

# COMMENTS

## *C.F. TRUST, INC. v. FIRST FLIGHT LIMITED PARTNERSHIP:* WILL THE VIRGINIA SUPREME COURT PERMIT OUTSIDER REVERSE VEIL-PIERCING AGAINST A LIMITED PARTNERSHIP?

### ABSTRACT

*This comment analyzes the Fourth Circuit's opinion in C.F. Trust, Inc. v. First Flight Limited Partnership. In particular, the author discusses whether the Virginia Supreme Court will recognize the doctrine of outsider reverse veil-piercing in the commercial context and apply it to a limited partnership. The author reviews and evaluates the characteristics of traditional veil-piercing and outsider reverse veil-piercing, as well as Virginia common law and the Virginia Revised Uniform Limited Partnership Act. Noting that Virginia law recognizes the doctrine of outsider reverse veil-piercing and will apply the doctrine under exceptional circumstances, the author concludes that the specific facts involved in C.F. Trust, Inc. call for the equitable remedy to be utilized by the Virginia Supreme Court.*

### I. INTRODUCTION

This comment considers whether the Virginia Supreme Court will recognize the doctrine of outsider reverse veil-piercing in the commercial context and apply it to, not only a corporation, but also to a limited partnership where the limited partner is truly the alter-ego of the limited partnership. In *C.F. Trust, Inc. v. First Flight Limited Partnership*,<sup>1</sup> the United States District Court for the Eastern District of Virginia found that Virginia law permitted the veil of limited partnerships to be pierced.<sup>2</sup> The court also held that Virginia has recognized a cause of action for outsider reverse piercing, provided the plaintiff can establish the requisite grounds required under the traditional veil-piercing doctrine.<sup>3</sup> On appeal, however, the United States Court of Appeals for the Fourth Circuit was not convinced after a review of the applicable Virginia authorities that Virginia

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<sup>1</sup>*C.F. Trust, Inc. v. First Flight Ltd. P'ship*, 111 F. Supp. 2d 734 (E.D. Va. 2000), *findings of fact/conclusions of law* at 140 F. Supp. 2d 628 (E.D. Va. 2001), *questions certified* by 301 F.3d 187 (4th Cir.), *modified by*, 306 F.3d 126 (4th Cir. 2002).

<sup>2</sup>*Id.* at 740.

<sup>3</sup>*Id.* at 740-41.

would permit a reverse veil-piercing claim in a commercial case against a limited partnership.<sup>4</sup> Accordingly, the court of appeals certified the question to the Supreme Court of Virginia to determine whether Virginia law would allow such reverse veil-piercing.<sup>5</sup>

A traditional veil-piercing claim involves a creditor of a corporation seeking access to the assets of a corporate shareholder or director to satisfy a corporate debt.<sup>6</sup> Outsider reverse veil-piercing, however, permits an individual's creditor to pierce the veil in reverse to satisfy the debts of the *individual* out of the corporation's assets.<sup>7</sup> The Virginia courts do not lightly disregard the corporate veil,<sup>8</sup> and opine that piercing the corporate veil is an "extraordinary" remedy, permitted only in exceptional circumstances when "necessary to promote justice."<sup>9</sup>

Part II of this comment provides an overview of the traditional veil-piercing doctrine under Virginia law and examines the growing recognition of the doctrine of reverse piercing throughout the country. Part II also sets forth the relevant provisions of the Virginia Revised Uniform Limited Partnership Act (VRULPA)<sup>10</sup> which governs the liability of limited partnerships. Part III analyzes both the district court and court of appeals' decisions and their outcomes. Finally, Part IV evaluates the judicial state of the law, its application to the *C.F. Trust* case, and predicts that it is likely that the Virginia Supreme Court will recognize a reverse piercing cause of action.

## II. BACKGROUND

### A. *Traditional Veil-Piercing: An Overview of the Alter Ego Doctrine under Virginia Law*

Virginia courts have long recognized the doctrine of traditional veil-piercing as an "extraordinary" exception to the general rule that "a corporation is a legal entity entirely separate and distinct from [its]

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<sup>4</sup>*C.F. Trust, Inc. v. First Flight Ltd. P'ship*, 306 F.3d 126, 141 (4th Cir.), *modifying*, 301 F.3d 187 (4th Cir. 2002)

<sup>5</sup>*Id.*

<sup>6</sup>*Id.* at 134.

<sup>7</sup>*Id.* (citing *Goya Foods, Inc. v. Unanue*, 233 F.3d 38, 43 (1st Cir. 2000), *cert. denied*, 532 U.S. 1022 (2001)).

<sup>8</sup>*See, e.g., Cheadle v. Rudd's Swimming Pool Supply Co.*, 360 S.E.2d 828, 831 (Va. 1987).

<sup>9</sup>*Id.*

<sup>10</sup>V.A. CODE ANN. §§ 50-73.1 to 50-73.78 (LexisNexis 2002).

shareholders or members."<sup>11</sup> Piercing the corporate veil is only allowed in circumstances which demand the promotion of justice.<sup>12</sup> The Virginia Supreme Court has held that veil-piercing "is justified when the unity of interest and ownership is such that the separate personalities of the corporation and the individual no longer exist and to adhere to that separateness would work an injustice."<sup>13</sup>

Although Virginia law does not apply any single rule or criterion to determine whether to pierce the corporate veil,<sup>14</sup> the Virginia courts will normally disregard the corporate form if the party seeking to pierce can establish: (1) that the corporate entity is the "alter ego, alias, stooge, or dummy of the individual[]"<sup>15</sup> or entity and (2) that the individual or entity has "controlled or used the corporation to evade a personal obligation, to perpetuate fraud or a crime, to commit an injustice, or to gain an unfair advantage."<sup>16</sup> There are several factors Virginia law recognizes as possibly denoting control and unity of interest.<sup>17</sup> Those factors are: (1) whether business and personal assets were commingled, (2) whether the individual siphoned corporate assets for personal use, (3) whether corporate formalities were observed,<sup>18</sup> or (4) whether the business entity was undercapitalized.<sup>19</sup>

A mere showing that the corporation was the alter ego of the shareholder, however, is insufficient to justify piercing the corporate veil.<sup>20</sup> Virginia also requires evidence of fraud or a legal wrong as a requisite to recovery.<sup>21</sup> Thus, to prevail on a traditional veil-piercing claim, the

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<sup>11</sup>*Cheatle*, 360 S.E.2d at 831.

<sup>12</sup>*Beale v. Kappa Alpha Order*, 64 S.E.2d 789, 797-98 (Va. 1951).

<sup>13</sup>*O'Hazza v. Executive Credit Corp.*, 431 S.E.2d 318, 320-21 (Va. 1993).

<sup>14</sup>*Id.* at 320.

<sup>15</sup>*Cheatle*, 360 S.E.2d at 831; *see also* *Lewis Trucking Corp. v. Commonwealth*, 147 S.E.2d 747, 753 (Va. 1966) (agreeing that the corporate veil can be pierced when a corporation is merely a sham used to protect fraud).

<sup>16</sup>*O'Hazza*, 431 S.E.2d at 320.

<sup>17</sup>*C.F. Trust, Inc. v. First Flight Ltd. P'ship*, 140 F. Supp. 2d 628, 643 (E.D. Va. 2001), *questions certified* by 301 F.3d 187 (4th Cir.), *modified by*, 306 F.3d 126 (4th Cir. 2002).

<sup>18</sup>*See Cheatle*, 360 S.E.2d at 831.

<sup>19</sup>*O'Hazza*, 431 S.E.2d at 320-21.

<sup>20</sup>*See Beale v. Kappa Alpha Order*, 64 S.E.2d 789, 797-98 (Va. 1951).

<sup>21</sup>*See Cheatle*, 360 S.E.2d at 831; *Beale*, 64 S.E.2d at 797-98. *See also* *Perpetual Real Estate Servs., Inc. v. Michaelson Prop., Inc.*, 974 F.2d 545, 548 (4th Cir. 1992) (requiring proof that the defendant used the corporation to "disguise" some legal "wrong"); *O'Hazza*, 431 S.E.2d at 320 (stating that a shareholder could be liable if he used the corporation to "evade a personal obligation").

plaintiff must establish that "the corporation was a device or sham used to disguise wrongs, obscure fraud, or conceal crime."<sup>22</sup>

The decision to disregard the corporate entity is a fact-specific determination, requiring an examination of the totality of the circumstances surrounding the corporation and the acts in question,<sup>23</sup> with the burden of proof resting upon the party seeking to pierce the veil.<sup>24</sup> Thus, whether a corporation will be regarded as the "adjunct, creature, instrumentality, device, stooge, or dummy of another . . . is usually held to be a question of fact in each case."<sup>25</sup> The Virginia courts will only pierce the corporate veil "when one is used to defeat public convenience, justify wrongs, protect fraud or crime of the other."<sup>26</sup> Moreover, in cases involving one-man corporations or a corporation where all or a majority of the stock is owned by a single individual, the Virginia courts have willingly disregarded the corporate form, declaring "the sole shareholder and the corporation to be one and the same."<sup>27</sup>

### B. *Outsider Reverse Veil-Piercing*

Where traditional veil-piercing involves holding the corporate owners liable for the debts of the corporate entity, reverse veil-piercing involves holding the corporate entity liable for the personal debts of its owners based upon a showing that the corporate entity is really the alter ego of the individual owner(s).<sup>28</sup> Reverse piercing has been applied in two distinct situations.<sup>29</sup> The most common reverse pierce cases involve "insider" reverse piercing claims. Such claims involve a dominant shareholder or other controlling insider who "attempts to have the corporate entity disregarded to avail the insider of corporate claims against third parties or to bring corporate assets under the shelter of protection from

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<sup>22</sup>*Cheatle*, 360 S.E.2d at 831.

<sup>23</sup>*Greenberg v. Commonwealth*, 499 S.E.2d 266, 272 (Va. 1998); *O'Hazza*, 431 S.E.2d at 320-21.

<sup>24</sup>See *Cheatle*, 360 S.E.2d at 831 (stating that whether the corporate entity can be disregarded depends on resolutions of questions of fact and the burden of proof is upon the party who seeks to pierce).

<sup>25</sup>*Beale*, 64 S.E.2d at 798 (quoting *State v. Swift & Co.*, 187 S.W.2d 127, 133 (Tex. Civ. App. 1945)).

<sup>26</sup>*Id.*

<sup>27</sup>*Lewis Trucking Corp. v. Commonwealth*, 147 S.E.2d 747, 753 (Va. 1966) (citations omitted).

<sup>28</sup>See generally Gregory S. Crespi, *The Reverse Pierce Doctrine: Applying Appropriate Standards*, 16 J. CORP. L. 33, 34-37 (1990) (examining case law on outsider reverse veil-piercing).

<sup>29</sup>*Id.* at 37.

third party claims that are available only for assets owned by the insider."<sup>30</sup> Other reverse piercing cases, however, involve "outsider" reverse piercing claims where third party claimants or judgment creditors with claims against a corporate insider attempt to disregard the corporate entity to reach the assets of the corporation to satisfy those claims.<sup>31</sup>

Virginia courts have never directly addressed the issue of outsider reverse piercing. Many other jurisdictions, however, have considered the issue and allowed such piercing.<sup>32</sup> In fact, "[m]any jurisdictions recognize that the same considerations that justify piercing the corporate veil may justify piercing the veil in 'reverse.'"<sup>33</sup> Specifically, the jurisdictions that have allowed reverse veil-piercing claims recognize the remedy as an appropriate vehicle "to prevent fraud or to achieve equity."<sup>34</sup> For example, in *Select Creations, Inc. v. Paliafito Amercia, Inc.*,<sup>35</sup> the court declared, "It is particularly appropriate to apply the alter ego doctrine in 'reverse' when the controlling party uses the controlled entity to hide assets or secretly to conduct business to avoid the *pre-existing liability* of the controlling party."<sup>36</sup> Moreover, as the Supreme Court of Vermont explained in *Winey v. Cutler*,<sup>37</sup> "[a]lthough one purpose of corporation law is to limit

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<sup>30</sup>*Id.*

<sup>31</sup>*Id.* at 55-56.

<sup>32</sup>*See, e.g.,* *Goya Foods, Inc. v. Unanue*, 233 F.3d 38, 44 (1st Cir. 2000), *cert. denied*, 532 U.S. 1022 (2001) (applying New York law); *Select Creations, Inc. v. Paliafito Am., Inc.*, 852 F. Supp. 740, 774-76 (E.D. Wis. 1994) (applying both California and Tennessee law); *Shamrock Oil & Gas Co. v. Ethridge*, 159 F. Supp. 693, 698 (D. Colo. 1958); *Minich v. Gem State Developers, Inc.*, 591 P.2d 1078, 1083-84 (Idaho 1979); *Central Nat'l Bank & Trust Co. of Des Moines v. Wagener*, 183 N.W.2d 678, 682 (Iowa 1971); *LFC Mktg. Group, Inc. v. Loomis*, 8 P.3d 841, 846-47 (Nev. 2000); *State v. Easton*, 647 N.Y.S.2d 904, 909-10 (Sup. Ct. 1995); *Winey v. Cutler*, 678 A.2d 1261, 1262-63 (Vt. 1996); *Olen v. Phelps*, 546 N.W.2d 176, 181 (Wis. Ct. App. 1996). *Cf. Litchfield Asset Mgmt. Corp. v. Howell*, 799 A.2d 298, 316 (Conn. App. Ct.), *appeal denied*, 806 A.2d 49 (Conn. 2002) (upholding lower court's decision to disregard structures of two limited liability companies so as to hold them liable for personal debt of owner).

<sup>33</sup>1 WILLIAM MEADE FLETCHER ET AL., *FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 41.70, at 685 (perm. ed., rev. vol. 1999). *See also* *Goya Foods*, 233 F.3d at 43; *Zahra Spiritual Trust v. United States*, 910 F.2d 240, 243-45 (5th Cir. 1990) (applying Texas law); *LFC Mktg. Group*, 8 P.3d at 846 (concluding that both types have the "goal of preventing abuse in the corporate form").

<sup>34</sup>*Litchfield Asset Mgmt.*, 799 A.2d at 311. *See also* *Easton*, 647 N.Y.S.2d at 909 (stating that "justice requires that the principles of 'traditional' piercing not be withheld from this case involving 'reverse' piercing"); *Lambert v. Farmers Bank*, 519 N.E.2d 745, 747 (Ind. Ct. App. 1988) (allowing the separate existence of a corporation to be "disregarded to prevent injustice when a third party transacts business with an individual who fraudulently uses a corporation as a shield from liability").

<sup>35</sup>852 F. Supp. 740 (E.D. Wis. 1994).

<sup>36</sup>*Id.* at 774 (emphasis added).

<sup>37</sup>678 A.2d 1261 (Vt. 1996).

shareholders' liability for corporate debts . . . corporations are not intended to be used to shelter the assets of shareholders from lawful claims of judgment creditors."<sup>38</sup> Thus, outsider reverse veil-piercing has been deemed "appropriate in those limited instances where the particular facts and equities show the existence of an alter ego relationship and require that the corporate fiction be ignored so that justice may be promoted."<sup>39</sup>

Conceptually, outsider reverse veil-piercing is consistent with traditional veil-piercing because both are used to prevent abuse of the corporate form. In fact, most courts in recognizing that they are dealing with a "reverse pierce" concept, apply the traditional veil-piercing elements of: (1) unity of interest which (2) results in fraud, injustice or inequity, to determine whether a corporate disregard in reverse is justified. While the doctrine of reverse piercing is growing in recognition, "some courts will recognize a 'reverse pierce' of the corporate veil only under very limited circumstances."<sup>40</sup> As Judge Learned Hand recognized in *Kingston Dry Dock Co. v. Lake Champlain Transportation Co.*,<sup>41</sup> the circumstances allowing an outsider reverse veil-pierce are "extremely rare."<sup>42</sup> In rejecting reverse veil-piercing claims, a concern has been that where the corporation has "other non-culpable shareholders," those shareholders will be unfairly prejudiced when assets in which they have any interest are attached by the outsider to satisfy its claim against the wrongdoing insider.<sup>43</sup>

[A] necessary element of the [alter ego] theory is that the fraud or inequity sought to be eliminated must be that of the party against whom the doctrine is invoked, and such party must have been an actor in the course of conduct constituting the abuse of corporate privilege—the doctrine cannot be applied to prejudice the rights of an innocent third party.<sup>44</sup>

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<sup>38</sup>*Id.* at 1262.

<sup>39</sup>LFC Mktg. Group, Inc. v. Loomis, 8 P.3d 841, 846 (Nev. 2000).

<sup>40</sup>1 FLETCHER ET AL., *supra* note 33, § 41.70, at 685. See also *Roepke v. Western Nat'l Mut. Ins. Co.*, 302 N.W.2d 350, 353 (Minn. 1981) (recognizing that a reverse pierce would not be permitted where a shareholder or creditor would be adversely affected).

<sup>41</sup>31 F.2d 265 (2d Cir. 1929). *Kingston Dry Dock Co.* is the earliest case to discuss an outsider reverse piercing claim. Crespi, *supra* note 28, at 56.

<sup>42</sup>*Kingston Dry Dock Co.*, 31 F.2d at 267.

<sup>43</sup>*Cascade Energy & Metals Corp. v. Banks*, 896 F.2d 1557, 1577 (10th Cir. 1990). See also *Floyd v. Internal Revenue Serv.*, 151 F.3d 1295, 1299 (10th Cir. 1998) (recognizing that a reverse piercing theory may unfairly prejudice innocent shareholders and harm a corporation's ability to raise credit).

<sup>44</sup>*Cascade Energy & Metals Corp.*, 896 F.2d at 1577 (alternation in original) (emphasis added) (quoting 1 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 41.20 at 413 (1988 Supp.)).

As the court recognized in *Floyd v. Internal Revenue Service*, however, "the problems associated with reverse-piercing may be viewed as less serious in cases where a corporation is controlled by a single shareholder . . . [and thus] no third-party shareholders to be unfairly prejudiced by disregarding the corporate form."<sup>45</sup>

Despite these reservations, reverse veil-piercing has been applied in various contexts. It has been applied in probate proceedings,<sup>46</sup> bankruptcy proceedings,<sup>47</sup> in the context of prejudgment attachment,<sup>48</sup> and in tax liability cases.<sup>49</sup> State courts, including Virginia, have also used reverse piercing in the domestic relations context.<sup>50</sup> Those courts that have refused to pierce the corporate veil in reverse, however, have done so, not because they reject outsider veil-piercing per se, but because the facts of the given case were not sufficient to justify traditional veil-piercing let alone reverse veil-piercing.<sup>51</sup>

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<sup>45</sup>*Floyd*, 151 F.3d at 1300.

<sup>46</sup>See *Roepke v. Western Nat'l Mut. Ins. Co.*, 302 N.W.2d 350, 352 (Minn. 1981) (allowing the reverse pierce of the corporate veil where decedent was the president and sole shareholder of the corporation and no shareholder or creditor would be adversely affected).

<sup>47</sup>See *Smith v. Richels (In re Richels)*, 163 B.R. 760, 764 (Bankr. E.D. Va. 1994) (applying Virginia law) (holding that under certain circumstances reverse piercing of the corporate veil may be justified to eliminate or minimize "wrongdoing of the party against whom the doctrine is invoked").

<sup>48</sup>See *Estudios, Proyectos E Inversiones De Centro Am., S.A. (Epica) v. Swiss Bank Corp.*, 507 So.2d 1119 (Fla. Dist. Ct. App. 1987) (holding that "once a sufficient showing has been made that the corporation is the alter ego of the debtor . . . its property may be attached to ensure that the final judgment will be satisfied should the creditor ultimately prevail).

<sup>49</sup>See *Zahra Spiritual Trust v. United States*, 910 F.2d 240, 244 (5th Cir. 1990) (citing two cases which held corporations liable for the taxpayer's personal obligations).

<sup>50</sup>See *Zisblatt v. Zisblatt*, 693 S.W.2d 944 (Tex. Ct. App. 1985) (allowing a wife to assert reverse piercing claim to attach assets of corporation partially owned by her husband in controversy over whether assets were divisible community property); *Fox v. Fox*, Nos. 0721-97-4 & 1094-97-4, 1998 Va. App. LEXIS 157 (Va. Ct. App. Mar. 17, 1998) (allowing a wife to reach the assets of a corporation owned by her husband when the husband was the sole shareholder and used the corporations to defraud and hide the assets from both his wife and taxing authorities); *Stainback v. Stainback*, 396 S.E.2d 686, 692-93 (Va. Ct. App. 1990) (expressly approving the use of outsider reverse veil-piercing in a divorce proceeding and upholding trial court's finding that a corporation, formed by the husband and his father, whose assets consisted exclusively of artwork created by the husband, was the husband's alter ego).

<sup>51</sup>See *American Fuel Corp. v. Utah Energy Dev. Co.*, 122 F.3d 130, 134-35 (2d Cir. 1997) (although recognizing that "reverse piercing" was a valid claim, the facts were insufficient to meet either test for piercing the corporate veil under New York law); *Thomsen Family Trust v. Peterson Family Enters., Inc.*, 989 S.W.2d 934, 937 (Ark. Ct. App. 1999) (finding no evidence to warrant disregarding the corporate form in reverse); *Plaza Prop., Ltd. v. Prime Bus. Invs., Inc.*, 524 S.E.2d 306, 310 (Ga. Ct. App. 1999), *aff'd*, 538 S.E.2d 51 (Ga. 2000) (holding that the court did not need to consider whether piercing the corporate veil may be applied in reverse because the theory was not raised in the trial court, and even if it were applicable, there was no evidence of abuse to support reverse piercing the corporate veil).

### C. *The Virginia Limited Partnership*

Similar to a corporation, a limited partnership is a business entity separate from its members created under state statutory law.<sup>52</sup> A limited partnership is comprised of one or more general partners and one or more limited partners.<sup>53</sup> Distinguished from general partners who manage the business and have unlimited liability, limited partners closely resemble shareholders of a corporation, in that a limited partner does not participate in the management and are generally liable only to the extent of their contributions.<sup>54</sup> Moreover, a limited partnership's debts, like that of a corporation, are generally not the personal liability of the limited partners.<sup>55</sup> "The reverse also holds true; limited partnerships and corporations generally bear no responsibility for the liabilities of limited partners or corporate shareholders."<sup>56</sup>

There are, however, exceptions to these general rules. Under the VRULPA,<sup>57</sup> a limited partner may be held liable for the obligations of a limited partnership if the limited partner is also a general partner or, if the limited partner participates in the control of the business.<sup>58</sup> A limited partner in control, however, is liable only to those "persons who transact business with the limited partnership reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner."<sup>59</sup> While the VRULPA sets forth the circumstances which do *not* constitute participation in control,<sup>60</sup> it does not affirmatively state what *does* constitute control.<sup>61</sup> Therefore, caselaw is used to determine the requisite control.<sup>62</sup> In fact,

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<sup>52</sup>See Virginia Revised Uniform Limited Partnership Act, VA. CODE ANN. § 50-73.1 (LexisNexis 2002).

<sup>53</sup>*Id.*

<sup>54</sup>*Estate of Godley v. Comm'r of Internal Revenue*, 286 F.3d 210, 215 (4th Cir. 2002); *First Union Nat'l Bank v. Allen Lorey Family Ltd. P'ship*, 34 Va. Cir. 474, 475 (Va. Cir. Ct. 1994); *Kumar v. Metro. Hosp., L.P.*, 30 Va. Cir. 226, 228 (Va. Cir. Ct. 1993).

<sup>55</sup>*Sloan v. Thornton*, 457 S.E.2d 60, 61 (Va. 1995).

<sup>56</sup>*C.F. Trust, Inc. v. First Flight Ltd. P'ship*, 306 F.3d 126, 139 (4th Cir.), *modifying* 301 F.3d 187 (4th Cir. 2002).

<sup>57</sup>VA. CODE ANN. §§ 50-73.1 to 50-73.78 (LexisNexis 2002).

<sup>58</sup>*Id.* § 50-73.24(A).

<sup>59</sup>*Id.*

<sup>60</sup>*Id.* § 50-73.24(B).

<sup>61</sup>See Stephen G. Christianson, *Piercing the Limited Partner Veil*, 30 AM. JUR. PROOF OF FACTS 3D 249, 257 (1995).

<sup>62</sup>*Id.*

[t]he circumstances under which a limited partner may be liable to third parties is similar to that principle of corporate law called "piercing the corporate veil." . . . [M]any courts draw upon case law concerning corporations in deciding limited partner litigation. It is not uncommon for such litigation to involve business transactions concerning both corporations and limited partnerships, which may have the effect of encouraging a court to look to case law involving corporations in analyzing limited partner liability.<sup>63</sup>

Determining whether a limited partner has the sufficient amount of control under VRULPA is a question of fact.<sup>64</sup> Thus, "in the absence of statutory guidance, the courts are largely free to draw upon the much older and well-established body of corporate veil piercing decisions" to determine the liability of a limited partner.<sup>65</sup>

The extent of a limited partner's participation in the control of the business was addressed in two related Virginia Court of Appeals cases. In *Fox v. Fox*,<sup>66</sup> the court permitted an outsider reverse veil-piercing claim against a limited partnership by upholding the trial court's decision.<sup>67</sup> The defendant, Dr. Fox, utilized a scheme to defraud his wife of marital assets through the use of a series of limited partnerships.<sup>68</sup> The court concluded, "The various entities and Dr. Fox shared a unity of interest and ownership, such that their separate personalities no longer existed."<sup>69</sup> In a later related proceeding against Dr. Fox, *Glanz v. Mendelson*,<sup>70</sup> the court of appeals again affirmed a decision by the trial court which subsequently permitted reverse veil-piercing against another limited partnership used by Dr. Fox to hide and divert his assets.<sup>71</sup>

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<sup>63</sup>*Id.*; see also *Cascade Energy & Metals Corp. v. Banks*, 896 F.2d 1557, 1574-1579 (10th Cir. 1990) (using traditional veil-piercing theories in analyzing limited partner liability in denying an outsider reverse piercing claim against certain limited partnerships and corporations).

<sup>64</sup>Gavin L. Phillips, Annotation, *Liability of Limited Partner Arising from Taking Part in Control of Business Under Uniform Partnership Act*, 79 A.L.R. 4TH 427, 432 (West 2002).

<sup>65</sup>Christianson, *supra* note 61, at 257.

<sup>66</sup>Nos. 0721-97-4 & 1094-97-4, 1998 Va. App. LEXIS 157 (Va. Ct. App. Mar. 17, 1998).

<sup>67</sup>*Id.* at \*19-\*20.

<sup>68</sup>*Id.*

<sup>69</sup>*Id.* at \*20.

<sup>70</sup>538 S.E.2d 348 (Va. Ct. App. 2000).

<sup>71</sup>*Id.* at 350. For another Virginia example upholding a reverse veil-piercing claim, see *Stainback v. Stainback*, 396 S.E.2d 686 (Va. Ct. App. 1990), discussed *supra* note 50.

The Supreme Court of Virginia, however, took a more narrow view in *Sloan v. Thornton*,<sup>72</sup> suggesting that limited partners may be held liable for a limited partnership's debts only under circumstances expressly set forth in the VRULPA.<sup>73</sup> The court stated, "The liabilities of limited partners for the debts of limited partnerships are governed by [the VRULPA], not the common law."<sup>74</sup> Specifically, the VRULPA provides that on application by a judgment creditor of an individual limited partner, "the court may charge the partnership interest of the partner with payment of the unsatisfied amount of the judgment with interest."<sup>75</sup> Interestingly, *Sloan* does not necessarily preclude veil-piercing of a limited partnership. *Sloan* leaves uncertain whether, under Virginia law, the VRULPA provides the exclusive remedy for judgment creditors of individual limited partners, because the case did not apply the veil-piercing doctrine to a limited partnership.<sup>76</sup> The plaintiff in *Sloan* only sought to pierce the veil of a corporation, or hold the limited partner liable under the statutory law of the VRULPA.<sup>77</sup>

The Appellate Court of Connecticut recently considered this issue and upheld a reverse piercing claim against a *limited liability company*.<sup>78</sup> There, the court extended the reverse veil-piercing doctrine to a limited liability company where the debtor "did not receive regular distributions but rather, paid her personal bills directly using limited liability company funds" to the detriment of the judgment creditor's attempts to attach the debtor's assets to satisfy the judgment.<sup>79</sup> While recognizing that the corporate or limited liability form should not be disregarded lightly, the court concluded that "[w]hen the statutory privilege of doing business in

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<sup>72</sup>457 S.E.2d 60 (Va. 1995).

<sup>73</sup>*Id.* at 64.

<sup>74</sup>*Id.* The plaintiff in *Sloan* sought to hold an individual, who was both a limited partner of the limited partnership and a shareholder of the partnership's general partner, a corporation, personally liable for the debts of a limited partnership. *Id.* at 61.

<sup>75</sup>VA. CODE ANN. § 50-73.46 (LexisNexis 2002). See *infra* note 90 and accompanying text.

<sup>76</sup>*Sloan*, 457 S.E.2d at 63-64. See also *C.F. Trust, Inc. v. First Flight Ltd. P'ship*, 306 F.3d 126, 140 (4th Cir. 2002), *modifying*, 301 F.3d 187 (4th Cir. 2002) (discussing the ramifications of the *Sloan* decision in determining whether Virginia would recognize an outsider reverse piercing claim as to a limited partnership).

<sup>77</sup>*Sloan*, 457 S.E.2d at 61, 63-64.

<sup>78</sup>*Litchfield Asset Mgmt. Corp. v. Howell*, 799 A.2d 298 (Conn. Ct. App.), *appeal denied*, 806 A.2d 49 (Conn. 2002). See also *C.F. Trust*, 306 F.3d at 140-41 (discussing *Litchfield Asset Mgmt.* and the similarities between a limited partnership and a limited liability company, and finding that if the Virginia court followed the rationale of *Litchfield Asset Management*, "outsider reverse veil-piercing would be a viable option" against limited partnerships who are merely the alter ego of the limited partners).

<sup>79</sup>*Litchfield Asset Mgmt.*, 799 A.2d at 312 n.14.

the corporate [or limited liability company] form is employed *as a cloak for the evasion of obligations, as a mask behind which to do injustice, or invoked to subvert equity*, the separate personality of the corporation [or limited liability company] will be disregarded."<sup>80</sup>

### III. ANALYSIS

In *C.F. Trust, Inc. v. First Flight Limited Partnership*,<sup>81</sup> the Fourth Circuit Court of Appeals, ruling in an action brought by judgment creditors, was unable to determine first, whether Virginia law would permit an outsider reverse veil-piercing claim in a commercial context, and second, if they would, what standards must be met before Virginia would allow reverse veil-piercing of a limited partnership.<sup>82</sup> The court thereby certified the following questions to the Supreme Court of Virginia: "(1) Would Virginia recognize a claim for outsider reverse veil-piercing under the facts of [*C.F. Trust, Inc.*]? (2) If the answer to (1) is yes, what standards must be met before Virginia would allow reverse veil-piercing of [a] limited partnership?"<sup>83</sup>

#### A. *The Factual and Procedural History*

The plaintiffs, C.F. Trust, Incorporated (C.F. Trust), a Florida corporation, and Atlantic Funding Corporation (AFC), a Nevada corporation, brought this action to collect on judgments they hold against the defendant, Barrie Peterson.<sup>84</sup> C.F. Trust and AFC alleged that Peterson used various corporations, partnerships, and individuals as alter egos to avoid payment of his obligations under the judgments and sought to pierce the corporate veil in reverse to reach the assets of those entities.<sup>85</sup>

C.F. Trust owns two commercial notes dated November 1, 1993 on which Barrie Peterson, individually, Barrie Peterson as a trustee, and Nancy

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<sup>80</sup>*Id.* at 316 (alteration in original) (emphasis added) (quoting *Toshiba Am. Med. Sys., Inc. v. Mobile Med. Sys., Inc.*, 730 A.2d 1219 (Conn. App. Ct.), *cert. denied*, 733 A.2d 851 (Conn. 1999).

<sup>81</sup>306 F.3d 126 (4th Cir.), *modifying* 301 F.3d 187 (4th Cir. 2002).

<sup>82</sup>*Id.* at 141.

<sup>83</sup>*Id.*

<sup>84</sup>*C.F. Trust, Inc. v. First Flight Ltd. P'ship*, 111 F. Supp. 2d 734, 736 (E.D. Va. 2000), *findings of fact/conclusions of law* at 140 F. Supp. 2d 628 (E.D. Va. 2001), *questions certified* by 301 F.3d 187 (4th Cir.), *modified by*, 306 F.3d 126 (4th Cir. 2002).

<sup>85</sup>*Id.*

Peterson, his wife, are personally liable as endorsers and guarantors.<sup>86</sup> Following the Petersons' default, C.F. Trust obtained a judgment against these parties jointly and severally in the amount of \$6.1 million plus nine percent interest per annum.<sup>87</sup> AFC owns a single note, endorsed and guaranteed by Barrie Peterson, individually and as trustee, in the principal amount of \$1 million.<sup>88</sup> AFC also has a judgment against Peterson, individually and as trustee, in the amount of \$1.2 million plus interest.<sup>89</sup> In addition to these judgments, C.F. Trust and AFC each sought and obtained charging orders<sup>90</sup> charging the Petersons' interests in various partnerships, including the defendant First Flight Limited Partnership (First Flight), with payment on the judgments.<sup>91</sup>

After having received no payment on their judgments from Peterson or the various partnerships charged, the plaintiffs filed a diversity action against Barrie Peterson, Nancy Peterson, and their son, Scott Peterson.<sup>92</sup> They also named as defendants three Virginia corporations wholly owned and controlled by Barry Peterson, and a limited partnership (First Flight) in which Barrie Peterson was a forty-nine percent partner along with his son Scott Peterson.<sup>93</sup> Among the various claims filed, the plaintiffs sought a declaration that First Flight and each of the other entities owned by Barrie or Scott Peterson are Barrie Peterson's alter egos, and that through these

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<sup>86</sup>*Id.* at 736-37; *C.F. Trust, Inc. v. First Flight Ltd. P'ship*, 140 F. Supp. 2d 628, 629 (E.D. Va. 2001), *questions certified by* 301 F.3d 187 (4th Cir.), *modified by*, 306 F.3d 126 (4th Cir. 2002).

<sup>87</sup>*C.F. Trust*, 140 F. Supp. 2d at 629-30; *C.F. Trust*, 111 F. Supp. 2d at 737.

<sup>88</sup>*C.F. Trust*, 306 F.3d at 129.

<sup>89</sup>*C.F. Trust*, 140 F. Supp. 2d at 630; *C.F. Trust*, 111 F. Supp. 2d at 737.

<sup>90</sup>If the debtor is a partner in a general or limited partnership, the creditor may attempt to collect its judgment by means of a charging order which diverts future partnership distributions that may flow to the debtor to the creditor until the creditor has been paid in full. *See* Norman W. Nash & Jeffrey T. Bedingfield, *Charging Partnership and LLC Interests to Satisfy Debts of Individuals*, 23 COLO. LAW. 2743 (1994). *See also* *First Union Nat'l Bank v. Allen Lorey Family Ltd. P'ship*, 34 Va. Cir. 474, 476 (Va. 1994) (stating that obtaining a charging order is the first step toward satisfying an outstanding debt); Virginia Revised Uniform Limited Partnership Act, VA. CODE ANN. § 50:73-46 (LexisNexis 2002) (providing specifically that a partnership interest is subject to a charging order).

<sup>91</sup>*C.F. Trust*, 140 F. Supp. 2d at 630; *C.F. Trust*, 111 F. Supp. 2d at 737.

<sup>92</sup>*C.F. Trust*, 140 F. Supp. 2d at 630; *C.F. Trust*, 111 F. Supp. 2d at 737-38.

<sup>93</sup>*C.F. Trust*, 140 F. Supp. 2d at 630-31; *C.F. Trust*, 111 F. Supp. 2d at 738. Barrie Peterson initially owned and controlled 100% of the partnership interest in First Flight. *C.F. Trust*, 140 F. Supp. 2d at 633. Six weeks after C.F. Trust obtained a judgment against Barrie Peterson and two weeks after AFC obtained its first charging order, Barrie Peterson transferred half of his partnership interest in First Flight to Scott Peterson, his son, and purportedly surrendered control. *C.F. Trust*, 306 F.3d at 131.

various entities, Peterson hindered and evaded the collections of the plaintiffs' judgments.<sup>94</sup>

Plaintiffs allege that before and after the initial judgments were entered, the defendants engaged in numerous transactions among themselves for the purpose of avoiding Barrie Peterson's obligations to plaintiffs.<sup>95</sup> Plaintiffs also contended that Barrie and Scott Peterson conducted business through the various entities that they owned for Barrie and Nancy Peterson's personal benefit, and that Barrie Peterson used these entities as his alter ego.<sup>96</sup> Thus, because, as plaintiffs allege, Barrie and Scott Peterson's business practices were for the purpose of frustrating plaintiffs' attempts to collect on their judgments, plaintiffs sought to access the various entities' assets.<sup>97</sup>

### B. *The District Court*

The United States District Court for the Eastern District of Virginia concluded that Virginia law allows reverse piercing of the corporate veil.<sup>98</sup> In reaching its decision, the district court first acknowledged that while Virginia law permits actions to disregard the independent legal existence of a corporation, such piercing should be permitted "only when necessary to promote justice" and only under exceptional circumstances.<sup>99</sup> The district court also found the alter ego doctrine to be applicable to limited partnerships as well as corporations.<sup>100</sup>

Next, while noting that the Virginia Supreme Court had not yet addressed the reverse piercing doctrine, the district court found, through a review of other state and federal authorities, that outsider reverse veil-piercing actions were gradually gaining acceptance throughout the country.<sup>101</sup> The district court also found support in a 1998 decision by the Court of Appeals of Virginia which recognized the outsider reverse piercing cause of action against a husband seeking to avoid his obligations

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<sup>94</sup>*C.F. Trust*, 111 F. Supp. 2d at 738-39.

<sup>95</sup>*Id.* at 738.

<sup>96</sup>*Id.* at 738-39.

<sup>97</sup>*Id.* at 739.

<sup>98</sup>*C.F. Trust*, 111 F. Supp. 2d at 740. At the district court level, the parties filed cross-motions for summary judgment based on the issue of outsider reverse veil-piercing of the corporate veil. *See id.* at 739-40.

<sup>99</sup>*Id.* at 740 (quoting *Cheatle v. Rudd's Swimming Pool Supply Co.*, 360 S.E.2d 828, 831 (Va. 1987)).

<sup>100</sup>*Id.* (citing *Sloan v. Thornton*, 457 S.E.2d 60 (Va. 1995); *Fox v. Fox*, Nos. 0721-97-4 & 1094-97-4, 1998 Va. App. LEXIS 157 (Va. Ct. App. Mar. 17, 1998)).

<sup>101</sup>*Id.*

under a divorce decree.<sup>102</sup> In *Fox*, the husband was held to have abused the legal form of his partnerships and corporations, and treated them as his alter egos.<sup>103</sup> Based on these facts, and application of the Virginia alter ego standards, the court of appeals pierced the veils of the husband's limited partnerships, trusts, and corporations, to allow his wife to reach the assets of each of those entities to satisfy the terms of the divorce decree.<sup>104</sup>

In *C.F. Trust*, the district court found further support in the policy considerations underlying the recognition of outsider reverse piercing claims.<sup>105</sup> The court observed that "the rationale for traditional piercing operates with equal force in support of reverse piercing."<sup>106</sup> The district court reasoned that when the corporate form is abused, courts have, under appropriate circumstances, disregarded the corporate form, and on principle, this should be so "whether the fiction is misused to shield the owner's assets from claims against the corporation or to shield the corporation's assets from claims against the owner."<sup>107</sup> To hold otherwise would allow an individual to "abuse the corporate or partnership forms with impunity so as to evade personal obligations and to hinder the collection of valid judgments."<sup>108</sup> The alter ego doctrine was developed to provide creditors with a means of disregarding the corporate or limited partnership forms, under certain limited circumstances, when that legal fiction has been abused by corporate insiders.<sup>109</sup>

Having concluded that Virginia law would recognize a reverse piercing cause of action, the district court went on to articulate the standard for such piercing. Recognizing that "no single rule or criterion . . . can be applied to determine whether piercing the corporate veil is justified[,]"<sup>110</sup> the district court stated that the veil-piercing determination depends on the totality of the facts and circumstances encompassing the parties involved, the corporate activities, and the conduct in question.<sup>111</sup> Moreover, "piercing the corporate veil is justified when the 'unity of interest and ownership is such that the separate personalities of the corporation and the individual no

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<sup>102</sup>*C.F. Trust*, 111 F. Supp. 2d at 740-41; *Fox v. Fox*, Nos. 0721-97-4 & 1094-97-4, 1998 Va. App. LEXIS 157 (Va. Ct. App. Mar. 17, 1998).

<sup>103</sup>*C.F. Trust*, 111 F. Supp. 2d at 740-41; *Fox*, 1998 Va. App. LEXIS 157, at \*19-\*20.

<sup>104</sup>See *supra* note 103. OR *C.F. Trust*, 111 F. Supp. 2d at 740-41; *Fox*, 1998 Va. App. LEXIS 157, at \*19-\*20.

<sup>105</sup>*C.F. Trust*, 111 F. Supp. 2d at 741.

<sup>106</sup>*Id.*

<sup>107</sup>*Id.*

<sup>108</sup>*Id.*

<sup>109</sup>*C.F. Trust*, 111 F. Supp. 2d at 744.

<sup>110</sup>*Id.* (quoting *O'Hazza v. Executive Credit Corp.*, 431 S.E.2d 318, 320 (Va. 1993)).

<sup>111</sup>*Id.* at 741-42.

longer exist and to adhere to that separateness would work an injustice."<sup>112</sup> Thus, because the Court of Appeals of Virginia had recognized the outsider reverse piercing cause of action in *Fox*, it is likely that the Supreme Court of Virginia would also do so "provided that the plaintiff c[ould] establish the requisite grounds."<sup>113</sup>

The district court then set forth the traditional veil-piercing standards that must be established under Virginia law to warrant disregard of the corporate form.<sup>114</sup> The court declared, "[I]t is not enough, however, that the plaintiff establish that the individual had control over the corporation or that 'the corporate entity was [simply] the alter ego, alias, stooge, or dummy of the individuals sought to be charged personally.'<sup>115</sup> The plaintiff must also establish that the individual "used the corporation to *evade a personal obligation*, to perpetuate fraud or a crime, to commit an injustice, or to gain an unfair advantage."<sup>116</sup>

Finally, the district court found that an individual could not be the alter ego of another individual, and thus, granted defendants' joint motion for summary judgment in part as to Nancy and Scott Peterson.<sup>117</sup> The court, however, refused to grant summary judgment to the remaining parties, Barrie Peterson, First Flight, and his other controlled entities.<sup>118</sup> The court found issues of material fact in dispute as to whether Barrie Peterson abused the corporate and partnership forms of his "captive" business entities with the intent to defraud creditors or to evade a personal obligation.<sup>119</sup>

Accordingly, the district court, during the trial stage, found that the plaintiffs had "conclusively established the grounds necessary to support piercing the corporate veil in reverse."<sup>120</sup> As to the first factor, the district court expressly found that "First Flight is the alter ego of Barrie

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<sup>112</sup>*Id.* at 742 (quoting *O'Hazza*, 431 S.E.2d at 320).

<sup>113</sup>*C.F. Trust*, 111 F. Supp. 2d at 740-41.

<sup>114</sup>*Id.* at 741-42.

<sup>115</sup>*Id.* at 742 (alteration in original) (quoting *Cheatle v. Rudd's Swimming Pool Supply Co.*, 360 S.E.2d 828, 831 (Va. 1987)).

<sup>116</sup>*Id.* (quoting *O'Hazza*, 431 S.E.2d at 320).

<sup>117</sup>*C.F. Trust*, 111 F. Supp. 2d at 744.

<sup>118</sup>*Id.* at 743-44. Other entities under Peterson's control were Maryland Air Industries, Birchwood Holding Group (BHG), and Birchwood Organizations, Inc. (B.O.I.). *Id.* at 737.

<sup>119</sup>*Id.* at 743.

<sup>120</sup>*C.F. Trust, Inc. v. First Flight Ltd. P'ship*, 140 F. Supp. 2d 628, 645 (E.D. Va. 2001), questions certified by 301 F.3d 187 (4th Cir.), modified by, 306 F.3d 126 (4th Cir. 2002).

Peterson"<sup>121</sup> and "that the unity of interest is such that the 'separate personalities of [First Flight and Barrie Peterson] no longer exist."<sup>122</sup>

Abundant evidence proved that Barrie Peterson had "treated his corporate and personal affairs as if they were indistinguishable."<sup>123</sup> He used the First Flight partnership "as a device to pay his personal expenses,"<sup>124</sup> while he maintained control and retained decision-making authority over First Flight,<sup>125</sup> and used this control to force First Flight to make distributions to his son Scott Peterson, and to BHG to pay his personal expenses.<sup>126</sup> He also "commingled his personal funds with the funds of the entities that he controlled and owned,"<sup>127</sup> "siphoned business assets for his personal use,"<sup>128</sup> and "caused First Flight to ignore the requirements of its partnership agreement."<sup>129</sup> The court concluded that all of this evidence established that First Flight "failed to follow the requisite business and corporate formalities."<sup>130</sup>

The district court further held that the plaintiffs had satisfied the second factor for traditional veil-piercing.<sup>131</sup> Barrie Peterson was able to *evade his obligations to his creditors* through his "control and unity of interest with First Flight, . . . by directing the transfer of millions of dollars out of First Flight to Scott Peterson and to BHG for the payment of his personal expenses."<sup>132</sup> For these reasons, the district court held the plaintiffs were "entitled to an order declaring that First Flight . . . [was] the alter ego[] of Barrie Peterson and that [First Flight's] assets are subject to the [plaintiffs'] judgment[s]."<sup>133</sup>

### C. *The Fourth Circuit*

First Flight appealed from the district court's order declaring "First Flight the alter ego of Barrie Peterson" and "making [First Flight's] assets

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<sup>121</sup>*Id.* at 644.

<sup>122</sup>*Id.* (alteration in original) (quoting *O'Hazza*, 431 S.E.2d at 321).

<sup>123</sup>*Id.* at 645 (citations omitted).

<sup>124</sup>*C.F. Trust*, 140 F. Supp. 2d at 633.

<sup>125</sup>*Id.* at 634.

<sup>126</sup>*Id.*

<sup>127</sup>*Id.* at 644.

<sup>128</sup>*C.F. Trust*, 140 F. Supp. 2d at 644.

<sup>129</sup>*Id.*

<sup>130</sup>*Id.* at 635.

<sup>131</sup>*Id.* at 644.

<sup>132</sup>*C.F. Trust*, 140 F. Supp. 2d at 644. *See supra* note 118 and accompanying text.

<sup>133</sup>*C.F. Trust*, 140 F. Supp. 2d at 645.

subject to judgments entered against Peterson in favor of the [plaintiffs]."<sup>134</sup> The United States Court of Appeals for the Fourth Circuit, not convinced by the district court's reliance on *Fox* and *Sloan*, certified the question to the Virginia Supreme Court to determine whether Virginia law would permit reverse veil-piercing in a commercial context against a limited partnership and, if so, what standards must be met to allow such piercing.<sup>135</sup>

The Fourth Circuit did not believe that Virginia case law supported the conclusion that the reverse veil-piercing doctrine was "generally available" and "not [just] confined to the particular circumstances in *Fox* . . . or the domestic relations context."<sup>136</sup> Given "Virginia's well-established treatment of traditional veil-piercing as an 'extraordinary exception,' a Virginia court might refuse to extend the doctrine to allow reverse veil-piercing beyond the particular facts of *Fox* and *Stainback*, or the domestic relations context."<sup>137</sup> While "a Virginia court might regard reverse veil-piercing as particularly appropriate in [a] domestic relations case[] because of the special nature of marital property,"<sup>138</sup> "reverse veil-piercing is less common in ordinary commercial cases."<sup>139</sup> Thus, a court could find a difference between the commercial context and the domestic relations context and conclude that reverse veil-piercing should only apply to domestic relations cases.<sup>140</sup>

Turning to the question of standards, the Fourth Circuit stated that while "a Virginia court might well permit reverse veil-piercing in the commercial context," it may find that other factors need to be satisfied in addition to the two factors necessary for traditional veil-piercing.<sup>141</sup> In other words, it may require proof that "no innocent third party . . . would suffer harm or prejudice as a consequence of a reverse veil-piercing."<sup>142</sup> The Fourth Circuit reasoned that such a safeguard may be necessary to protect "against the potential harm or prejudice to innocent third-party

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<sup>134</sup>C.F. Trust, Inc. v. First Flight Ltd. P'ship, 306 F.3d 126, 128 (4th Cir.), *modifying* 301 F.3d 187 (4th Cir. 2002).

<sup>135</sup>*Id.* at 139-40.

<sup>136</sup>*Id.* at 137. The court of appeals did recognize, however, that the district court acted reasonably in applying the two-factor test required in a traditional veil-piercing case and in making detailed findings supported by ample evidence, that the plaintiffs had established both factors. *Id.* at 137-38.

<sup>137</sup>*Id.* at 138 (quoting *Cheatle v. Rudd's Swimming Pool Supply Co.*, 360 S.E.2d 828, 831 (Va. 1987). *See also* *Stainback v. Stainback*, 396 S.E.2d 686, 692-93 (Va. Ct. App. 1990) (recognizing reverse veil-piercing eight years before *Fox* in another domestic relations suit).

<sup>138</sup>C.F. Trust, 306 F.3d at 138.

<sup>139</sup>*Id.*

<sup>140</sup>*Id.*

<sup>141</sup>*Id.*

<sup>142</sup>C.F. Trust, 306 F.3d at 138.

shareholders or creditors not otherwise liable on the underlying judgment," which may result if the veil was pierced in reverse.<sup>143</sup> This is especially so because with traditional veil-piercing, this is never a risk.<sup>144</sup>

Finally, the Fourth Circuit addressed whether Virginia law would recognize a reverse veil-piercing claim against a limited partnership.<sup>145</sup> The court did not agree that Virginia law was "settled" in the application of the alter ego doctrine to limited partnerships as well as corporations.<sup>146</sup> In fact, the Fourth Circuit began its analysis with a summary of the rights and responsibilities of limited partners under the VRULPA.<sup>147</sup> The court noted that "[t]he liabilities of limited partners for the debt of limited partnerships are governed by the [VRULPA], not the common law."<sup>148</sup> The court stated that while "*Sloan* does not necessarily preclude veil-piercing of a limited partnership,"<sup>149</sup> the Supreme Court of Virginia "seems to have suggested a possible distinction between the application of veil-piercing to a corporation and its application to a limited partnership."<sup>150</sup> It is therefore "uncertain whether, under Virginia law, the [VRULPA] provides the exclusive remedy for judgment creditors of individual limited partners."<sup>151</sup> The implication in *Sloan* suggests that the common law allows shareholders to be held liable for a corporation's actions, but only the VRULPA allows a remedy against a limited partner for the acts of the limited partnership.<sup>152</sup>

Interestingly, however, the Fourth Circuit cited to case law which supports a reverse veil-piercing cause of action against a limited partnership.<sup>153</sup> In *Litchfield Asset Management Corp. v. Howell*,<sup>154</sup> the "court upheld reverse veil-piercing against a limited liability company—a business organization similar to a limited partnership—notwithstanding a

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<sup>143</sup>*Id.*

<sup>144</sup>*Id.* at 138-39.

<sup>145</sup>*Id.* at 139.

<sup>146</sup>See *C.F. Trust*, 306 F.3d at 139-40; cf. *C.F. Trust*, 111 F. Supp. 2d at 740 (noting that the alter ego doctrine also applies to limited partnerships).

<sup>147</sup>*C.F. Trust*, 306 F.3d at 139; Virginia Revised Uniform Limited Partnership Act, VA. CODE ANN. §§ 50-73.1 to 50-73.78 (LexisNexis 2002).

<sup>148</sup>*C.F. Trust*, 306 F.3d at 140 (quoting *Sloan v. Thornton*, 457 S.E.2d 60, 64 (Va. 1995)). See *supra* text accompanying notes 72-75.

<sup>149</sup>*C.F. Trust*, 306 F.3d at 140.

<sup>150</sup>*Id.* at 139.

<sup>151</sup>*Id.* at 140.

<sup>152</sup>*Id.*

<sup>153</sup>*C.F. Trust*, 306 F.3d at 140.

<sup>154</sup>799 A.2d 298 (Conn. App. Ct.), *appeal denied*, 806 A.2d 49 (Conn. 2002).

statutory provision worded almost identically to [VRULPA] § 50-73.46.<sup>155</sup> In *Litchfield*, the court found that an extension of the reverse veil-piercing doctrine to limited liability companies was justified.<sup>156</sup> The court found this to be particularly true where "the debtor 'did not receive regular distributions but rather, paid her personal bills directly using limited liability company funds [and that] [a]ny attempt by the plaintiff to attach distributions . . . would have been fruitless."<sup>157</sup> The Fourth Circuit concluded that if the Virginia Supreme Court followed the rationale of *Litchfield Asset Management*, "outsider reverse veil-piercing would be a viable option in this case, even if not generally permitted in cases involving limited partnerships."<sup>158</sup>

#### IV. EVALUATION AND PREDICTION

Assuming *arguendo* that Virginia will recognize the doctrine of outsider reverse veil-piercing in a commercial context, I believe that under certain circumstances, the Virginia Supreme Court will also apply the doctrine equally to a limited partnership. Without a doubt, the Fourth Circuit was troubled with the circumstances in *C.F. Trust* and as a result, has left the Virginia Supreme Court to decide the issue.<sup>159</sup> The issue, however, could have been decided on the facts alone.

The Virginia Supreme Court has held that veil-piercing is clearly permitted in exceptional circumstances when "necessary to promote justice."<sup>160</sup> Given the extraordinary circumstances in *C.F. Trust* and the egregiousness of the facts, it is not necessary to have a "clear statement" by the state's highest court adopting the doctrine.<sup>161</sup> First, the Virginia Supreme Court itself has held that there is "no single rule or criterion that can be applied to determine whether [veil-]piercing . . . is justified."<sup>162</sup>

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<sup>155</sup>*C.F. Trust*, 306 F.3d at 140; see also *Litchfield Asset Mgmt.*, 799 A.2d at 316 (holding that a limited liability partnership was liable for the personal debts of one of the limited partners). See *supra* note 78 and accompanying text.

<sup>156</sup>*Litchfield Asset Mgmt.*, 799 A.2d at 316.

<sup>157</sup>*C.F. Trust*, 306 F.3d at 140 (quoting *Litchfield Asset Mgmt.*, 799 A.2d at 312 n.14).

<sup>158</sup>See *id.* at 141.

<sup>159</sup>See *id.*

<sup>160</sup>*Cheatle v. Rudd's Swimming Pool Supply Co.*, 360 S.E.2d 828, 831 (Va. 1987); *Beale v. Kappa Alpha Order*, 64 S.E.2d 789, 797-98 (Va. 1951).

<sup>161</sup>See *C.F. Trust*, 306 F.3d at 137 n.6 (noting an appellate court's refusal to permit outsider reverse veil-piercing "[a]bsent a clear statement" by the state's highest court adopting the doctrine, and where no state case in the applicable jurisdiction had previously recognized reverse veil-piercing).

<sup>162</sup>*O'Hazza v. Executive Credit Corp.*, 431 S.E.2d 318, 320 (Va. 1993).

Second, unlike in *Cascade Energy & Metals Corp. v. Banks*,<sup>163</sup> where no state case in the jurisdiction had previously recognized reverse veil-piercing,<sup>164</sup> the Virginia courts have recognized and applied the doctrine in the domestic relations context,<sup>165</sup> and the federal court, while applying Virginia law, has recognized the doctrine in bankruptcy proceedings.<sup>166</sup> Finally, when the Virginia courts have refused to pierce the corporate veil in the traditional context, they have done so because the facts of the given case were not sufficient to justify the piercing.<sup>167</sup> Similarly, in other jurisdictions applying the reverse-pierce doctrine, some have refused to permit reverse veil-piercing, not because they reject outsider veil-piercing per se, but because the facts of the given case were not sufficient to justify reverse veil-piercing let alone traditional veil-piercing.<sup>168</sup>

Indeed, the Virginia Supreme Court has continuously held that the decision to disregard the corporate form is a *fact-specific* determination, requiring an examination of the factual circumstances surrounding the business form and the acts in question,<sup>169</sup> with the burden of proof resting upon the party seeking to pierce.<sup>170</sup> A decision to disregard the corporate or limited partnership form is usually warranted if the party seeking to pierce can establish: (1) that the corporation or limited partnership is the "alter ego, alias, stooge, or dummy" of another,<sup>171</sup> and (2) that one has used and controlled that corporation or limited partnership form as a device or sham to "evade a personal obligation, to perpetuate fraud or a crime, to commit an injustice, or to gain an unfair advantage."<sup>172</sup> Thus, regardless of whether or not the Virginia Supreme Court will recognize a cause of action for outsider reverse veil-piercing in general, the decision to disregard is "held to be a *question of fact* in each case."<sup>173</sup>

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<sup>163</sup>896 F.2d 1557 (10th Cir. 1990).

<sup>164</sup>*See id.* at 1576-77.

<sup>165</sup>*See* Fox v. Fox, Nos. 0721-97-4 & 1094-97-4, 1998 Va. App. LEXIS 157 (Va. Ct. App. Mar. 17, 1998); Stainback v. Stainback, 396 S.E.2d 686, 692-93 (Va. Ct. App. 1990).

<sup>166</sup>*See* Smith v. Richels (*In re* Richels), 163 B.R. 760 (Bankr. E.D. Va. 1994).

<sup>167</sup>*E.g.*, *O'Hazza*, 431 S.E.2d at 321; *Cheatle*, 360 S.E.2d at 831.

<sup>168</sup>*See, e.g.*, cases cited *supra* note 51.

<sup>169</sup>*O'Hazza*, 431 S.E.2d at 320-21; *Greenberg v. Commonwealth*, 499 S.E.2d 266, 272 (Va. 1998).

<sup>170</sup>*Cheatle*, 360 S.E.2d at 831.

<sup>171</sup>*Id.* (emphasis omitted).

<sup>172</sup>*O'Hazza*, 431 S.E.2d at 320. *See also* *Cheatle*, 360 S.E.2d at 831 (noting that the plaintiff must show that the "corporation was a device or sham used to disguise wrongs, obscure fraud, or conceal crime").

<sup>173</sup>*Beale*, 64 S.E.2d at 798 (quoting *State v. Swift & Co.*, 187 S.W.2d 127, 133 (Tex. Civ. App. 1945) (emphasis added)).

Moreover, "the rationale for traditional [veil-]piercing operates with equal force in support of reverse piercing[]"<sup>174</sup>—justified *only* "when the unity of interest and ownership is such that the separate personalities of the corporation [or limited partnership] . . . no longer exist and to adhere to that separateness would work an injustice."<sup>175</sup> For example, in *Litchfield Asset Management Corp. v. Howell*,<sup>176</sup> the Appellate Court of Connecticut recognized that under appropriate circumstances, "a reverse pierce is a viable remedy that a court may employ when necessary [to prevent fraud or to achieve equity], and when unfair prejudice will not result."<sup>177</sup> The court further recognized that "when the statutory privilege of doing business in the . . . [limited partnership] form is employed as a cloak for the evasion of obligations, [or] as a mask behind which to do injustice, . . . the separate personality of the . . . [limited partnership] will be disregarded."<sup>178</sup>

The circumstances in *C.F. Trust* parallel the facts set forth in *Litchfield Asset Management*, where the Appellate Court of Connecticut upheld a reverse veil-piercing of a limited liability company.<sup>179</sup> Similar to the facts in *Litchfield*, Barrie Peterson did not receive regular distributions from the limited partnership, but rather, paid his personal bills directly using the limited partnership's funds to the detriment of the judgment creditor's attempts to attach said distributions under section 50-73.46 of the VRULPA.<sup>180</sup> The evidence clearly demonstrated that First Flight was the alter ego of Barrie Peterson and that the unity of interest was such that the "separate personalities of [First Flight and Barrie Peterson] no longer exist[ed]."<sup>181</sup> In addition, through Barrie Peterson's control and unity of interest with First Flight, he was able to shelter his assets from the lawful claims of his judgment creditors "by directing the transfer of millions of dollars out of First Flight to Scott Peterson and to BHG for the payment of

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<sup>174</sup>C.F. Trust, Inc. v. First Flight Ltd. P'ship, 111 F. Supp. 2d 734, 741 (E.D. Va. 2000), *findings of fact/conclusions of law* at 140 F. Supp. 2d 628 (E.D. Va. 2001), *questions certified* by 301 F.3d 187 (4th Cir.), *modified by*, 306 F.3d 126 (4th Cir. 2002).

<sup>175</sup>*O'Hazza*, 431 S.E.2d at 320-21.

<sup>176</sup>799 A.2d 298 (Conn. App. Ct.), *appeal denied*, 806 A.2d 49 (Conn. 2002).

<sup>177</sup>*Id.* at 312.

<sup>178</sup>*Id.* at 316 (quoting *Toshiba Am. Med. Sys., Inc. v. Mobile Med. Sys., Inc.*, 730 A.2d 1219, 1220 (Conn. App. Ct.), *appeal denied*, 733 A.2d 851 (Conn. 1999)).

<sup>179</sup>*Litchfield Asset Mgmt.*, 799 A.2d at 316.

<sup>180</sup>*See* C.F. Trust, Inc. v. First Flight Ltd. P'ship, 306 F.3d 126, 129 n.2, 130-31, 140 (4th Cir.), *modifying* 301 F.3d 187 (4th Cir. 2002); Virginia Revised Uniform Limited Partnership Act, VA. CODE ANN. § 50-73.46 (LexisNexis 2002). *See also supra* note 90 and accompanying text.

<sup>181</sup>C.F. Trust, Inc. v. First Flight Ltd. P'ship, 140 F. Supp. 2d 628, 644-45 (E.D. Va. 2001), *questions certified* by 301 F.3d 187 (4th Cir.), *modified by*, 306 F.3d 126 (4th Cir. 2002) (quoting *O'Hazza*, 431 S.E.2d at 321).

his personal expenses.<sup>182</sup> Thus, following the rationale of *Litchfield Asset Management*, Barrie Peterson should not benefit from the statutory privilege of doing business in the limited partnership form when it is clear that he employed the limited partnership form "as a cloak for the evasion of obligations, [or] as a mask behind which to do injustice."<sup>183</sup>

Indeed, the evidence supports the district court's conclusion that the carefully designed business arrangements between Barrie Peterson, Scott Peterson, First Flight, and BHG contributed to the creditors inability to collect on their judgments.<sup>184</sup> Moreover, in light of the creditors strong equitable claims, the district court correctly applied the reverse veil-piercing doctrine, thus making First Flight's assets (as the alter ego of Barrie Peterson) subject to plaintiffs' legitimate judgments.<sup>185</sup>

Recognizing that Virginia law might well permit reverse veil-piercing in the commercial context, the Fourth Circuit was uncertain whether proof beyond the two factors necessary for traditional veil piercing would be required.<sup>186</sup> Specifically, commentators and courts have indicated that injury to innocent third party shareholders is a potential consequence of reverse veil-piercing.<sup>187</sup> Thus, in determining whether the corporate veil can be pierced to satisfy the debt of an individual out of businesses assets, potential harm to innocent third-parties should be considered.<sup>188</sup> But such a determination is also a question of fact requiring an examination of the factual circumstances surrounding the business form and the acts in question.<sup>189</sup>

For example, in *Floyd v. Internal Revenue Service*,<sup>190</sup> the court recognized that the harm element "may be viewed as less serious in cases where a corporation [or limited partnership] is controlled by a single shareholder [or limited partner] . . . [thus there are] no third-part[ies] . . . to be unfairly prejudiced by disregarding the corporate [or limited

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<sup>182</sup>*Id.* at 644.

<sup>183</sup>*Litchfield Asset Mgmt.*, 799 A.2d at 316 (quoting *Toshiba Am. Med. Sys.*, 730 A.2d at 1224).

<sup>184</sup>*See C.F. Trust*, 140 F. Supp. 2d at 636, 644-45.

<sup>185</sup>*Id.* at 645.

<sup>186</sup>*C.F. Trust*, 306 F.3d at 138.

<sup>187</sup>*See supra* notes 40-44 and accompanying text. *See also C.F. Trust*, 306 F.3d at 138 (suggesting the possibility that third parties could be harmed in an outsider reverse veil-piercing case).

<sup>188</sup>1 WILLIAM MEADE FLETCHER ET AL., *FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 41.70, at 52 (perm. ed., cum. supp. 2002).

<sup>189</sup>*See Greenberg v. Commonwealth*, 499 S.E.2d 266, 272 (Va. 1998); *O'Hazza v. Executive Credit Corp.*, 431 S.E.2d 318, 321 (Va. 1993).

<sup>190</sup>151 F.3d 1295 (10th Cir. 1998).

partnership] form."<sup>191</sup> Also, in *Zisblatt v. Zisblatt*,<sup>192</sup> a Texas marital property case, the court was not swayed by the fact that allowance of an outsider reverse piercing claim would be prejudicial to another shareholder who was a relative and who obtained her shares gratuitously.<sup>193</sup>

In *C.F. Trust*, Barrie Peterson initially owned and controlled 100% of the partnership interest in First Flight.<sup>194</sup> Six weeks after C.F. Trust obtained a judgment against Barrie Peterson and two weeks after Atlantic Funding obtained its first charging order, Barrie Peterson transferred half of his partnership interest in First Flight to Scott Peterson, his son, and purportedly surrendered control.<sup>195</sup> The evidence convincingly showed, however, that he merely transferred his ownership interest in First Flight to his son as part of his scheme to insulate himself from payment of plaintiffs' outstanding judgments.<sup>196</sup> Moreover, although both Barrie Peterson and his son currently hold forty-nine percent limited partnership interests in First Flight as limited partners, the abundant evidence clearly established that Barrie Peterson continued to maintain control and retained decision-making authority over First Flight.<sup>197</sup> It was further evident that he used this control "to direct that [First Flight] make distributions of substantial funds to Scott Peterson . . . for the payment of [his] personal expenses."<sup>198</sup> Given the circumstances, an allowance of an outsider reverse piercing claim would not be prejudicial to Scott Peterson, because, as noted by the district court, the transfer in ownership to Scott Peterson was merely "a gift to enable Barrie Peterson to develop and further his scheme to evade payment of the plaintiffs' judgments."<sup>199</sup>

Finally, the Fourth Circuit was also uncertain whether the VRULPA provided the exclusive remedy for judgment creditors of individual limited

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<sup>191</sup>*Id.* at 1300.

<sup>192</sup>693 S.W.2d 944 (Tex. Ct. App. 1985).

<sup>193</sup>*Id.* at 955.

<sup>194</sup>*C.F. Trust, Inc. v. First Flight Ltd. P'ship*, 140 F. Supp. 2d 628, 633 (E.D. Va. 2001), *questions certified by* 301 F.3d 187 (4th Cir.), *modified by*, 306 F.3d 126 (4th Cir. 2002). Barrie Peterson's 100% interest in First Flight was comprised directly of 98% as sole limited partner and indirectly through his wholly owned corporation, Top Flight Airpark, Inc., the sole general partner owning a 2% limited partnership interest. *Id.* On August 27, 1992, Upland, a corporation wholly owned by Scott Peterson, became the sole general partner of First Flight, replacing Top Flight. *Id.*

<sup>195</sup>*Id.*; *C.F. Trust, Inc. v. First Flight Ltd. P'ship*, 306 F.3d 126, 131 (4th Cir.), *modifying* 301 F.3d 187 (4th Cir. 2002).

<sup>196</sup>*C.F. Trust*, 140 F. Supp. 2d at 633.

<sup>197</sup>*Id.* at 634.

<sup>198</sup>*Id.*

<sup>199</sup>*Id.* at 636.

partners.<sup>200</sup> It noted that the "liabilities of limited partners . . . are governed by the [VRULPA], not the common law."<sup>201</sup> Under the VRULPA, a limited partner may be liable for the obligations of the limited partnership if the limited partner is also a general partner or if he participates in the control of the business.<sup>202</sup> As a commentator has suggested, however, whether a limited partner is in control is a question of fact.<sup>203</sup>

In *C.F. Trust*, the facts are sufficient on their face to hold that Barrie Peterson was indeed a limited partner in control.<sup>204</sup> Again, the VRULPA will not endorse continued limited liability where, in the words of the court in *Litchfield Asset Management*, the limited partnership form "is employed as a cloak for the evasion of obligations, [or] as a mask behind which to do injustice."<sup>205</sup> Thus, the Supreme Court will most likely allow an exception given the extraordinary circumstances in this case. Both of the plaintiffs, consistent with the VRULPA, sought and obtained charging orders charging Barrie Peterson's partnership interests in First Flight.<sup>206</sup> As the Fourth Circuit correctly recognized, however, those efforts proved futile based on "Peterson's engineered plan to disclaim any partnership interest [in First Flight] while simultaneously siphoning millions of dollars from First Flight."<sup>207</sup>

## V. CONCLUSION

In sum, veil-piecing is an equitable doctrine intended to prevent injustice and fraud. As noted above, Virginia law will permit veil-piercing only in exceptional circumstances when "necessary to promote justice."<sup>208</sup> Furthermore, "[m]any jurisdictions recognize that the same considerations that justify piercing the corporate veil may justify piercing the veil in 'reverse.'"<sup>209</sup> Specifically, those jurisdictions that have allowed reverse veil-

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<sup>200</sup>*C.F. Trust*, 306 F.3d at 140-41.

<sup>201</sup>*Id.* at 140 (quoting *Sloan v. Thornton*, 457 S.E.2d 60, 64 (Va. 1995)).

<sup>202</sup>Virginia Revised Uniform Limited Partnership Act, VA. CODE ANN. § 50-73.24(A) (LexisNexis 2002).

<sup>203</sup>Phillips, *supra* note 64, at 432.

<sup>204</sup>*C.F. Trust*, 140 F. Supp. 2d at 634.

<sup>205</sup>*Litchfield Asset Mgmt. Corp. v. Howell*, 799 A.2d 298, 316 (Conn. App. Ct.), *appeal denied*, 806 A.2d 49 (Conn. 2002) (quoting *Toshiba Am. Med. Sys., Inc. v. Mobile Med. Sys., Inc.*, 730 A.2d 1219, 1224 (Conn. App. Ct.), *appeal denied*, 733 A.2d 851 (Conn. 1999)).

<sup>206</sup>*C.F. Trust*, 306 F.3d at 140.

<sup>207</sup>*Id.*

<sup>208</sup>*Cheatle v. Rudd's Swimming Pool Supply Co.*, 360 S.E.2d 828, 831 (Va. 1987).

<sup>209</sup>1 FLETCHER ET AL., *supra* note 33, § 41.70, at 685.

piercing claims recognize "the remedy as appropriate under certain circumstances to prevent fraud or to achieve equity."<sup>210</sup>

Indeed, exceptional circumstances were present in *C.F. Trust*. The plaintiffs not only established that First Flight was the alter ego of Barrie Peterson, but also that Barrie Peterson used his control over First Flight to evade his personal obligations. Absent allowance of an outsider reverse veil-piercing cause of action, the plaintiffs are without a remedy to collect on their lawful judgments, and thus, subject to injustice. Therefore, given the extraordinary circumstances and the egregiousness of the facts in *C.F. Trust*, it is likely that the Supreme Court of Virginia will permit a reverse veil-piercing claim in this commercial case against a limited partnership.

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<sup>210</sup>*Litchfield Asset Mgmt.*, 799 A.2d at 311.

