

**PIERCING THE CORPORATE VEIL: THE UNIQUE
RELATIONSHIP OF A PARENT CORPORATION AND A
MAQUILADORA UNDER TEXAS LAW**

CARLOS RINCON

crin@delgadoacosta.com

DELGADO, ACOSTA, BRADEN & JONES, P.C.

221 North Kansas, Ste. 2000

El Paso, Texas 79901

(915) 544-9997

(915) 544-8544 (Fax)

ROBERTO J. CALVO

rcalvo@calvo.com.mx

CALVO, RENTERIA Y GONZALEZ, S.C.

Blvd. Tomas Fernandez 7930, Edificio B, Suite 309

Ciudad Juarez, Chihuahua, Mexico 32470

011-52-(656) 629-0677

1. Introduction

Along the United States/Mexico border, issues relating to the liability of parent corporations for the acts of their subsidiaries take on unique characteristics. The "Maquiladora" Program has promoted the proliferation of manufacturing assembly operations that typically operate as the wholly owned subsidiary of parent corporations from the United States, Europe or the Pacific Rim.¹ The majority of Maquiladora operations are located in the northern region of Mexico in the border cities of Tijuana, Cd. Juarez, Nuevo Laredo and Matamoros.² Because of location, the assembly operations are as a matter of course supported by administrative offices of the parent corporations; said offices located in the United States border cities of San Diego, El Paso, Laredo and Brownsville, respectively. To facilitate the provision of administrative support, the parent corporations deploy managers from their headquarters who are able to monitor the Mexican operations and serve as the communication conduit between the Mexican entity and the parent corporations.

The manner in which this monitoring takes place is at the cornerstone of the creation of a factual record that serves as the impetus of piercing the corporate veil of the parent entity. In the

¹ A Maquiladora must be a Mexican legal entity before applying for a Maquiladora Program. The most recommended (and most used) types of Mexican corporations are the Sociedad de Responsabilidad Limitada (S. de R.L) and the Sociedad Anonima (S.A.). The S. de R.L. is a closely held type of corporation while the S.A. is a stock corporation. The capital stock of these Mexican entities may be 100% foreign owned. The S. de R.L. and the S.A. can be managed by one or more persons. If the S. de R.L. is managed by one person, he or she is the General Manager. If, on the other hand, it is managed by several persons, they form a Management Board. If the S.A. is managed by one person, he or she is the Sole Administrator. If it is managed by several persons, they form the Board of Directors. A Maquiladora is subject to income tax, value added tax, and asset tax. The applicable income tax rate is 30% percent. The value added tax is 10% in the border region and 15% in the interior of Mexico and is payable by the maquiladora on all purchases of goods and services in Mexico. However, a 0% rate is applicable on all exports of the Maquiladora. The tax on assets is 1.8% on the average value of a company's assets during the tax year and can be off-set by income tax paid for the period. *The Mexican Maquiladora Industry Legal Framework*, Pasero Abogados, S.C., at <http://www.paseroabogados.com/maquiladoras3.html>.

² Mexico is a prime location for U.S. assembly activities abroad due to lower wages, utilities and overhead and the proximity to the U.S. Transportation costs from practically any location in continental U.S. to the Mexican border are lower than to almost any point overseas. The Maquiladora industry is Mexico's second largest industry. Gerard Morales et al., *An Overview of the Maquiladora Program*, (1994), U.S. Department of Labor, Bureau of International Labor Affairs (1994), at <http://www.dol.gov/ilab/media/reports/nao/maquilad.htm>.

typical scenario, the Maquiladora operation receives component parts from its parent entity, assembles those parts into a product and then ships the assembled product back to the parent. In so doing, the Maquiladora does not operate in the same manner as subsidiaries in other settings. In short, Maquiladoras receive 100% of their product orders from their parent entity and do not sell a product to third party customers nor develop a separate legal identity in the market place. In practice, Maquiladoras operate as off shore production facilities for the parent and have very little other role.

Additionally, the scope and extent of the discretion of Maquiladora management is usually limited by directive of the parent by pre-set caps in permissible expenditures, capital expenditures to increase output and capacity, hiring of employees, termination of mid to upper management employees and selection of outside contractors and vendors. Because of its relationship with the parent, the Maquiladora receives its entire operating budget from the parent and, as a result, the parent plays a significant role, if not assumes exclusive domain, over setting the operating budget for the Maquiladora.

In relation to limitations on authority and discretion, the structure of the management team for the Maquiladora is comprised of management representatives who are employees of the Mexican legal entity and are, most often than not, Mexican citizens, residing in Mexico who are bilingual in English and Spanish. The Mexican management personnel will also be assisted in the operation of the plant operations by the liaison management representative of the parent corporation. During a normal work week, the liaison for the parent will spend several hours each day at the Maquiladora. Close proximity between the Maquiladora plant and the parent support office in the U.S. lends itself to daily commuting. Organizational charts of the parent will in certain instances overlap with those of the Mexican subsidiary. With the stated purpose of the Maquiladora operation being an operations/production facility for the parent as opposed to a

subsidiary that operates as a division developing, marketing and manufacturing a unique product line, very little autonomy between the Maquiladora and parent exists.

In many instances, what drives the parent's decision to micro-manage the operations of the Maquiladora is the cultural, geographical, language, legal and political differences that are presented when operating a facility in a foreign country. These issues, if not properly managed, can defeat the beneficial purpose of creating the Maquiladora in the first place. Some of the most advantageous aspects of creating a Maquiladora, as discussed in footnote 2, are the labor cost savings of operating off shore in Mexico due to relatively low labor and the reduced transportation costs to ship raw materials, components, and finished products.

Furthermore, from both an internal and external vantage point, because the Maquiladora exists only to support the parent, the need for autonomy is not perceived. Driven by its desire to "manage" the various challenges confronting off shore operations, parent companies often create a factual record that lends support for the proposition that the parent and the Maquiladora are one in the same and that the acts of the Maquiladora are to be imputed to the parent. In other words, the corporate distinctions between the two separate corporations ought to be ignored and, in an appropriate setting, the corporate veil ought to be pierced.

These operation realities present legal challenges for parent entities when encountering allegations that the parent is legally responsible for the acts of its subsidiaries. What follows is an overview of the basic tenants of the law of piercing the corporate veil in Texas, a state which is directly impacted by the Maquiladora program.

2. The Law

Texas law adheres to the long standing principle that the corporate form normally insulates shareholders, officers and directors from liability for corporate obligations, but when these individuals abuse the corporate privilege, courts will disregard the corporate fiction and hold

them individually liable. *Gentry v. Credit Plan Corp. of Houston*, 528 S.W.2d 571, 573 (Tex. 1975). However, courts will disregard the corporate fiction, even though corporate formalities have been observed and corporate and individual property have been kept separately, when the corporate form has been used as part of a basically unfair device to achieve an inequitable result. *Bell Oil & Gas Co. v. Allied Chemical Corp.*, 431 S.W.2d 336, 340 (Tex. 1968). Disregarding the legal fiction of a corporate entity is an exception to the general rule which forbids disregarding corporate legal existence. *First Nat'l Bank in Canyon v. Gamble*, 132 S.W.2d 100, 119-20 (Tex. 1939). In *Castleberry v. Branscum*, the Texas Supreme Court summarized those instances where the corporate fiction would be disregarded as follows:

- (1) When the fiction is used as a means of perpetrating a fraud;
- (2) Where a corporation is organized and operated as a mere tool or business conduit of another corporation;
- (3) Where the corporate fiction is resorted to as a means of evading an existing legal obligation;
- (4) Where the corporate fiction is employed to achieve or perpetuate a monopoly;
- (5) Where the corporate fiction is used to circumvent a statute; and
- (6) Where the corporate fiction is relied upon as a protection of crime or to justify wrong.

Castleberry v. Branscum, 721 S.W.2d 270, 272 (Tex. 1986).

While there are other bases to disregard the corporate fiction,³ alter ego applies when there is such unity between corporation and individual that the separateness of the corporation has ceased and holding only the corporation liable would result in injustice. *Id.*

³ For instance, the court in *Castleberry* noted the following four doctrines besides disregarding the corporate fiction have been used in similar cases: fraudulent conveyance, Tex. Bus. & Comm. Code ch. 24 (Vernon Supp. 1986) and *Texas Sand Co. v. Shield*, 381 S.W.2d 48, 52-53 (Tex. 1964); the trust fund doctrine, *Henry I. Siegel Co., Inc. v. Holliday*, 663 S.W.2d 824 (Tex. 1984); breach of fiduciary duties, *International Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 577 (Tex. 1963); and the denuding theory, *World Broad. Sys., Inc. v. Bass*, 328 S.W.2d 863, 866 (Tex. 1959). *Castleberry*, 721 S.W.2d at 272 n.1. These four doctrines and disregarding the corporate fiction have

Factors that are weighed in determining whether alter ego applies include the total dealings of the corporation and the individual, including the degree to which corporate formalities have been followed and corporate and individual property have been kept separately, the amount of financial interest, ownership and control the individual maintains over the corporation, and whether the corporation has been used for personal purposes. *Castleberry*, 721 S.W.2d at 272. *But see* TEX. BUS. CORP. ACT art. 2.21 (A)(3) (Vernon 2004) (stating that the failure of the corporation to observe a corporate formality is no longer a ground for piercing the corporate veil). The *Castleberry* Court went on to hold that the rationale of alter ego is this: “if the shareholders themselves disregard the separation of the corporate enterprise, the law will also disregard it so far as necessary to protect individual and corporate creditors.” *Castleberry*, 721 S.W.2d at 272 (citing BALLANTINE, CORPORATIONS § 123 at 294). Said differently, the corporate entity of the subsidiary must have been used to “bring about results which are condemned by the general statements of public policy which are enunciated by the courts as ‘rules’ which determine whether the courts will recognize their own child. *Roylex Inc. v. Langson Brothers Construction Co.*, 585 S.W.2d 768, 772 (Tex. Civ. App. - Houston [1st Dist.] 1979, writ ref’d n.r.e.).

The type of proof needed to satisfy the plaintiff’s burden in an alter ego case varies depending on whether the underlying cause of action is for breach of contract or tort. *Lucas v. Texas Indus., Inc.*, 696 S.W.2d 372, 375 (Tex. 1984). Courts have generally been less reluctant to disregard the corporate entity in tort cases than in breach of contract cases. *Id.* That notwithstanding, to prove there has been a sham to perpetrate a fraud, tort claimants and contract creditors must show only constructive fraud. *Castleberry*, 721 S.W.2d at 273. Actual fraud and

different elements and remedies, and they protect different parties and interests at different times; but they serve very similar ideals and principles. *Id.* In practice, the doctrine of disregarding the corporate fiction functions to “loosen up the level of proof and the atomistic nature of the analyses required in a fraudulent conveyance action explicitly denominated as such.” *Id.* (quoting R.Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 HARV. L. REV. 505, 552).

constructive fraud are distinguished from one another. Actual fraud usually involves dishonesty of purpose or intent to deceive, whereas constructive fraud is the breach of some legal or equitable duty which, irrespective of moral guilt, the law declares fraudulent because of its tendency to deceive others to violate confidence, or to injure public interests. *Castleberry*, 721 S.W.2d at 273. Since disregarding the corporate fiction is an equitable doctrine, Texas courts adopt a flexible fact-specific approach focusing on equity when weighing these factors. *Gentry*, 528 S.W.2d at 575. Under this approach, when the facts are such that adherence to the fiction would promote injustice and lead to an inequitable result, courts will disregard the corporate fiction. *Castleberry*, 721 S.W.2d at 273. Quoting Dean Hildrebrand, a leading expert on Texas corporation law, the *Castleberry* Court went on to explain the equitable approach as follows: “When this [disregarding the corporate fiction] should be done is a question of fact and common sense. The court must weigh the facts and circumstances in each case carefully, and common sense and justice must determine [its] decision.” *Id.*

3. Disregarding the Corporate Fiction

As described above, the structure of the operation between the parent and the Maquiladora is such that to a lay jury, evaluating whether alter ego applies, could easily be confused into answering that question in the affirmative. The exclusive relationship of the Maquiladora to its parent and the lack of independent discretion of the Maquiladora lead the way as the most potentially problematic aspects of having the distinct legal corporate fictions of the Maquiladora and parent recognized.

In this relationship, the liaison management representative of the parent corporation will often maintain an office within the Maquiladora plant. In some situations, parents and Maquiladoras have shared managers who have dual employment capacities, both in the U.S and Mexico. The practice of dual capacity employees is obviously ill advised and can be a lightning

rod to blur the distinction between corporate entities. Surprisingly, it the experience of this author that the practice of dual capacity employees in managerial positions is more common than one would expect. Other factors such as utilizing separate stationary, maintaining separate phone numbers and ignoring tradename distinctions between the parent and the Maquiladora lend fodder to the contention that alter ego applies. While the parent and Maquiladora will have separate bank accounts, because the Maquiladora is created only to assemble components and materials and ship them back to the parent, the necessity of the Maquiladora to be title owner to much property outside the wares of the facility is unlikely. Additionally, the illusion of separate bank accounts is distorted by the customary practice of the parent corporation controlling the funds of the Maquiladora on a daily or weekly basis. Further, the only contracts a Maquiladora is likely to enter into in its own name would be with vendors and potentially as leaseholder for the physical plant that serves to host its operations.

4. Conclusion

In the author's experience, the majority of instances where parent corporations face the allegation that a Maquiladora operation is their alter ego arises in the tort arena where an employee of the Maquiladora is injured or where a third party is injured by an employee of the Maquiladora. In such cases, the injured party will bring such claims in the United States in order to avail themselves of more generous damage prospects and the right to a trial by jury. Such actions are almost always met with a motion to dismiss based on forum non conveniens or some other type of jurisdictional type challenge; however, many times efforts to dispose of such claims as a matter of law are unsuccessful.

Furthermore, because of the fact that claims or suits arising from this fact pattern will inherently occur in Mexico, prospective claimants looking to pursue the parent have to first establish that the law of the corresponding state within the United States should apply, as

opposed to the law of Mexico. Under Mexican law, the concept of piercing the corporate veil is virtually unheard of.⁴ Consequently, to the extent one desires to pierce the corporate veil of a Mexican corporation, a litigant needs to look at other jurisdictions, like the United States, where a court, under the appropriate circumstances and applying the applicable law, will pierce the corporate veil.

If it is determined that suit will be maintainable in the U.S. and be governed by the law of a particular U.S. state, then such claimant will assert a variety of different theories in an effort to hold the parent liable for what may have transpired in Mexico in connection with the Maquiladora operations. As discussed in footnote 3, in addition to the various forms of attempting to have a court ignore a corporate fiction, there are theories of direct liability against the parent for assumption of duties that are not otherwise theirs. The same evidence of control

⁴ Below are references to the General Law of Commercial Companies, a Mexican statute, setting forth the general principle that shareholders of a corporation are shielded from liability and, to the extent they face any liability, such liability is limited to their investment in the corporation. The provisions of this statute do not allow a litigant to pierce the corporate veil and hold shareholders individually liable.

Article 2 – Mercantile companies when recorded in the Public Registry of Commerce become legal entities independent from that of their constituent associates.

Article 24 – Judicial decisions passed against a company condemning it to meet obligations toward a third party, shall have the full force and effect of a decision in judgment against the associates, if the suit was instituted against both them and the company. Under such circumstances, the judgment shall first be executed on property of the company, and only if there be no property or it be insufficient, shall the judgment be executed on property of the associates against whom action was entered. Whenever the liability of the associates is limited to the payment or their contributions to the capital equity, the judgment shall only be executed up to the unpaid amount, of such equity contributions.

Article 58 – Limited liability companies are those formed by associates whose obligations are limited to the payment of their contributions to the capital equity, but where the equity contributions may not be represented by negotiable certificates, whether nominal or to the bearer, since such contributions may only be transferable in the cases and with the requisites set forth in this law.

Article 87 – A Corporation (Sociedad Anónima) is that which exists under a company name and is formed exclusively by stockholders whose liability is limited to paying for their shares of stock.

that is relied upon on the alter ego theory will be relied upon to make a case under Restatement Second of Torts Section 324A.⁵

In sum, the potential liability issues that may have to be contended with by the parent of a Mexican Subsidiary - Maquiladora are diverse. By keeping in mind the unique features of the parent/Maquiladora relationship and the basic tenants of alter ego liability in Texas, parent corporations participating in this arena would be well served to carefully evaluate what they can do to minimize potential exposure in this regard. Beginning with creating a documented record that can be followed by laypersons that keeps and operates separate corporations separately is a goal worthy of achieving.

⁵ Section 324A states: One who undertakes, gratuitously or for consideration, to render services to another which he should recognize as necessary for the protection of a third person or his things, is subject to liability to the third person for physical harm resulting from his failure to exercise reasonable care to protect his undertaking if:

- (a) his failure to exercise reasonable care increases the risk of such harm, or
- (b) he has undertaken to perform a duty by the other to the third person, or
- (c) the harm is suffered because of reliance of the other or the third person upon the undertaking.

RESTATEMENT (SECOND) OF TORT § 324A (1965).