to the degree of proof that that would be required at trial. Defendants have thus met their burden.

[35]

In response, Folger argued that Defendants were friends and experienced skydivers who were solely responsible for the invention and development of the Reflex product and for Fliteline's incorporation and subsequent operation. However, she does not explain how these facts assist her case. No unity of interest between Defendants and Fliteline can be inferred from the fact that the owners and directors of the corporation were friends who developed a product that they wanted to produce and market. Indeed, as Defendants have observed, many companies start under similar circumstances. Were we to adopt Folger's position, we would virtually nullify the limited liability nature of closely held corporations.

[36]

She also claims that Fliteline was undercapitalized in that it was organized and carried on business in such a way that it was unlikely to have sufficient assets to meet its debts, particularly in that it had no product liability insurance and failed to reserve sufficient funds to self-insure. Fliteline's capital has grown increasingly negative over the years.

[37]

However, it is uncontradicted that Burrows's rudimentary finance plans projected that the company could be profitable in three to four years. Within two and one-half years of incorporation, Fliteline had obtained \$100,000 in exchange for 100,000 shares of stock. It had obtained additional amounts totaling in the area of \$200,000 in loans between the time of its incorporation and July 2000. Over its first five years of operation, from 1995 through 1999, Fliteline's sales averaged \$263,386 per year. These figures demonstrate that the amount of stock sold and money invested in the company was not negligible in comparison to the business being done.

[38]

Folger has produced no evidence, but only her unsupported conclusion that because Fliteline does not have enough assets to pay her should her product liability action be successful, it is undercapitalized. The fact that Fliteline is not yet profitable, and that Burrows's estimates were incorrect, does not lead to the conclusion that the company was undercapitalized in order to hide assets from potential future product liability claimants. Corporations can and do fail. It does not necessarily follow, in the absence of any showing of bad faith, that the shareholders, who presumably would have lost their capital investment, should also suffer the loss of liability protection provided by the corporate form.

[39]

Folger's assertion that Defendant's loans to Fliteline support application of the alter ego doctrine is similarly not tenable. Misconduct or injustice is not proved, even by many advances Burrows made for Fliteline's benefit, unless such advances are shown to have been made with a fraudulent or deceptive intent. Defendants did not expose themselves to liability for Fliteline's obligations when they contributed funds to it for the purpose of

assisting it in meeting its financial obligations and not for the purpose of perpetrating a fraud. (*Sonora Diamond Corp. v. Superior Court*, supra, 83 Cal.App.4th at p. 539.) Folger has produced no evidence tending to demonstrate that Defendants were motivated by any intent to defraud when making loans to Fliteline.

[40]

Folger further claims that Defendants disregarded legal and corporate formalities. She asserts that stock transactions were not documented as required by certain provisions of the Corporations Code and the California Code of Regulations. Further, Cottle was elected as a second director, when the bylaws allowed for a maximum of one director. The bylaws were not amended to allow an additional director. Most importantly, Folger claims that the annual minutes show that the board of directors abdicated responsibility for managing the affairs of the corporation since they demonstrate only that all of the officers' actions were ratified after the fact. She also criticizes the fact that Fliteline's directors met only once annually.

[41]

Even if we assume that all of these assertions are true, a proposition for which there is some doubt, Folger has failed to produce any evidence that tends to show a causal connection between Defendants' failure to observe these corporate formalities and her prospective inability to collect a judgment against the corporation. Absent such a showing, this evidence does not assist her in piercing the corporate veil. (*Cascade Energy and Metals Corp. v. Banks* (10th Cir. 1990) 896 F.2d 1557, 1578.) *fn2 Further, in light of the evidence in support of the legitimacy of the corporation, it cannot be reasonably inferred from the failure to observe the formalities alleged, that Defendants conducted themselves with an improper motive.

[42]

Folger insists that an improper motive or bad faith can be inferred from her evidence and that the trial court improperly resolved factual issues on summary judgment by choosing between competing inferences. We disagree. "[A] judgment may be supported by inference, but the inference must be a reasonable conclusion from the evidence and cannot be based upon suspicion, imagination, speculation, surmise, conjecture or guesswork. [Citation.] Thus, an inference cannot stand if it is unreasonable when viewed in light of the whole record. [Citation.] [Citation.] [A] trier of fact may not indulge in inferences rebutted by clear, positive and uncontradicted evidence. [Citation.]' [Citation.]" (*Western Digital Corp. v. Superior Court* (1998) 60 Cal.App.4th 1471, 1487.)

[43]

Finally, Folger asserted that Defendants had diverted corporate funds and/or assets to other than corporate uses. Since 1995, Fliteline has paid for all of Burrows's jumps. She claims that it is inconceivable that all of Burrows's jumps could have been made for a business purpose. Similarly, she claims that Defendants did not have a legitimate business reason to charge Fliteline with nearly \$700 for restaurant meals from May through December of 1995. However, she provides no factual basis for her claims that these were not legitimate business expenses. Without facts from which some reasonable inference might be made, her assertion is pure speculation that does not rise to the level of evidence. (*Hanson v. Lucky Stores, Inc.* (1999) 74 Cal.App.4th 215, 225 [speculation is not evidence and cannot defeat summary judgment].)

[44]

With respect to the second element required for the imposition of alter ego liability, Folger countered Defendants' showing with the assertion that she would receive no compensation for her husband's death unless Fliteline's corporate form was ignored by the court. This is the essence of her entire claim. As we have repeatedly stated above, such allegations are completely insufficient to satisfy the second prong for application of the alter ego doctrine. (*Sonora Diamond Corp. v. Superior Court*, supra, 83 Cal.App.4th at p. 539; *Associated Vendors, Inc. v. Oakland Meat Co.*, supra, 210 Cal.App.2d at p. 842.) The law specifically permits owners of a business to incorporate for the specific purpose of shielding themselves from its liabilities. (*Las Palmas Associates v. Las Palmas Center Associates* (1991) 235 Cal.App.3d 1220, 1249; *Cascade Energy and Metals Corp. v. Banks*, supra, 896 F.2d at p. 1578.) Thus, even if Folger had demonstrated a triable issue as to a unity of interest between Defendants and Fliteline, her failure to provide any evidence that Defendants improperly used the corporate form intending to deprive her of that to which she was entitled dooms her action against them. She has shown nothing more than that they have done what the law allows them to do.

[45]

Thus, Folger has failed to produce evidence of specific facts showing that a triable issue of material fact exists as to each element of her alter ego theory of liability. Under such circumstances we must affirm the summary judgment.

[46]

In addition to her evidentiary showing, Folger also makes a novel legal argument. She requests that we recognize and impose a new legal burden upon those that engage in the business of manufacturing products. Essentially, Folger urges that the public policy of this state, which strongly supports the imposition of strict liability on the manufacturers of defective products, mandates that manufacturers have sufficient assets to pay off any product liability claim as a prerequisite to doing business in a corporate form. The Legislature has seen fit to require insurance as a prerequisite to engaging in certain activities, for example driving a car (*Veh. Code*, § 16500), and employing persons (*Lab. Code*, § 3700). It has not, as far as we can discern, seen fit to require that product manufacturers maintain adequate insurance to pay potential product liability claims. It is not the province of this court to legislate. (*Williams v. California Physicians' Service* (1999) 72 Cal.App.4th 722, 731.) We will leave the myriad considerations involved in assessing the appropriateness of Folger's proposed rule to the branch of government more properly suited to such deliberations.

[47]

Disposition

[48]

The judgment is affirmed. Defendants to recover their costs on appeal.

[49]

NOT TO BE PUBLISHED

[50]

We concur:

[51]

HOLLENHORST, J.

[52]

GAUT, J.

Opinion Footnotes

[53]

*fn1 The original authorization, issued on October 13, 1995, misspelled the corporate name. Therefore a second authorization was issued on October 17, 1995.

[54]

*fn2 While Cascade Energy was decided under Utah law, the federal court observed that California's standard for piercing the corporate veil was not materially different from Utah's. (Cascade Energy and Metals Corp. v. Banks, *supra*, 896 F.2d at p.1575, fn. 18.)