

# Because Judges Are Not Angels Either:<sup>1</sup> Limiting Judicial Discretion by Introducing Objectivity into Piercing Doctrine

Jonathan A. Marcantel\*

## I. INTRODUCTION

Ordinarily, individual shareholders are immune from liability arising from a corporation's activities through the doctrine of limited liability.<sup>2</sup> That is, absent a personal breach of duty either in contract or in tort, an individual shareholder is only financially exposed to judgments against, or debts of, the corporation up to the shareholder's investment.<sup>3</sup> All rules, of course, have exceptions. The most frequently litigated of those exceptions is the doctrine of piercing the corporate veil.<sup>4</sup>

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\* Associate Dean of Assessment & Assistant Professor of Law, Lincoln Memorial University-Duncan School of Law. I would like to thank Dean Sydney A. Beckman and Professors J. Kirkland Grant and Barnali Choudhury for their thoughts and criticisms on this Article. Special thanks to Professor Sheila B. Scheuerman for both reviewing this Article and forcing me to work harder and be better. I would also like to thank Librarian David C. Walker and research assistants Jennifer Price and Patrick Slaughter for their research assistance.

1. The title references works by James Madison and Thomas Jefferson. See THE FEDERALIST NO. 51, at 264 (James Madison) (Ian Shapiro ed., 2009) ("But what is government itself, but the greatest of all reflections on human nature? If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary."); Thomas Jefferson, *First Inaugural Address*, in 1 A COMPILATION OF THE MESSAGES AND PAPERS OF THE PRESIDENTS 1789-1902, 321, 322 (James D. Richardson ed., 1897) ("Sometimes it is said that man cannot be trusted with the government of himself. Can he, then, be trusted with the government of others? Or have we found angels in the forms of kings to govern him?").

2. E.g., Patricia A. Cardeaux, Note, *Corporations—Shareholder Liability—Louisiana Adopts a Balancing Test for Piercing the Corporate Veil*, 58 TUL. L. REV. 1089, 1091 (1984); Douglas J. Gardner, Comment, *An Innovative Approach to Piercing the Corporate Veil: An Introduction to the Individual Factor and Cumulative Effects Analysis*, 25 LAND & WATER L. REV. 563, 563 (1990).

3. E.g., Stephen M. Bainbridge, *Abolishing LLC Veil Piercing*, 2005 U. ILL. L. REV. 77, 79 (2005); Rebecca J. Huss, *Revamping Veil Piercing for All Limited Liability Entities: Forcing the Common Law Doctrine into the Statutory Age*, 70 U. CIN. L. REV. 95, 103 (2001); Sung Bae Kim, *A Comparison of the Doctrine of Piercing the Corporate Veil in the United States and in South Korea*, 3 TULSA J. COMP. & INT'L L. 73, 73 (1995); Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1036 (1991); Gardner, *supra* note 2, at 563.

4. Sandra K. Miller, *Piercing the Corporate Veil Among Affiliated Companies in the European Community and in the U.S.: A Comparative Analysis of U.S., German, and U.K. Veil-Piercing Approaches*, 36 AM. BUS. L.J. 73, 77 (1998); Stephen B. Presser, *The Bogalusa Explosion*,

Notwithstanding the frequent litigation surrounding the doctrine<sup>5</sup> and the “bright-line rules” courts have created to cabin the doctrine, disparate results frequently occur both within jurisdictions and between jurisdictions<sup>6</sup> as—in most cases—courts use a factors analysis to determine when piercing is proper.<sup>7</sup> These disparate results have led to concerns by corporate scholars<sup>8</sup> because the lack of predictability and consistency in the doctrine’s application causes concerns as a matter of justice, as a matter of logical consistency, and, perhaps most practically, as a matter of counseling clients<sup>9</sup> to avoid this unruly beast.

This Article argues that jurisdictions could make the piercing doctrine predictable and consistent by adopting a conjunctive test requiring objective criteria for the elements of injustice, unity, causation, and insolvency. Part II of this Article briefly discusses the historical roots of the piercing doctrine, indicating its origination and the typical

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“Single Business Enterprise,” “Alter Ego,” and Other Errors: Academics, Economics, Democracy, and Shareholder Limited Liability: Back Towards a Unitary “Abuse” Theory of Piercing the Corporate Veil, 100 NW. U. L. REV. 405, 411 (2006); Thompson, *supra* note 3, at 1036.

5. Commentators have described the use of the doctrine as “rare.” See Bainbridge, *supra* note 3, at 78; Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 89 (1985). *Contra* Mark A. Olthoff, *Beyond the Form—Should the Corporate Veil Be Pierced?*, 64 UMKC L. REV. 311, 311 (1995) (“The doctrine of ‘piercing the corporate veil’ is a frequently used but not necessarily well understood concept.”). Nonetheless, the doctrine is litigated more than any other issue in corporate law. Daniel J. Morrissey, *Piercing All the Veils: Applying an Established Doctrine to a New Business Order*, 32 J. CORP. L. 529, 541–42 (2007); Presser, *supra* note 4, at 411 (“The critics of the doctrine are wrong that cases raising veil-piercing issues are rare. In fact, the problem is one of the most frequently litigated in all of corporate law.”); Thompson, *supra* note 3, at 1036.

6. Carteaux, *supra* note 2, at 1092 (“The inconsistent articulation and application of these theories have left the law of piercing the corporate veil in hopeless disarray in many jurisdictions.”); see also Huss, *supra* note 3, at 110 (“Each state (and sometimes even an individual court within a state) has a different view on the appropriate circumstances for piercing the veil.”).

7. Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479, 507 (2001) (“[Veil piercing is] an area all too often characterized by ambiguity, unpredictability, and even a seeming degree of randomness.”); Easterbrook & Fischel, *supra* note 5, at 89 (“Piercing’ seems to happen freakishly. Like lightning, it is rare, severe, and unprincipled.”); Jonathan M. Landers, *A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy*, 42 U. CHI. L. REV. 589, 620 (1975); Thompson, *supra* note 3, at 1037.

8. Bainbridge, *supra* note 3, at 78; Huss, *supra* note 3, at 108–10; John H. Matheson & Raymond B. Eby, *The Doctrine of Piercing the Veil in an Era of Multiple Limited Liability Entities: An Opportunity to Codify the Test for Waiving Owners’ Limited-Liability Protection*, 75 WASH. L. REV. 147, 150 (2000); David Millon, *Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability*, 56 EMORY L.J. 1305, 1307 (2007); Morrissey, *supra* note 5, at 532; Presser, *supra* note 4, at 411; Robert B. Thompson, *Piercing the Veil: Is the Common Law the Problem?*, 37 CONN. L. REV. 619, 619–20 (2005); Aaron Dean Wiles, Jr., Comment, *The Tortious Conduct Exception: Holding Limited Liability Companies Accountable for Their Misconducts in Light of Estate of Countryman v. Farmers Cooperative Ass’n*, 40 NEW ENG. L. REV. 1065, 1066–67 (2006).

9. See Miller, *supra* note 4, at 112 (“The degree of judicial discretion surrounding the law of entity recognition poses a distinct challenge to the business planner in search of predictability in the law.”).

categorizations and classifications of its various incarnations. Part II further reviews each state's classifications of the piercing doctrine, ultimately finding the traditional classifications are generally lip service used to mask an unguided, and inconsistently applied, factors test. Part III of this Article explains the importance of establishing guidelines for the doctrine's use that will promote the goals of consistency and predictability. Part IV of this Article discusses four remedies other scholars have advocated to alleviate the doctrine's predictability concerns. Part IV further discusses the deficiencies of each of those proposals. Finally, Part V argues jurisdictions can cabin the doctrine through the introduction of a four-part conjunctive test. First, the proposed test requires an injustice prong, compelling plaintiffs to demonstrate the corporation engaged in fraud, engaged in misrepresentation, or undercapitalized the corporation. Special emphasis is provided to the element of undercapitalization and a novel method of generating an objective test for determining undercapitalization. Ultimately, the Article advocates adopting the tort doctrine of custom as a mechanism to contain the discretion otherwise rampant in undercapitalization determinations. Second, the proposed test requires an objective unity element that is premised upon control over the decision-making process. This element dispenses with the notion of seeking to determine which shareholder has corporate unity and instead focuses the piercing analysis on which shareholder or shareholders have unity with the decision giving rise to liability. Third, the proposed test requires a causal element, requiring plaintiffs to demonstrate the inequitable conduct gave rise to the plaintiff's harm. This element incorporates but-for causation and proximate causation into the piercing test. Finally, the proposed test requires an insolvency element, requiring plaintiffs to prove the corporation is insolvent to pay the plaintiffs' damages.

## II. THE ORIGIN AND EVOLUTION OF THE PIERCING DOCTRINE

Limited liability is a bedrock feature of corporate law<sup>10</sup> for it encourages diversification and liquidity,<sup>11</sup> promotes market efficiency,<sup>12</sup>

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10. See 45 AM. JUR. PROOF OF FACTS 3D *Corporations* § 1, at 7 (1998) ("A fundamental principle of Anglo-American law is that a corporation is an entity separate and distinct from its shareholders. . . . This concept of limited liability has been called the most attractive feature of the corporation. . . . and must therefore be credited with a significant role in the industrial revolution and the subsequent development of global economy.")

11. See Bainbridge, *supra* note 7, at 490-91; John P. Glode, *Piercing the Corporate Veil in Wyoming—An Update*, 3 WYO. L. REV. 133, 134-35 (2003); Huss, *supra* note 3, at 105-06; Millon,

and decreases the need for monitoring agents and officers.<sup>13</sup> Although the origins of limited liability are unclear and have become the subject of scholarly debate,<sup>14</sup> it is clear that limited liability began in the United States as a fairly rare event achieved through an individual act of the legislature for special, usually infrastructural projects.<sup>15</sup> That changed with the Industrial Revolution, and by the 1840s, the majority of jurisdictions in the United States had adopted some form of limited liability for incorporated entities, embracing the notion that limited liability would encourage investment as well as increase competitiveness in business markets.<sup>16</sup> With the growth of limited liability as a statutory

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*supra* note 8, at 1312; Daniel Q. Posin, *Turning Green: Louisiana's Piercing-the-Corporate-Veil Jurisprudence and Its Economic Effects*, 79 TUL. L. REV. 311, 314 (2004); Thompson, *supra* note 3, at 1040 ("Limited liability encourages development of public markets for stocks and thus helps make possible the liquidity and diversification benefits that investors receive from those markets."); Bradley C. Reed, Note, *Clearing Away the Mist: Suggestions for Developing a Principled Veil Piercing Doctrine in China*, 39 VAND. J. TRANSNAT'L L. 1643, 1646–48 (2006).

12. See Bainbridge, *supra* note 7, at 490–91; Glode, *supra* note 11, at 134; Huss, *supra* note 3, at 105; Millon, *supra* note 8, at 1312; Posin, *supra* note 11, at 314–15; Reed, *supra* note 11, at 1646.

13. See Bainbridge, *supra* note 7, at 490–91; Huss, *supra* note 3, at 105; Millon, *supra* note 8, at 1313; Morrissey, *supra* note 5, at 536–41; Posin, *supra* note 11, at 314–15; Reed, *supra* note 11, at 1647.

14. Rutherford B. Campbell, *Limited Liability for Corporate Shareholders: Myth or Matter-of-Fact*, 63 KY. L.J. 23, 24 (1975).

15. See Morrissey, *supra* note 5, at 534.

16. Huss, *supra* note 3, at 103–04; see also Morrissey, *supra* note 5, at 534 ("As the industrial revolution began in earnest in the U.S. around 1825, businesses began to need capital from widespread investors. At that time, corporate statutes first started providing limited liability for shareholders."). For recent information regarding an individual jurisdiction's limited liability status, see ALA. CODE § 10-2B-6.22 (1999); ALASKA STAT. ANN. § 10.06.438 (West 2007); ARIZ. REV. STAT. ANN. § 10-622 (2009); ARK. CODE ANN. § 4-27-622 (West 2004); CAL. CORP. CODE § 17101 (West 2006); COLO. REV. STAT. ANN. § 7-106-203 (West 2006); CONN. GEN. STAT. ANN. § 33-673 (West 2005); DEL. CODE ANN. tit. 8, § 162 (West 2001); FLA. STAT. ANN. § 607.0622 (West 2007); GA. CODE ANN. § 14-2-622 (West 2003); HAW. REV. STAT. § 414-87 (West 2008); IDAHO CODE ANN. § 30-1-622 (West 2006); 805 ILL. COMP. STAT. ANN. 310/23 (West 2004); IND. CODE ANN. § 23-1-26-3 (West 2005); IOWA CODE ANN. § 490.622 (West 1999); KY. REV. STAT. ANN. § 271B.6-220 (West 2006); LA. REV. STAT. ANN. § 12:93 (1994); ME. REV. STAT. ANN. tit. 13C, § 623 (2005); MD. CODE ANN., CORPS. & ASS'NS § 2-215 (West 2002); MICH. COMP. LAWS ANN. § 450.1317 (West 2002); MINN. STAT. ANN. § 302A.425 (West 2004); MISS. CODE ANN. § 79-4-6.22 (West 1999); MO. ANN. STAT. § 347.057 (West 2001); MONT. CODE ANN. § 35-1-534 (2009); NEB. REV. STAT. § 21-2041 (2009); NEV. CONST. art. 8, § 3; N.H. REV. STAT. ANN. § 293-A:6.22 (1999); N.J. STAT. ANN. § 14A:5-30 (West 2003); N.M. STAT. ANN. § 53-11-25 (West 2003); N.Y. BUS. CORP. LAW § 628 (McKinney 2003); N.C. GEN. STAT. ANN. § 55-6-22 (West 2000); N.D. CENT. CODE ANN. § 10-19.1-69 (West 2008); OHIO REV. CODE ANN. § 1701.18 (West 2009); OR. REV. STAT. ANN. § 60.151 (West 2003); 15 PA. CONS. STAT. ANN. § 1526 (Supp. 2010); S.C. CODE ANN. § 33-6-220 (2006); S.D. CODIFIED LAWS § 47-1A-622 (2007); TENN. CODE ANN. § 48-16-203 (West 2010); TEX. BUS. ORGS. CODE ANN. § 101.114 (West 2010); UTAH CODE ANN. § 16-10a-622 (West 2004); VT. STAT. ANN. tit. 11A, § 6.22 (West 2007); VA. CODE ANN. § 13.1-644 (West 2007); WASH. REV. CODE ANN. § 23B.06.220 (West 1994); W. VA. CODE ANN. § 31D-6-622 (West 2002); WIS. STAT. ANN. § 180.0622 (Supp. 2009); WYO. STAT. ANN. § 17-16-622 (West 2007).

norm, courts began to recognize situations where limited liability created inequitable results, and, as a reaction, developed the piercing doctrine.<sup>17</sup>

Theoretically, the piercing doctrine is nothing more than a judicially created equitable remedy,<sup>18</sup> permitting plaintiffs to look beyond an entity's limited liability when the entity or its owners have failed to behave in a manner consistent with legitimate corporate institutions.<sup>19</sup> The rub, of course, has always been in determining what circumstances constitute a failure to act legitimately.<sup>20</sup> While the courts have generated various tests to determine under what circumstances a corporation is not acting legitimately, very little consensus exists.<sup>21</sup> Furthermore, while scholars have attempted to organize the tests into concrete categories, the similarities of those tests tend to overshadow their differences. Specifically, various scholars and courts have denominated three types of tests<sup>22</sup>—the alter ego test,<sup>23</sup> the instrumentality test,<sup>24</sup> and the injustice or

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17. See Glenn D. West & Stacie L. Cargill, *Corporations*, 62 SMU L. REV. 1057, 1060 (2009).

18. Although limited liability exists statutorily for incorporated entities in every jurisdiction in the United States, the piercing doctrine is not a legislative exception to most of those statutes. See Thompson, *supra* note 3, at 1041 (“Almost all state corporations statutes simply ignore the whole idea of piercing the corporate veil.”). Furthermore, the piercing doctrine is not an independent legislative construct in most United States jurisdictions. Morrissey, *supra* note 5, at 542 (“State statutes typically provide limited liability for shareholders unqualified by any reference to [the piercing doctrine].”). Instead, the piercing doctrine is a judicial exception created through the court's equity powers. FRANKLIN A. GEVURTZ, *CORPORATION LAW* § 1.5.1, at 70 (2000); Kenneth B. Watt, Comment, *Piercing the Corporate Veil: A Need for Clarification of Oklahoma's Approach*, 28 TULSA L.J. 869, 870 (1993) (“Courts pierce the corporate veil in order to protect third party plaintiffs from unjust injury by the corporation, and most jurisdictions recognize the doctrine as an equitable concept.”).

19. See, e.g., Henry W. Ballantine, *Separate Entity of Parent and Subsidiary Corporations*, 14 CALIF. L. REV. 12, 19 (1925) (stating the test is whether the corporation used the corporation in good faith for legitimate ends); Presser, *supra* note 4, at 407 (“It is, or at least once was and ought again to be, hornbook law that a shareholder or a parent corporation should not lose the protection of limited liability unless that shareholder or parent has somehow ‘abused’ the corporate form.”). Other scholars have defined the doctrine as a judicially created mechanism that ostensibly addresses excessive externalizing by companies who would otherwise possess limited liability. See, e.g., Bainbridge, *supra* note 3, at 77.

20. See Presser, *supra* note 4, at 412 ([t]here is no consensus on what constitutes ‘abuse.’ There are some jurisdictions that have [required] . . . proof of actual fraud before the shield of limited liability is removed. In other jurisdictions, fraud is not required, and some other ‘injustice,’ ‘illegality,’ or ‘inequity’ is all that is necessary to pierce the corporate veil.”).

21. *Id.*

22. See Campbell, *supra* note 14, at 33–37.

23. Matthew D. Caudill, *Piercing the Corporate Veil of a New York Not-For-Profit Corporation*, 8 FORDHAM J. CORP. & FIN. L. 449, 464–65 (2003). The elements of the alter ego test are

(1) that the corporation is not only influenced by the owners, but also that there is such unity of ownership and interest that their separateness has ceased; and (2) that the facts are such that an adherence to the normal attributes, . . . treatment as a separate entity, of separate corporate existence would sanction a fraud or promote injustice.

White v. Winchester Land Dev. Corp., 584 S.W.2d 56, 61–62 (Ky. Ct. App. 1979) (citing G.E.J.

equity test.<sup>25</sup> Nevertheless, most states explicitly or implicitly use all or portions of all three tests in their individual piercing jurisprudence.<sup>26</sup> In the final analysis, while some states have paid lip service to the idea of a multipart conjunctive test, these denominations are “useless metaphors,”<sup>27</sup> and most states have settled for a factors test,<sup>28</sup> permitting

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Corp. v. Uranium Aire, Inc., 311 F.2d 749, 756 (9th Cir. 1962)). To the extent a discernable difference exists between this test and the instrumentality test, this test is usually used to pierce vertically—in situations where a corporation is owned by one or more individual shareholders. Marilyn Blumberg Cane & Robert Burnett, *Piercing the Corporate Veil in Florida: Defining Improper Conduct*, 21 NOVA L. REV. 663, 667 (1997).

24. Caudill, *supra* note 23, at 465–66. The instrumentality test was first introduced by Professor Powell in 1931 and required the finding of three elements. Campbell, *supra* note 14, at 33 (citing P. POWELL, PARENT AND SUBSIDIARY CORPORATIONS (1931)). First, the corporation must be a mere instrumentality of the shareholder. *Id.* Second, the shareholder must have exercised control over the corporation in a manner that harmed the plaintiff. *Id.* Finally, the refusal to disregard the corporate shell must subject the plaintiff to unjust loss. *Id.* To the extent a discernable difference exists between this test and the alter ego test, this test is typically used to pierce horizontally—when a corporation is owned by one or more corporations. Cane & Burnett, *supra* note 23, at 667.

25. Caudill, *supra* note 23, at 466 (stating the types of tests). The equity test has a variety of formulations but generally takes the form of a factors test that focuses on the element of inequity. *See id.*

26. *See* Michael J. Gaertner, Note, *Reverse Piercing the Corporate Veil: Should Corporation Owners Have It Both Ways?*, 30 WM. & MARY L. REV. 667, 668 (1989); *see also, e.g.*, Angelo Tomasso, Inc. v. Armor Const. & Paving, Inc., 447 A.2d 406, 410 (Conn. 1982) (using the instrumentality, alter ego, and injustice language); Escobedo v. BHM Health Assocs., 818 N.E.2d 930, 933 (Ind. 2004) (using the instrumentality, alter ego, and injustice language); Kvassay v. Murray, 808 P.2d 896, 904 (Kan. Ct. App. 1991) (using the instrumentality, alter ego, and injustice language); Saidawi v. Giovanni’s Little Place, Inc., 987 S.W.2d 501, 504–05 (Mo. Ct. App. 1999) (using the instrumentality, alter ego, and injustice language); Berlin v. Boedecker, 887 P.2d 1180, 1188 (Mont. 1994) (using the instrumentality, alter ego, and injustice language); Scott v. AZL Res., Inc., 753 P.2d 897, 900 (N.M. 1988) (using the instrumentality, alter ego, and injustice language); John John, LLC v. Exit 63 Dev., LLC, 826 N.Y.S.2d 657, 659 (App. Div. 2006) (using the instrumentality and alter ego language); Monteau v. Reis Trucking & Constr., Inc., 553 S.E.2d 709, 712 (N.C. Ct. App. 2001) (using the instrumentality, alter ego, and injustice language); Amfac Foods, Inc. v. Int’l Sys. & Controls Corp., 654 P.2d 1092, 1099 (Or. 1982) (using the instrumentality, alter ego, and injustice language); R & B Elec. Co. v. Amco Constr. Co., 471 A.2d 1351, 1354–55 (R.I. 1984) (using the instrumentality, alter ego, and injustice language); Ethan Dairy Prods. v. Austin, 448 N.W.2d 226, 230 (S.D. 1989) (using the instrumentality, alter ego, and injustice language); Oak Ridge Auto Repair Serv. v. City Fin. Co., 425 S.W.2d 620, 622 (Tenn. Ct. App. 1967) (using the instrumentality, alter ego, and injustice language); Mancorp, Inc. v. Culpepper, 802 S.W.2d 226, 227–28 (Tex. 1990) (using the instrumentality, alter ego, and injustice language); Transamerica Cash Reserve, Inc. v. Dixie Power & Water, Inc., 789 P.2d 24, 26 (Utah 1990) (using the instrumentality, alter ego, and injustice language); Miles v. CEC Homes, Inc., 753 P.2d 1021, 1023–24 (Wyo. 1988) (using the instrumentality, alter ego, and injustice language); Miller, *supra* note 4, at 91 (“[T]he ‘instrumentality’ theory, the ‘alter ego’ theory, and the ‘identity’ theory . . . are not helpful in light of the numerous descriptive phrases that are used, apparently interchangeably, by the courts. Some courts have abandoned all efforts to articulate a theory and instead take a ‘laundry list’ approach to the identification of factors likely to justify veil-piercing . . .”).

27. Cane & Burnett, *supra* note 23, at 667.

28. *See* Econ Mktg., Inc. v. Leisure Am. Resorts, Inc., 664 So. 2d 869, 870 (Ala. 1994); Murat v. F/V Shelikof Strait, 793 P.2d 69, 76 (Alaska 1990); Anderson v. Stewart, 234 S.W.3d 295, 298

trial courts to consider, ignore, and weigh various factors as the situation necessitates.<sup>29</sup> Of course, because these decisions are necessarily

(Ark. 2006); *Mid-Century Ins. Co. v. Gardner*, 11 Cal. Rptr. 2d 918, 922 (Ct. App. 1992); *Estate of Raleigh v. Mitchell*, 947 A.2d 464, 470–71 (D.C. 2008); *Graham v. Palmtop Props., Inc.*, 645 S.E.2d 343, 346 (Ga. Ct. App. 2007); *Robert's Haw. Sch. Bus, Inc. v. Laupahoehoe Transp. Co.*, 982 P.2d 853, 871 (Haw. 1999); *Hutchison v. Anderson*, 950 P.2d 1275, 1279 (Idaho Ct. App. 1997); *Cosgrove Distribs., Inc. v. Haff*, 798 N.E.2d 139, 141 (Ill. App. Ct. 2003); *Escobedo*, 818 N.E.2d at 933; *Kvassay*, 808 P.2d at 904; *White v. Winchester Land Dev. Corp.*, 584 S.W.2d 56, 62 (Ky. Ct. App. 1979); *Pine Tree Assocs. v. Doctors' Assocs.*, 654 So. 2d 735, 738–39 (La. Ct. App. 1995); *Johnson v. Exclusive Props. Unlimited*, 720 A.2d 568, 571 (Me. 1998); *Evans v. Multicon Constr. Corp.*, 574 N.E.2d 395, 398 (Mass. App. Ct. 1991); *Hoyt Props., Inc. v. Prod. Res. Grp., L.L.C.*, 736 N.W.2d 313, 318–19 (Minn. 2007); *Hardy v. Brock*, 826 So. 2d 71, 75 (Miss. 2002); *Medlock v. Medlock*, 642 N.W.2d 113, 124 (Neb. 2002); *Lorenz v. Beltio, Ltd.*, 963 P.2d 488, 497 (Nev. 1998); *Verni ex rel. Burstein v. Harry M. Stevens, Inc.*, 903 A.2d 475, 498 (N.J. Super. Ct. App. Div. 2006); *Scott*, 753 P.2d at 900–01; *E. Hampton Union Free Sch. Dist. v. Sandpebble Builders, Inc.*, 884 N.Y.S.2d 94, 99 (App. Div. 2009); *Atl. Tobacco Co. v. Honeycutt*, 398 S.E.2d 641, 643 (N.C. Ct. App. 1990); *Coughlin Constr. Co. v. Nu-Tec Indus., Inc.*, 755 N.W.2d 867, 873 (N.D. 2008); *Lewis v. Cent. Okla. Med. Grp., Inc.*, 998 P.2d 202, 206 (Okla. Civ. App. 1999); *Osloond v. Osloond*, 609 N.W.2d 118, 122 (S.D. 2000); *Colman v. Colman*, 743 P.2d 782, 786 (Utah Ct. App. 1987); *Olen v. Phelps*, 546 N.W.2d 176, 180–81 (Wis. Ct. App. 1996); *Kaycee Land & Livestock v. Flahive*, 46 P.3d 323, 325 (Wyo. 2002); Elizabeth E. Brown, *A Guide to Winning Alter Ego Claims*, AM. BANKR. INST. J., June 1996, at 15, 15 (“Although they may combine or state them differently, most courts utilize . . . 12 factors . . . .”); Matheson & Eby, *supra* note 8, at 173 (“The failure of the courts’ previous attempts to articulate a single test for disregarding the corporate form and holding the owners of the corporation responsible for the business’s financial responsibilities has resulted in a number of overlapping lists of factors that are passed off as tests.”).

29. The California Court of Appeals attempted to create an exhaustive list of factors used by courts in *Associated Vendors, Inc. v. Oakland Meat Co.*, 26 Cal. Rptr. 806, 813–15 (Ct. App. 1962). There, the court provided the following as a list of factors used by courts to justify their piercing decisions:

[1] Commingling of funds and other assets, failure to segregate funds of the separate entities, and the unauthorized diversion of corporate funds or assets to other than corporate uses; [2] the treatment by an individual of the assets of the corporation as his own; [3] the failure to obtain authority to issue stock or to subscribe to or issue the same; [4] the holding out by an individual that he is personally liable for the debts of the corporation; [5] the failure to maintain minutes or adequate corporate records, and the confusion of the records of the separate entities; [6] the identical equitable ownership in the two entities; [7] the identification of the equitable owners thereof with the domination and control of the two entities; [8] identification of the directors and officers of the two entities in the responsible supervision and management; [9] sole ownership of all of the stock in a corporation by one individual or the members of a family; [10] the use of the same office or business location; [11] the employment of the same employees and/or attorney; [12] the failure to adequately capitalize a corporation; [13] the total absence of corporate assets, and undercapitalization; [14] the use of a corporation as a mere shell, instrumentality or conduit for a single venture or the business of an individual or another corporation; [15] the concealment and misrepresentation of the identity of the responsible ownership, management and financial interest, or concealment of personal business activities; [16] the disregard of legal formalities and the failure to maintain arm’s length relationships among related entities; [17] the use of the corporate entity to procure labor, services or merchandise for another person or entity; [18] the diversion of assets from a corporation by or to a stockholder or other person or entity, to the detriment of creditors, or the manipulation of assets and liabilities between entities so as to concentrate the assets in one and the liabilities in another; [19] the contracting with another with intent to avoid performance by use of a corporate entity as a shield against personal liability, or the use of a corporation as a subterfuge of illegal transactions; [20] and the formation and use

factually charged, they are largely more reflective of the judge's personal opinion on the instant case as opposed to the judge's interpretation of the general law.<sup>30</sup> Thus, in terms of predictability and consistency, the tests have become only slightly more sophisticated than the smell test.<sup>31</sup>

The lack of a specific test is further exacerbated by the existence of multiple types of piercing cases. That is, in addition to the multifarious tests in general, the courts weigh different factors more heavily depending on the type of piercing case.<sup>32</sup> There are tort versus contract cases,<sup>33</sup> horizontal versus vertical piercing cases,<sup>34</sup> reverse piercing cases,<sup>35</sup> and triangular piercing cases.<sup>36</sup> Each of these, of course, asks the judge to focus attention on specific types of factors within the test but does not provide any objective means for deciding when piercing would be appropriate.

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of a corporation to transfer to it the existing liability of another person or entity.

*Id.* (citations omitted). Nevertheless, courts have used other factors as well. See *Kavanaugh v. Ford Motor Co.*, 353 F.2d 710, 717 (7th Cir. 1965); *Millon*, *supra* note 8, at 1327 ("When one attempts to rationalize the piercing cases according to some other set of values, one encounters a dismal morass of repetitive rhetoric masking conclusory evaluation. The cases typically list a series of more or less standard factors. Little if anything is said about how they are to be weighted or which ones are necessary or sufficient by themselves to support a piercing result."); *Morrissey*, *supra* note 5, at 544 ("Without a unified criterion for piercing, courts have relied on what one commentator called, 'a number of overlapping lists of factors that are passed off as a test.'" (quoting *Matheson & Eby*, *supra* note 8, at 173)).

30. See *Bainbridge*, *supra* note 7, at 514–15; Robert W. Hamilton, *The Corporate Entity*, 49 TEX. L. REV. 979, 982–83 (1971) (stating the tests used to determine when piercing is appropriate are merely artifices used by courts to justify their conclusions); *Presser*, *supra* note 4, at 411 ("[T]he current state of veil-piercing law is chaotic . . .").

31. See *Huss*, *supra* note 3, at 109 (noting that the principle is "seemingly random" in its application).

32. See Franklin A. Gevurtz, *Piercing Piercing: An Attempt to Lift the Veil of Confusion Surrounding the Doctrine of Piercing the Corporate Veil*, 76 OR. L. REV. 853, 884–87 (1997) (stating undercapitalization is only typically deemed important in tort cases).

33. *Caudill*, *supra* note 23, at 467 (summarizing Judge Posner's view that horizontal and vertical piercing should only be available in fraudulent misrepresentation cases); *Gevurtz*, *supra* note 32, at 884 (stating the difference between contract and tort piercing cases); *Morrissey*, *supra* note 5, at 545 (noting a distinction between contract and tort cases for purposes of piercing).

34. John H. Matheson, *The Limits of Business Limited Liability: Entity Veil Piercing and Successor Liability Doctrines*, 31 WM. MITCHELL L. REV. 411, 419–20 (2004) (noting the distinction between horizontal and vertical veil piercing cases).

35. *Caudill*, *supra* note 23, at 467 ("Reverse piercing occurs when a court holds a controlled corporation, which has been misused as the alter ego or instrumentality of a shareholder, liable for the debts of that controlling shareholder.").

36. *Id.* at 469 ("Triangular piercing occurs when a controlled corporation is held liable for the debts of an affiliated corporation, through an intermediary controlling shareholder. The liability flows in a triangle, first from the controlled corporation to the controlling shareholder, then from the controlling shareholder to the affiliated corporation.").

*A. Tort Versus Contract Cases*

While the separation between tort and contract theories in ordinary litigation can sometimes prove difficult,<sup>37</sup> courts have routinely viewed the two as finitely distinct in both the application of piercing and its theory.<sup>38</sup> The separation of tort and contract, as it applies to piercing theory, stems from perceived choice of the parties.<sup>39</sup> That is, in tort cases, the plaintiff does not necessarily choose to engage in a relationship with the defendant.<sup>40</sup> Rather, in many cases that relationship is thrust upon the plaintiff.<sup>41</sup> In contrast, contract cases are ordinarily the result of two or more bargaining parties who each possess the power to investigate one another prospectively before entering the relationship.<sup>42</sup> While this distinction seems somewhat irrelevant in a vacuum, its theoretical underpinning makes sense, if nowhere else, when discussing the injustice element of the piercing doctrine.

The injustice element in the piercing doctrine stems from the doctrine's historical roots. That is, the piercing doctrine evolved as a judicial, equitable response to the perceived—or actual—unfairness that could result from the application of strict limited liability statutes.<sup>43</sup> Thus, notwithstanding the mandates of limited liability, courts have permitted plaintiffs to pierce the corporate veil in circumstances where permitting the defendant to hide behind the black letter of the law would be unjust—the defendant has engaged in fraud, misrepresentation, or undercapitalization.<sup>44</sup> In this context, the theoretical notion of choice plays a significant role because it defines what level of injustice could have existed between the parties and, thus, how rigorously the court will enforce the discretion of equity jurisdiction.<sup>45</sup> For example, in the context of fraud, one party to a contract can investigate another before entering the relationship.<sup>46</sup> Presumably, a party's diligent effort would uncover any material fraud. Thus, parties to a contract have some ability

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37. For instance, the fine bifurcation between the two is less clear in quasi-contractual, equitable theories such as promissory estoppel because those theories have developed in both tort and contract jurisprudence.

38. See, e.g., *Edwards Co. v. Monogram Indus., Inc.*, 730 F.2d 977, 982 (5th Cir. 1984).

39. See *Gevurtz*, *supra* note 32, at 858–59.

40. See *Millon*, *supra* note 8, at 1355.

41. See *id.*

42. See *Gevurtz*, *supra* note 32, at 858–59; *Millon*, *supra* note 8, at 1315–17, 1355; *Thompson*, *supra* note 3, at 1039–40.

43. *West & Cargill*, *supra* note 17, at 1058, 1060.

44. See *id.* at 1060.

45. See sources cited *supra* note 42.

46. See *Millon*, *supra* note 8, at 1368.

to engage in self-help prospectively.<sup>47</sup> This theoretically, of course, would lead to a less rigorous exercise of equity jurisdiction on the basis that the courts will only invoke equity jurisdiction to help those who have done everything possible to help themselves.<sup>48</sup> In contrast, classic tort plaintiffs do not always possess this ability.<sup>49</sup> For instance, if a plaintiff is injured by a faulty widget produced by the defendant and used by a third party, then the plaintiff lacked the ability to investigate for undercapitalization, and, thus, the plaintiff's claim for the exercise of equity jurisdiction is presumably better.

Notwithstanding this seemingly sound theoretical argument, empirical studies do not indicate that courts actually apply this model on the average.<sup>50</sup> Rather, contrary to what one might think, courts most frequently pierce in contract cases.<sup>51</sup> Nevertheless, the distinction still plays some role in which factors a court deems important in a piercing analysis.<sup>52</sup> For instance, in contract cases, undercapitalization is largely ignored,<sup>53</sup> while in tort cases, undercapitalization is generally deemed important.<sup>54</sup> Thus, in terms of application, the distinction between the two types of cases tends to focus on the element of injustice.

### *B. Horizontal Versus Vertical Piercing Cases*

In contrast with the dichotomy between tort and contract cases—a dichotomy that affects all piercing cases—the distinction between horizontal and vertical piercing cases only affects a small subclass of piercing cases—a plaintiff seeks to pierce through one corporation that possesses some relationship with another corporation.

Horizontal piercing involves a plaintiff's attempt to pierce the veil of one subsidiary to reach the assets of another subsidiary who shares a

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47. *Id.*

48. See 1 CHARLES FISK BEACH, JR., MODERN EQUITY: COMMENTARIES ON MODERN EQUITY JURISPRUDENCE AS DETERMINED BY THE COURTS AND STATUTES OF ENGLAND AND THE UNITED STATES § 54, at 53–54 (1892); 27 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 69:34, at 25 (4th ed. 2003) (“Equity will not interfere on behalf of one alleging fraud where the person relying on the misrepresentation had an opportunity to prevent any injury by due diligence.”); Watt, *supra* note 18, at 872–73 (“Typically, in contract claims, . . . the plaintiff must prove a higher degree of culpability . . . than in a tort case for the court to pierce the corporate veil because the plaintiff has sufficient information to make an informed choice . . . before entering the transaction.”).

49. See *supra* notes 40–42 and accompanying text.

50. Thompson, *supra* note 3, at 1038.

51. *Id.*

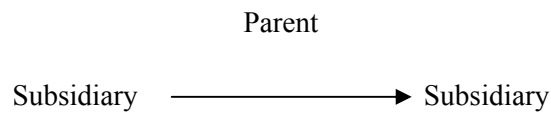
52. See Presser, *supra* note 4, at 412.

53. See Gevurtz, *supra* note 32, at 884–87.

54. See *id.* at 887.

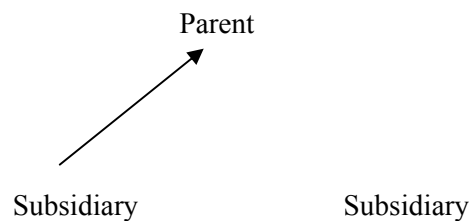
parent corporation.<sup>55</sup> Thus, for example, imagine corporation *A*, a parent corporation, owns shares in three subsidiary corporations, *B*, *C*, and *D*, each of whom produce different types of widgets. A horizontal piercing claim would involve a plaintiff attempting to pierce the veil of *B* to attack the assets of *C*. If this process were drawn, as in Figure 1, then, the plaintiff would literally be attempting to simultaneously attack two corporations of equal power within the larger corporate hierarchy—thus, the term *horizontal*.

**Figure 1: Horizontal Piercing**



The phrase *vertical piercing* evolved from the same visual notions. Vertical piercing occurs when a plaintiff attempts to pierce through the corporate shield of a subsidiary to reach the assets of a parent.<sup>56</sup> Thus, in the example above, a plaintiff would be attempting to pierce the corporate shield of *B* to reach the assets of *A*. In contrast with horizontal piercing, the plaintiff is no longer attempting to pierce two corporations of equal power within the hierarchy of the corporate structure. Rather, the plaintiff is now attempting to pierce an inferior corporate entity—a subsidiary—in an attempt to reach the assets of a superior corporate entity—the parent. If drawn, as in Figure 2, the plaintiff would literally draw a piercing line upwards—hence, the name.

**Figure 2: Vertical Piercing**



55. Matheson, *supra* note 34, at 420.

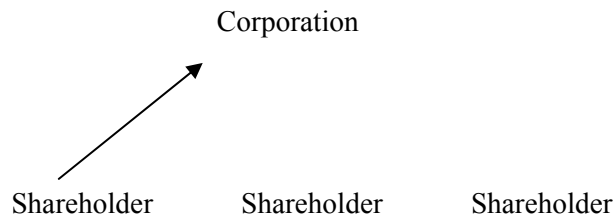
56. See Gevurtz, *supra* note 32, at 898–99.

In terms of application, courts tend to focus their inquiry on control or unity factors when analyzing horizontal and vertical piercing cases and deemphasize injustice elements.<sup>57</sup>

*C. Reverse Piercing Cases*

Reverse piercing cases can occur as an overlay of any of the types of piercing cases discussed above, as reverse piercing is an attempt by a plaintiff to pierce a shareholder—or, in the case of a multicorporate structure, a superior—to reach the assets of an inferior.<sup>58</sup> Thus, in the common corporate context where there is a single corporate entity and a number of shareholders, a reverse pierce would be an attempt by the plaintiff to pierce through the shareholder to reach the assets of the corporation.<sup>59</sup> This is demonstrated in Figure 3.

**Figure 3: Reverse Piercing Shareholder**



Or, in the context of a multicorporate structure, a reverse pierce would occur where a plaintiff attempts to pierce a parent to reach the assets of a subsidiary.<sup>60</sup> This is demonstrated in Figure 4.

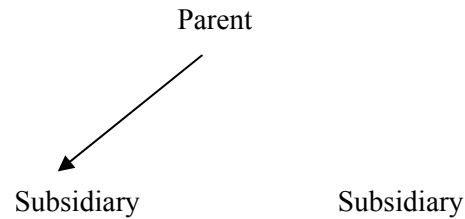
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57. *Id.*

58. *See* Caudill, *supra* note 23, at 467.

59. *Id.* at 467–68.

60. *Id.* at 467.

**Figure 4: Reverse Piercing Parent**

In terms of application, as with horizontal and vertical piercing cases, courts tend to emphasize the control and unity elements and deemphasize the injustice elements. In addition, some have argued this type of piercing should only be available in contractual misrepresentation cases.<sup>61</sup>

#### *D. Triangular Piercing Cases*

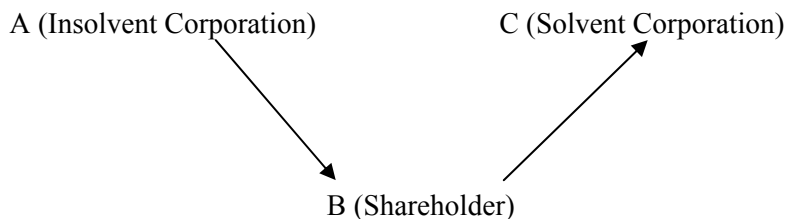
Triangular piercing cases are the most complicated of the piercing structures, as they potentially entail all of the hallmarks of the above structures with a twist—triangular piercing cases can arise from tort or contract cases, have elements of horizontal and vertical structures, and involve reverse piercing.<sup>62</sup> Triangular piercing cases exist where a plaintiff attempts to pierce a parent corporation to reach a shareholder of the parent, in an attempt to reach an otherwise unrelated corporation of which the shareholder owns an interest.<sup>63</sup> Thus, imagine a parent company, *A*, is solely owned by a shareholder, *B*. Furthermore, imagine that *B* owns shares in an unrelated corporation, *C*. Now imagine that while the plaintiff has only dealt with *A* and *B*, the plaintiff has had no direct relationship with *C*. Nevertheless, both *A* and *B* are insolvent. Thus, the plaintiff seeks to pierce *A* to reach *B* to reach *C*, as Figure 5 demonstrates. This, of course, forms a triangle, giving rise to the name.

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61. *Id.* at 470–72 (summarizing Judge Posner’s views on reverse piercing).

62. *See id.* at 469–70.

63. *Id.* at 469.

**Figure 5: Triangular Piercing**

In terms of application, as with horizontal, vertical, and reverse piercing cases, courts tend to emphasize the control and unity elements and deemphasize the injustice elements.<sup>64</sup> In addition, some have argued this type of piercing should only be available in contractual misrepresentation cases.<sup>65</sup>

### III. PREDICTABILITY AND CONSISTENCY AS GOALS OF MODERN JURISPRUDENCE

The concepts of predictability and consistency are said to have first arisen on a mandatory basis, at least in England, in the Magna Carta.<sup>66</sup> While the Magna Carta was designed to limit the power of the king, as opposed to the powers of democratic governments, its ideals of nonarbitrary government action have nonetheless formed the essential basis of our modern democratic system<sup>67</sup> and have worked their way into some of the most prominent documents in the United States.<sup>68</sup> While predictability and consistency have certainly formed the basis for larger discussions about all of our governmental branches,<sup>69</sup> these twin goals

64. See *id.* at 464–67.

65. *Id.* at 470–72 (summarizing Judge Posner’s views on triangular piercing).

66. See Christine N. Cimini, *Principles of Non-Arbitrariness: Lawlessness in the Administration of Welfare*, 57 RUTGERS L. REV. 451, 459 (2005) (“Historically, concepts of non-arbitrariness extend back to the Magna Carta, and a general repudiation of governmental arbitrariness is evidenced in many documents that form the foundation of our current legal system.”).

67. See *id.*

68. See Thomas R. Phillips, *The Constitutional Right to a Remedy*, 78 N.Y.U. L. REV. 1309, 1310 (2003) (stating that portions of the Magna Carta exist in at least forty state constitutions).

69. See John Harrison, *The Power of Congress over the Rules of Precedent*, 50 DUKE L.J. 503, 516 (2000) (noting adherence to judicial precedent is sound policy because it promotes evenhandedness, predictability, consistency, and reliance); Julia Shear Kushner, Comment, *The Right to Control One’s Name*, 57 UCLA L. REV. 313, 358–59 (2009) (noting a statute with fewer guidelines for a court to consider would lead to less predictability and consistency and more litigation); David C. Weiss, Note, *The Foreign Corrupt Practices Act, SEC Disgorgement of Profits, and the Evolving International Bribery Regime: Weighing Proportionality, Retribution, and*

are most pressing in the context of judicial decisions and have assisted the reasoning of nearly every appellate court in the country.<sup>70</sup> Most notably, they are the key goals embedded within the doctrine of stare decisis.<sup>71</sup>

While many civilizations have recognized the prudence of reviewing historical judicial decisions as a means to understand current litigation,<sup>72</sup> stare decisis—or “stand by the thing decided and do not disturb the calm”<sup>73</sup>—ultimately originated in its present form in England.<sup>74</sup> The

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*Deterrence*, 30 MICH. J. INT’L L. 471, 502–03 (2009) (noting the FCPA’s regulatory scheme owes some level of predictability and consistency to parties that it seeks to regulate).

70. See, e.g., *Planned Parenthood of Se. Pa. v. Casey*, 505 U.S. 833, 854 (1992) (stating the doctrine of stare decisis is indispensable to the rule of law); *Thomas v. Wash. Gas Light Co.*, 448 U.S. 261, 272 (1980) (holding stare decisis plays “an important role in orderly adjudication . . . [and] serves the broader societal interests in evenhanded, consistent, and predictable application of legal rules.”); *Moragne v. States Marine Lines, Inc.*, 398 U.S. 375, 403 (1970); *Keck v. Dryvit Sys., Inc.*, 830 So. 2d 1, 7–8 (Ala. 2002); *Sierra Club v. San Joaquin Local Agency Formation Comm’n*, 981 P.2d 543, 552 (Cal. 1999); *Conway v. Town of Wilton*, 680 A.2d 242, 246 (Conn. 1996); *Keeler v. Harford Mut. Ins. Co.*, 672 A.2d 1012, 1017 (Del. 1996); *Atlanta Coca Cola Bottling Co. v. Gates*, 171 S.E.2d 723, 734 (Ga. 1969); *Roberts v. Krupka*, 779 P.2d 447, 456 (Kan. Ct. App. 1989); *Irish v. Gimbel*, 743 A.2d 736, 737 (Me. 2000); *Livesay v. Baltimore Cnty.*, 862 A.2d 33, 40–41 (Md. 2004); *Stonehill Coll. v. Mass. Comm’n Against Discrimination*, 808 N.E.2d 205, 216 (Mass. 2004); *State v. Manford*, 106 N.W. 907, 908 (Minn. 1906); *Clark v. Clark*, 222 A.2d 205, 208 (N.H. 1966); *Arrow Builders Supply Corp. v. Hudson Terrace Apartments, Inc.*, 105 A.2d 387, 391 (N.J. 1954); *People v. Taylor*, 878 N.E.2d 969, 978 (N.Y. 2007); *Bacon v. Lee*, 549 S.E.2d 840, 851–52 (N.C. 2001); *Stilp v. Commonwealth*, 905 A.2d 918, 954 (Pa. 2006); *State v. Musumeci*, 717 A.2d 56, 68 (R.I. 1998); *Union Trust Co. v. Williamson Cnty. Bd. of Zoning Appeals*, 500 S.W.2d 608, 615 (Tenn. 1973); *State v. Shoulderblade*, 905 P.2d 289, 291–92 (Utah 1995); see also THE FEDERALIST NO. 80, *supra* note 1, at 401 (Alexander Hamilton) (“The mere necessity of uniformity in the interpretation of the national laws, decides the question. Thirteen independent courts of final jurisdiction over the same causes, arising upon the same laws, is a hydra in government, from which nothing but contradiction and confusion can proceed.”).

71. *Thomas*, 448 U.S. at 272 (stating that stare decisis plays “an important role in orderly adjudication . . . [and] serves the broader societal interests in evenhanded, consistent, and predictable application of legal rules”).

72. See Thomas Healy, *Stare Decisis as a Constitutional Requirement*, 104 W. VA. L. REV. 43, 54–55 (2001) (“In ancient Greece, judges relied on past cases to settle commercial disputes, while early Egyptian judges prepared a rudimentary system of law reports to help them guide their decisions. Roman judges also displayed a tendency to follow the example of their predecessors.”).

73. Mark Sabel, *The Role of Stare Decisis in Construing the Alabama Constitution of 1901*, 53 ALA. L. REV. 273, 274 (2001); Victor E. Schwartz et al., *Toward Neutral Principles of Stare Decisis in Tort Law*, 58 S.C. L. REV. 317, 320 (2006); James C. Rehnquist, Note, *The Power That Shall Be Vested in a Precedent: Stare Decisis, the Constitution and the Supreme Court*, 66 B.U. L. REV. 345, 347 (1986); see also Luis Diego Canseco & Enrique Pasquel, *Stare Decisis, Commercial Exchanges, and Predictability: A Proposal to Confront the Reform of the Judicial Branch*, 20 FLA. J. INT’L L. S31, 49 (2008) (stating stare decisis literally means to “keep to the determined decision and maintain the calm”).

74. For a thorough examination of the doctrine’s evolution in England, see Healy, *supra* note 72, at 54–72. See also Canseco & Pasquel, *supra* note 73, at 49–50 (stating stare decisis originated in Rome but developed in its present form in Great Britain).

doctrine was then transferred to the United States both through the colonial governments<sup>75</sup> and the understanding of our founding fathers.<sup>76</sup>

Predictability and consistency in judicial judgments are important for obvious reasons. They promote public confidence in the law;<sup>77</sup> foster certainty;<sup>78</sup> enhance stability in the law;<sup>79</sup> create efficiency;<sup>80</sup> promote unbiased, meritorious decisions;<sup>81</sup> and encourage judicial restraint.<sup>82</sup> However, they are particularly important in the context of business law, as business transactions inherently presume continuity in the law as it exists today.<sup>83</sup> Thus, predictability and consistency in this realm encourages citizens to conduct business, leading to a more viable economy.<sup>84</sup> Inversely, unpredictability and inconsistency discourage business by generating a lack of reliance. Notwithstanding this obvious truth, these integral twin principles do not exist in the piercing doctrine.<sup>85</sup> Instead, as stated earlier, the piercing doctrine operates in a factually

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75. Healy, *supra* note 72, at 75; Rehnquist, *supra* note 73, at 348.

76. THE FEDERALIST NO. 78, *supra* note 1, at 397 (Alexander Hamilton) (“To avoid an arbitrary discretion in the courts, it is indispensable that they should be bound down by strict rules and precedents, which serve to define and point out their duty in every particular case that comes before them . . . .”); Jordan Wilder Connors, Note, *Treating Like Subdecisions Alike: The Scope of Stare Decisis as Applied to Judicial Methodology*, 108 COLUM. L. REV. 681, 685 (2008) (“Although the Constitution contains no reference to stare decisis, ample evidence suggests that the Framers and commentators at the time of ratification contemplated its application and supported some manner of its use.”).

77. Sabel, *supra* note 73, at 274; Schwartz et al., *supra* note 73, at 320; Connors, *supra* note 76, at 687; Kelly Parker, Comment, *Of Sleeping Dogs and Silent Love: Stare Decisis and Lawrence v. Texas*, 41 IDAHO L. REV. 177, 188 (2004); Rehnquist, *supra* note 73, at 347.

78. Canseco & Pasquel, *supra* note 73, at 49; Healy, *supra* note 72, at 51; Christopher J. Peters, *Foolish Consistency: On Equality, Integrity, and Justice in Stare Decisis*, 105 YALE L.J. 2031, 2039 (1996).

79. Canseco & Pasquel, *supra* note 73, at 49; Healy, *supra* note 72, at 70; Peters, *supra* note 78, at 2039; Sabel, *supra* note 73, at 274.

80. Healy, *supra* note 72, at 108–09; Parker, *supra* note 77, at 188; Peters, *supra* note 78, at 2039; Sabel, *supra* note 73, at 274; Connors, *supra* note 76, at 685; Parisi G. Filippatos, Note, *The Doctrine of Stare Decisis and the Protection of Civil Rights and Liberties in the Rehnquist Court*, 11 B.C. THIRD WORLD L.J. 335, 338 (1991).

81. See Healy, *supra* note 72, at 109; Sabel, *supra* note 73, at 274; see also Connors, *supra* note 76, at 687 (stating stare decisis promoted fairness); Filippatos, *supra* note 80, at 339 (same).

82. Healy, *supra* note 72, at 109.

83. Peters, *supra* note 78, at 2039; Rehnquist, *supra* note 73, at 348; see also Miller, *supra* note 4, at 112 (“The degree of judicial discretion surrounding the law of entity recognition poses a distinct challenge to the business planner in search of predictability in the law.”).

84. Healy, *supra* note 72, at 108; Parker, *supra* note 77, at 188 (“*Stare decisis* provides some moorings so that men may trade and arrange their affairs with confidence. *Stare decisis* serves to take the capricious element out of the law and give stability to a society. It is a strong tie which the future has to the past.” (quoting William O. Douglas, *Stare Decisis*, 49 COLUM. L. REV. 735, 736 (1949))).

85. Huss, *supra* note 3, at 110 (noting the principle is arbitrary in its application).

intensive vacuum that is wholly removed from traditional notions of stare decisis.<sup>86</sup>

The crux of the problem has been, then, to create a system that preserves the fundamental notions of fairness entangled within the piercing doctrine, while attempting to achieve some level of predictability and consistency with its application. That problem has proven a tough beast to slay because the current piercing formulations provide an extraordinary degree of discretion to the judiciary. Nevertheless, a number of scholars have proposed a variety of mechanisms to alleviate the predictability and consistency problem.

#### IV. PROPOSALS BY OTHER SCHOLARS

A number of proposals already exist to remedy the predictability and consistency problems the doctrine currently generates. Generally, two types of theories exist, each respectively focusing on either abolishing the doctrine altogether or alleviating the doctrine's more inhospitable characteristics through codification of a more stringent test. All of these proposals suffer from deficiencies.

##### *A. Proposals Advocating Elimination of the Doctrine*

The first category of proposals attempts to eliminate the piercing doctrine. Three prominent theories exist for elimination of the doctrine: (1) the Bainbridge Proposal,<sup>87</sup> (2) the Mandatory Insurance Proposal, and (3) the Mandatory Capitalization Proposal.<sup>88</sup>

##### 1. The Bainbridge Proposal

Professor Bainbridge has been an outspoken critic of the piercing doctrine and has explicitly advocated its abolition for two reasons. First, he posits that the doctrine is unprincipled and uncontrollable.<sup>89</sup> Second, he argues the doctrine has predictability costs without serving any policy goals.<sup>90</sup>

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86. *Id.*

87. *See generally* Bainbridge, *supra* note 7 (outlining the proposal).

88. While the Mandatory Insurance and Mandatory Capitalization proposals do not explicitly recommend abolition of the doctrine, the proposals are, by their very nature, a replacement for the doctrine. Thus, the doctrine's abolition is implicit.

89. Bainbridge, *supra* note 7, at 481.

90. *Id.*

As to the first reason, Professor Bainbridge argues fairly simply, and correctly, that veil piercing lacks any objective criteria capable of prospective analysis or application.<sup>91</sup> Rather, veil-piercing tests are composed of a variety of factors that a court, retrospectively, will review to determine whether piercing is appropriate.<sup>92</sup> This obviously leads to uncertainty and unpredictability from a corporate planning perspective.<sup>93</sup> Exacerbating the problem, Professor Bainbridge argues, courts frequently seize on one aspect of the factors test and consider it dispositive, even when that aspect, standing alone, is simply a common virtue of even legitimate corporations.<sup>94</sup>

As to the second reason, Professor Bainbridge argues that this unpredictability has social costs without any social benefit.<sup>95</sup> The social costs, of course, are inconsistency, unpredictability, the potential for overcapitalization and, thus, reduction in liquidity, difficulty in advising clients prospectively, difficulty in planning from the client's perspective, and general undermining of limited liability.<sup>96</sup> In terms of social benefits, Professor Bainbridge does not believe veil piercing serves any.<sup>97</sup> Rather, because its application is unprincipled, he believes it could not serve any of the social benefits typically discussed as the policy basis supporting its existence—serving as a valve release for excessive externalization.<sup>98</sup> Furthermore, Professor Bainbridge argues the injustice purportedly prevented by the piercing doctrine is actually equally preventable using existing causes of action—misrepresentation, fraud, and fraudulent transfer.<sup>99</sup>

For the most part, Professor Bainbridge is correct—current veil-piercing jurisprudence is extremely unprincipled and wildly unpredictable. Furthermore, existing causes of action can serve the majority of the doctrine's effects and policy goals. Nevertheless, eliminating veil piercing has costs to the legitimate policy goals. Furthermore, while existing causes of action are sufficient to serve most areas of potential abuse, existing causes of action are nonetheless insufficient in the context of undercapitalization.<sup>100</sup>

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91. *Id.* at 513.

92. *Id.* at 510.

93. *See id.* at 481.

94. *See id.* at 511–13.

95. *Id.* at 524.

96. *Id.* at 481.

97. *Id.* at 481, 524.

98. *Id.* at 535.

99. *Id.* at 516, 521–22.

100. *See* Millon, *supra* note 8, at 1358–59 (“Actions for misrepresentation and fraudulent

First and foremost, piercing serves a deterrent goal. Second, piercing serves as a valve release for the extreme inequitable aspects of limited liability. As to the first, while the estimation is not easily susceptible to concrete proof, the intuitive notion seems unequivocal. The potential of piercing causes shareholders to act differently than they would if piercing did not exist.<sup>101</sup> Thus, for example, shareholders less frequently undercapitalize than they otherwise would for fear of exposure to piercing. Or shareholders of close corporations have greater incentives to watch each other to prevent fraud. Of course, one could argue, somewhat in line with Professor Bainbridge's second argument,<sup>102</sup> that these causes of action already exist in one form or another, and, thus, piercing is simply duplicative. In terms of deterrence, however, piercing still serves an independent goal. The fear of exposing one's personal assets to a judgment in part serves an overdeterrence goal analogous to that of punitive damages—it not only removes the financial incentives, creating a “break even” scenario, it also provides exposure over and above what the corporation might have actually sustained, making inequitable conduct a poor business decision.<sup>103</sup>

For example, imagine a corporation, *A*, is owned by shareholders *B*, *C*, and *D*. Imagine further that *B* engages in fraud against *E*, and *E* later sues, seeking to pierce. While *E* could certainly sue *A* and *B* for fraud even absent piercing, *E*'s recovery would be limited to funds available from *A* and *B*. With the addition of piercing, however, *C* and *D* are now potentially personally liable as well, creating an incentive to “watch the store” and prevent such activity.

Or imagine a circumstance where a corporation is constantly undercapitalized and is subsequently sued. While fraudulent transfer laws certainly permit “reach backs” for previous transfers, they only permit a plaintiff to access funds that were in fact fraudulently transferred. Thus, financial incentives could still exist for a corporation to undercapitalize because, even if successful, a plaintiff would only

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conveyance would not, however, reach all of the cases in which shareholders have used limited liability in ways that offend public policy. As argued above, shareholders who cause the corporation to incur debt while knowing that repayment is impossible or highly unlikely arguably should be treated differently from those whose corporations default despite their good faith efforts to manage the business in a financially responsible manner.”)

101. See Presser, *supra* note 4, at 412 (“[T]he very vagueness and uncertainty of the piercing doctrine encourages adequate capitalization (and the purchase of liability insurance) by corporations . . . .” (quoting ROBERT W. HAMILTON & JONATHAN R. MACEY, *CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES* 355 (8th ed. 2003))).

102. See *supra* notes 95–99 and accompanying text.

103. Cf. *Kemezy v. Peters*, 79 F.3d 33, 34 (7th Cir. 1996) (stating overdeterrence is a goal of punitive damages because it eliminates what could otherwise be a positive cost-benefit analysis).

recover the amounts of the transfers. Additionally, given the likelihood of the plaintiff's failure and the likelihood of never being sued, undercapitalizing could still make good fiscal sense in a cost-benefit analysis. That perspective, however, is at least less true when shareholders are faced with the possibility of personal liability exceeding that which the corporation could have ever been solvent to pay in the first place. Once overdeterrence enters the cost-benefit analysis, it could not only remove the financial incentives, it could cause the pendulum to shift in the other direction. Finally, although piercing is rare and currently unprincipled,<sup>104</sup> its rarity still likely bears some deterrent effect for people quite simply act differently when *no* risk exists than when *some* risk exists. More importantly, the deterrent effect could be enhanced through making application of the piercing doctrine more predictable. In other words, courts should not throw the baby out with the bathwater. Rather, they should just get new water.

Furthermore, in part responding to Professor Bainbridge's first reason and in part responding to his second reason, piercing does serve as a valve release in circumstances where existing causes of action would not. For instance, imagine a corporation "accidentally" grossly undercapitalizes such that the corporation is not within the reach of fraudulent transfer laws.<sup>105</sup> Imagine further there is no classic siphoning, and the only equitable basis for seeking funds outside the corporate assets is premised on the corporation's failure to properly capitalize—there is no basis for a cause of action for misrepresentation, fraud, and so on. This is one of many circumstances piercing was intended to prevent. That is, piercing is intended to mitigate some of the more extreme aspects of limited liability and serve as a mechanism for plaintiffs to achieve a remedy where a corporation has failed to act legitimately.<sup>106</sup> While academics and courts can certainly disagree on when it is appropriate to pierce, it is difficult for anyone to admit there are not at least some circumstances wherein piercing should be permitted.

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104. Bainbridge, *supra* note 7, at 481, 513–14.

105. This circumstance can happen more easily than one might think. See Nina A. Mendelson, *A Control-Based Approach to Shareholder Liability for Corporate Torts*, 102 COLUM. L. REV. 1203, 1269 (2002) ("Until a corporation has actual knowledge that a specific lawsuit is threatened or pending, a plaintiff will have difficult time showing that the transfer was made with knowledge that a lawsuit has been filed or threatened, and hence 'with actual intent to hinder, delay, or defraud any creditor.'" (quoting UNIF. FRAUDULENT TRANSFER ACT § 4(a)(1), 7A U.L.A. 301–02 (1999))).

106. See, e.g., Ballantine, *supra* note 19, at 19 (stating the test is whether the corporation used the corporation in good faith for legitimate ends); Presser, *supra* note 4, at 407 ("It is, or at least once was and ought again to be, hornbook law that a shareholder or a parent corporation should not lose the protection of limited liability unless that shareholder or parent has somehow 'abused' the corporate form.").

In the final analysis, the piercing doctrine, as currently conceived and applied, is unpredictable, inconsistent, and at least lackluster at achieving its stated goals. However, a better test would achieve better results.

## 2. The Mandatory Insurance Proposal

While adherents to the mandatory insurance proposals have not specifically noted that elimination of the doctrine is a goal,<sup>107</sup> the concept behind the proposal is in the nature of a replacement—a mechanism designed to eliminate the need for piercing doctrine altogether, using insurance as a vehicle.

The concept behind the mandatory insurance argument is that a corporation, as a matter of legislative requirement, should always carry “sufficient” insurance.<sup>108</sup> While this remedy certainly could create more predictability and consistency than existing piercing doctrine, at least as far as the theories have come, there does not appear to be any objective link that a corporation could use to “know” how much insurance to have. Nevertheless, the corporation would presumably need to discern the nature of its activities, the foreseeable—and sometimes less foreseeable—potential harms of its activities, the potential damage amounts for those activities, and other possible considerations. Again, at least as far as the theories have come, the corporation seemingly would need to know these things in a vacuum—untethered to any objective criteria or external information to assist with the decision-making process. Additionally, to the extent the mandate arose as a specific number or calculus promulgated by a legislative body, such a theory would require a legislative body to account for the various types of existing industries, the various types of potential industries, the potential harms those industries could create, and the types of damages those harms could create.<sup>109</sup> Needless to say, this is a tall order that would come with substantial prospective costs.

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107. See Huss, *supra* note 3, at 129–32; Gregory W. Wix, Comment, *Piercing the Corporate Veil: Should Michigan Consider Statutory Solutions?*, 79 U. DET. MERCY L. REV. 637, 654–56 (2002) (reviewing the proposals of other scholars).

108. Huss, *supra* note 3, at 129–30; Wix, *supra* note 107, at 654–56 (reviewing proposals by other scholars).

109. See Huss, *supra* note 3, at 131.

Assuming this could be achieved through actuarial models,<sup>110</sup> mandatory insurance nonetheless would encourage risky behavior.<sup>111</sup> This premise again needs no proof to sustain it because its intuitive roots are so strikingly clear. Insurance, in the first instance, is intended to create a sense of safety in the insured.<sup>112</sup> That safety derives from the notion that the insured has engaged in risk-sharing with the insurance company.<sup>113</sup> In the case of the insured's risk, the ultimate payment is made prospectively through a premium; thus, the insured's risk is disgorged each month. That, of course, is not true of the insurance company. This creates a situation where, at any given moment, the risk as to both parties is asymmetrical, even if the risk is ultimately evenly shared over time.

In the context of a piercing case, shareholders who are most likely to get pierced are those who play "fast and loose" with their corporate structure under the presumable notion that getting pierced is statistically unlikely. If insurance were mandatory, those individuals would be further emboldened to engage in even riskier behavior, as their risk of loss would be substantially less and they would have already paid for the privilege of the gamble. While this option would certainly serve to protect would-be plaintiffs from insolvent corporations, it would simply force some corporations to shoulder the burden for others—those corporations who do nothing wrong and are not the target of mandatory insurance would pay enhanced premiums for insurance they do not need to pay as a result of those who game the system by engaging in risky conduct. From a public policy perspective, this result is undesirable.

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110. "Actuarial methods are classical risk management techniques" that use mathematical equations to determine appropriate premiums for insurance policies. See Stephen A. Kane, *Identifying and Assessing Adverse Selection*, 3 J. BUS. & ECON. RES., Mar. 2005, at 9, 15.

111. See Richard Lempert, *Low Probability/High Consequence Events: Dilemmas of Damage Compensation*, 58 DEPAUL L. REV. 357, 385 (2009); see also George L. Priest, *Insurability and Punitive Damages*, 40 ALA. L. REV. 1009, 1025 (1989) ("An act for which the occurrence is subject to the volition of the insured is highly susceptible to insurance incentives: the existence of insurance directly reduces the costs of such acts and makes them uninsurable.").

112. See Jeffery W. Stempel, *Domtar Baby: Misplaced Notions of Equitable Apportionment Create a Thicket of Potential Unfairness for Insurance Policyholders*, 25 WM. MITCHELL L. REV. 769, 896 (1999) ("Insurance is usually described as one party's agreement to suffer a certain but relatively small loss (i.e., the premium payment) in return for obtaining the insurer's agreement to cover the possibility of contingent but larger losses.").

113. *Id.*

### 3. The Mandatory Capitalization Proposal

The concept behind mandatory capitalization is somewhat similar to the underlying notion behind mandatory insurance, with one exception: the origin of the fund maintained for would-be plaintiffs.<sup>114</sup> As explained above, in the context of mandatory insurance, the fund is derived from insurance. In the context of mandatory capitalization, however, the funds derive from the corporation itself.<sup>115</sup> The fund is then kept as retained earnings available in the event of liability.<sup>116</sup>

In many ways, mandatory capitalization theories suffer from the same types of criticisms seen in mandatory insurance schemes.<sup>117</sup> Thus, a legislative body, to determine the appropriate amount, would need to account for the various types of existing industries, the various types of potential industries, the potential harms those industries could create, and the types of damages those harms could create, among other considerations.<sup>118</sup> At least as far as the theories have come, these decisions would be made presumably using traditional mechanisms like actuarial models. As stated earlier, the costs for such an activity would be great.<sup>119</sup>

Admittedly, my test uses latent elements of mandatory capitalization. But, instead of using traditional actuarial models, which have substantial prospective costs, my test uses the doctrine of custom, described in more detail in the next Part. In addition, my test includes other elements of a conjunctive test—elements that would not substantially alter existing piercing doctrine while substantially making the test more objective.

#### *B. Codification Requiring Fraud or Siphoning and Insolvency*

The second category of proposals attempts to create predictability and consistency through the creation of a conjunctive test. By far, the

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114. See Huss, *supra* note 3, at 129; Wix, *supra* note 107, at 653–56 (reviewing the proposals of other scholars).

115. See Easterbrook & Fischel, *supra* note 5, at 115.

116. See *id.* at 114.

117. See Huss, *supra* note 3, at 130–31.

118. See *supra* note 109 and accompanying text.

119. Mandatory capitalization schemes exist in some isolated industries. For instance, the banking industry has capitalization requirements mandated by legislation. See generally Joseph Jude Norton, *Capital Adequacy Standards: A Legitimate Regulatory Concern for Prudential Supervision of Banking Activities?*, 49 OHIO ST. L.J. 1299, 1316–36 (1989) (discussing the history of capital adequacy regulations in the banking industry). However, those requirements are for a singular industry. Proponents of mandatory capitalization advocate extending those mechanisms to every industry, a much more daunting task.

most prominent of these proposals is the Matheson and Eby Proposal.<sup>120</sup> The crux of the Matheson and Eby Proposal is that the piercing doctrine should be refashioned to require a demonstration of two elements.<sup>121</sup> First, Matheson and Eby argue that plaintiffs should be required to demonstrate fraud or siphoning.<sup>122</sup> Second, Matheson and Eby argue plaintiffs should be required to demonstrate insolvency.<sup>123</sup>

On the positive side, this proposal is moving in the proper direction. That is, instead of attempting to eliminate the doctrine altogether, the proposal seeks to limit judicial discretion through the vehicle of a conjunctive test. Nevertheless, the proposal falls short in two respects. First, the proposal requires the existence of either fraud or siphoning to the exclusion of undercapitalization. As discussed below in Part V, undercapitalization is a necessary option for piercing if the judicial system is to preserve the purpose of piercing doctrine—prevention of injustice. Second, the proposal lacks a unity element in its codification.<sup>124</sup> While the unity element has been widely criticized as markedly unrelated to any equitable basis for piercing, the unity requirement ensures that not every shareholder could be personally liable for the corporate debts. Rather, only those shareholders who are truly controlling the corporation and using it improperly would be subject to that type of liability. Imagine for example that corporation *A* has two shareholders, *B* and *C*. Imagine that *C* is a completely passive shareholder who takes no interest in the day-to-day operations of *A*. Imagine further that *B* completely controls *A* and uses *A* as an alter ego, instrumentality, or any other creative metaphor. If a plaintiff sued *A* and successfully pierced, both *B* and *C* would have potential exposure because without the unity requirement, every shareholder of a corporation, however passive, would be exposed to piercing. In this circumstance, piercing doctrine would create more inequity than it was

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120. Matheson & Eby, *supra* note 8, at 181–93.

121. *Id.* at 184.

122. *Id.*

123. *Id.* As discussed in Part IV, the insolvency requirement is a concept inherent in the doctrine itself. Thus, properly viewed, Matheson and Eby's proposal simply argues that the doctrine should be applied when and only when a demonstration of fraud or siphoning exists. The proposal does not contemplate any other necessary conduct for application of the doctrine.

124. The proposed statute includes a comment indicating passive owners are not personally liable. *Id.* at 186. Nevertheless, given the proposed statute's language, passive owners who receive insolvency distributions could be exposed to a piercing claim, assuming the passive owners "knew that the Limited Liability Entity was insolvent or should have reasonably foreseen that the Insolvency Distribution would render Insolvent the Limited Liability Entity . . ." *Id.* Given that any shareholder has knowledge, either constructive or actual, of the corporation's finances, this portion of the proposed statute effectively eliminates the unity requirement.

designed to remedy. Furthermore, it would discourage passive investment.

Thus, while the Matheson & Eby Proposal certainly creates more predictability and consistency in the application of the piercing doctrine, it does so at the expense of the doctrine itself—it compromises the doctrine’s ability to achieve the purpose of preventing injustice.

## V. A PROPOSAL

While the twin goals of predictability and consistency are important, or should be, to the proper administration of the law, most academics and judges would agree that both must be sacrificed in those rare instances where those goals are in direct conflict with the goal of justice. While the piercing doctrine has certainly been viewed in that light for the course of its existence, the doctrine need not remain so unanchored to both achieve its goal of justice and provide predictability and consistency.

It is with this context that a new test, if adopted, would mitigate the problems of unpredictability and inconsistency generated by the overabundance of judicial discretion in the piercing doctrine. The piercing doctrine should become a static, conjunctive test that requires the following: (1) an injustice requirement that can be achieved through a showing of fraud, misrepresentation, or undercapitalization; (2) a unity requirement; (3) a causation requirement; and (4) an insolvency requirement.

### A. *Piercing Should Require Evidence of Injustice*

While some courts certainly require the existence of some injustice element before piercing, many do not.<sup>125</sup> Further, even among those that require an element of injustice, few courts specifically and explicitly require that a plaintiff demonstrate specific types of injustice.<sup>126</sup> Instead, courts have produced an incredibly broad definition of injustice that requires nothing even remotely close to an actual standard.<sup>127</sup> In some instances, this broad definitional structure has permitted courts to pierce

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125. See Gevurtz, *supra* note 32, at 865 (“[R]ecent opinions state that meeting the impermissible domination and control element can, in itself, justify piercing.”).

126. See Presser, *supra* note 4, at 412 (“It is usually understood that to pierce the corporate veil some sort of abuse is required, but there is no consensus on what constitutes ‘abuse.’”).

127. See *id.* at 412–13.

upon a simple showing of unity and insolvency.<sup>128</sup> In other cases, some type of fraud is required.<sup>129</sup> Thus, in effect, this broad inquiry creates both external inconsistency—or inconsistency between different jurisdictions—and internal inconsistency—or inconsistency between various decisions within the same jurisdiction.

Noting this background, the piercing doctrine should require a demonstration of fraud,<sup>130</sup> misrepresentation,<sup>131</sup> or undercapitalization.<sup>132</sup> This solves three problems. First, a static injustice requirement ensures that the shareholder or entity is in fact engaging in behavior that piercing should attempt to prevent—the use of limited liability as an absolute shield for injustice.<sup>133</sup> Thus, in addition to creating external consistency, it creates consistency with the goals of the doctrine. Second, and further elaborating on the goal of the doctrine, the introduction of an actual harm requirement will prevent piercing on the mere basis that unity and insolvency exist. Finally, creating set, stable types of injustice will encourage both internal and external consistency because it will prevent individual judges from simply checking their guts to see if something unjust has occurred.

In terms of predictability and consistency, the first two of these injustice tests—fraud<sup>134</sup> and misrepresentation<sup>135</sup>—are fairly simple; they

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128. See Gevurtz, *supra* note 32, at 865 (“[R]ecent opinions state that meeting the impermissible domination and control element can, in itself, justify piercing.”); Susan A. Kraemer, *Tenth Circuit Survey: Corporate Law*, 76 DENV. U. L. REV. 729, 734 n.32 (1999) (“[S]ome jurisdictions require fraud or inequitable result, while other jurisdictions will disregard the corporate entity based only on a finding of excessive unity of interest alone.”). While unity is certainly an important element to a piercing claim, its sufficiency to pierce absent harm makes little sense, as there is no doubting that close corporations will nearly always meet the test. Furthermore, as I will discuss later, insolvency is a necessary precondition to piercing in the first instance. Thus, in terms of discerning whether a corporation *should be* pierced, it adds little to the analysis.

129. Joseph E. Casson & Julia McMillen, *Protecting Nursing Home Companies: Limiting Liability Through Corporate Restructuring*, 36 J. HEALTH L. 577, 592 (2003).

130. This element incorporates a portion of both the Bainbridge and Matheson & Eby approaches. See Bainbridge, *supra* note 7, at 517; Matheson & Eby, *supra* note 8, at 184.

131. This element incorporates a portion of the Bainbridge approach. See Bainbridge, *supra* note 7, at 517.

132. While Professor Bainbridge certainly discussed the potential of undercapitalization serving as a basis of liability in the context of siphoning cases, this proposal views siphoning as a separate mechanism for piercing and extends the notion of undercapitalization much more broadly than Professor Bainbridge envisioned it. See *id.* at 519–20.

133. See Campbell, *supra* note 14, at 36 (“What the formula comes down to, once shorn of verbiage about control, instrumentality, agency and corporate entity, is that the liability is imposed to reach an equitable result.” (quoting ELVIN R. LATTY, *SUBSIDIARIES AND AFFILIATED CORPORATIONS: A STUDY IN STOCKHOLDER’S LIABILITY* 191 (1936))).

134. 37 AM. JUR. 2D *Fraud and Deceit* § 475 (2005) (“To establish a prima facie fraud claim, the plaintiff must prove the following elements by clear and convincing evidence: (1) false representation or concealment of a material fact; (2) reasonably calculated to deceive; (3) made with the intent to deceive; (4) resulting in injury or detrimental reliance.”).

rely on definitions already jurisprudentially well-worn. That is, fraud and misrepresentation are already fairly static concepts both within jurisdictions and between jurisdictions. Accordingly, rather than try to revamp those systems, which seem to be working well, courts should incorporate these traditional definitions into the piercing test in their existing forms.<sup>136</sup>

The final option in the test, however, is not as easily defined. The element of undercapitalization has proven to be one of the more difficult problems in the existing piercing doctrine, at least in terms of predictability and consistency. This truth is largely a result of the fact that few people could readily discern what it means to be undercapitalized from a corporate perspective.

### 1. Why Undercapitalization Is Important

A number of scholars have questioned, implicitly or explicitly, the prudence of continuing to permit piercing on the basis of undercapitalization without a showing of further injustice.<sup>137</sup> This largely stems from the notion that limited liability is, in the first instance, a means to shelter financial resources, and undercapitalization is simply a tool to further that goal.<sup>138</sup> Furthermore, capitalization, through retained earnings, limits financial resources and liquidity of the entity.<sup>139</sup> Finally, concerns have perennially existed over what moment in time would serve as the basis for undercapitalization<sup>140</sup> and what mechanism would be

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135. Generally, the elements of fraud and misrepresentation are similar. *See* 37 C.J.S. *Fraud* § 77 (2008) (“The difference between intentional or fraudulent misrepresentation and negligent misrepresentation is that the latter only requires that the statement or omission was made without a reasonable basis for believing its truthfulness, rather than an actual knowledge of its falsity.”).

136. This is somewhat of a change, as courts do not typically apply these tests stringently in piercing cases. *See* 18 AM. JUR. 2D *Corporations* § 57 (2004) (“Under the particular circumstances of the case, a showing of moral culpability, in addition to other factors, is often necessary to justify disregarding a corporate entity, although it has been said that proof of plain fraud is not a necessary element in a finding to disregard the corporate entity.”).

137. *See, e.g.*, Bainbridge, *supra* note 7, at 521 (“To be sure, undercapitalization is one of the factors courts commonly consider, which may result in personal liability, when taken in conjunction with the factors we discussed earlier, but it is not enough standing alone to pierce the corporate veil.”); Presser, *supra* note 4, at 413 (“The better reasoned cases do suggest that it is unlikely that undercapitalization alone is enough to remove the shield of limited liability.”); *see also* Thompson, *supra* note 3, at 1064 (stating piercing occurs in seventy-three percent of cases where undercapitalization is also present).

138. *See* Mary Elisabeth Kors, *Altered Egos: Deciphering Substantive Consolidation*, 59 U. PITT. L. REV. 381, 442–43 (1998).

139. *Id.*

140. *Compare* Mendelson, *supra* note 105, at 1262, 1264 (“If the corporation has been properly capitalized at the outset, later operation with clearly insufficient assets . . . will not suffice to show undercapitalization. . . . Similarly, that a corporation lacks sufficient assets even to address liabilities

used to discern what constituted adequate capitalization. Each of these concerns is discussed below.

Undercapitalization has long served as a basis for piercing the corporate veil, particularly for cases arising in tort.<sup>141</sup> That corporations are in fact engaging in a type of injustice by operating with insufficient means to pay foreseeable plaintiffs for foreseeable injuries stemming from the corporation's ordinary activities has served as an underlying notion for permitting undercapitalization as a means for piercing.<sup>142</sup> Thus, assuming undercapitalization exists, it is a mechanism used by corporations in combination with limited liability statutes to completely protect all assets from recovery by potential plaintiffs—in effect, both the corporation and the shareholders constantly remain judgment proof.

Given the traditional notions of equity—every wrong deserves a remedy<sup>143</sup>—it is obvious why undercapitalization necessarily could create circumstances of injustice. For instance, imagine corporation *A* sells blasting caps—small, explosive devices regularly used in mining activities. Imagine further that *A* knows that a particular set of blasting caps are especially dangerous due to some defect in their production. Rather than ceasing to sell that set of blasting caps, *A* decides to continue selling them while enacting a corporate policy of regularly paying out all earnings in dividends. Years after all of the caps are sold and *A* has paid out all of the dividends, *B* is injured by one of the caps and sues *A*. While *B* may win on liability and damages, *A* is insolvent to pay the claims, and, thus, *B* is out in the cold.<sup>144</sup>

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likely to flow from its operations generally is insufficient to pierce the corporate veil.”), with Harvey Gelb, *Piercing the Corporate Veil—The Undercapitalization Factor*, 59 CHI-KENT L. REV. 1, 4 (1983) (“Courts cannot focus solely on initial corporate capital or assets, as some are prone to do, in deciding whether inadequacy of assets warrants a decision to pierce because subsequent changes, such as increased hazards or reduced assets, may render a determination as to initial inadequacy irrelevant.”).

141. Campbell, *supra* note 14, at 39 (“Corporate undercapitalization is often a factor in a court’s decision to disregard the corporate entity.”); Presser, *supra* note 4, at 413 (“The most commonly targeted abuse or ‘injustice’ seems to be the failure adequately to capitalize the corporation, to operate it in a manner where the corporation’s assets will not be sufficient to meet the obligations to creditors.”); Thompson, *supra* note 3, at 1065; *see also* Millon, *supra* note 8, at 1336–37 (“Courts have occasionally stated that [undercapitalization] is a sufficient basis for veil piercing.”).

142. Gelb, *supra* note 140, at 3.

143. 1 AM. JUR. 2D *Actions* § 35 (2005) (“It is a principle of the common law that whenever the law gives a right or prohibits an injury, it also gives a remedy.”).

144. While it could be argued that a plaintiff could reach assets using either 11 U.S.C. § 548 (2007), or state fraudulent transfer statutes, plaintiffs attempting to use those forms of relief must prove an intent prong. While that prong could be much easier to prove in a context where a corporation maintains a level of constant insolvency, relief under those mechanisms is not necessarily likely in a scenario where the corporation is not actually aware of potential creditors and is seemingly solvent but is nonetheless unreasonably capitalized given the type of business. Furthermore, fraudulent transfer actions only permit a plaintiff to attack funds actually transferred—

While some would argue this is the necessary fallout of limited liability statutes, it need not be so. The piercing doctrine was created in the first instance to remedy these exact types of problems by permitting plaintiffs to seek recompense from otherwise protected shareholders, entities, or both, notwithstanding the otherwise strict prohibition of the statute.<sup>145</sup> The goal is to serve traditional notions of fairness while still achieving the purpose of limited liability in those circumstances when corporations are in fact behaving legitimately.<sup>146</sup> Thus, permitting undercapitalization as a basis of injustice for purposes of a piercing test serves a number of goals. First, it is consistent with traditional notions of equity jurisprudence; it is not a large shift in the law that would potentially create unforeseeable ripple effects. Second, it prohibits the type of patently unfair conduct described above. Finally, it acts as a deterrent device, providing negative incentives for corporations to adequately capitalize.

## 2. Defining Undercapitalization

The remaining, and more difficult question, is how to define the flashpoint when a corporation moves from being capitalized to being undercapitalized. This necessarily involves two interrelated questions. First, at what moment will capitalization be analyzed, and second, what does it mean to be undercapitalized?<sup>147</sup>

As to the first, only one moment is relevant to our discussion of capitalization—the moment a corporation is legally required to pay a judgment. If the corporation is solvent at that moment, then piercing is unnecessary. If the corporation is insolvent at the moment, then further

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they do not permit a plaintiff to attack a corporate shareholder's personal funds to the extent those personal funds are not a portion of the transfer. *See id.* While this perhaps seems legally intuitive, permitting a plaintiff to attack a corporate shareholder's personal funds serves a goal of deterrence analogous to that of punitive damages. That is, the availability of additional liability in this circumstance eliminates the economic incentives that could otherwise exist. *Cf. Kemezy v. Peters*, 79 F.3d 33, 34 (7th Cir. 1996) (stating overdeterrence is a goal of punitive damages because it eliminates what could otherwise be a positive cost-benefit analysis).

145. *See, e.g., Ballantine, supra* note 19, at 19 (stating the test is whether the corporation used the corporation in good faith for legitimate ends); *Presser, supra* note 4, at 407 (“It is, or at least once was and ought again to be, hornbook law that a shareholder or a parent corporation should not lose the protection of limited liability unless that shareholder or parent has somehow ‘abused’ the corporate form.”).

146. *See* sources cited *supra* note 145.

147. *Gevurtz, supra* note 32, at 888–89 (stating the difficult questions raised by undercapitalization are what is capital, when is it measured, and how much is enough).

analysis is necessary to discern whether the corporation is ripe for piercing. No other moment is probative.<sup>148</sup>

At first blush, this notion seems potentially counterintuitive because judging a corporation on a singular moment to determine whether its capitalization was legitimate ignores a number of other potentially probative facts that lead to inevitable “what ifs.” For example, what if the corporation were capitalized adequately, but immediately before the judgment, an unforeseeable natural disaster occurs? Although these doomsday scenarios seemingly cause pause, the fundamental question deals with them nonetheless—the ultimate inquiry in any piercing case is to determine whether a corporation acted legitimately like a separate entity intending to continue business.<sup>149</sup>

So then, what does a legitimate corporation do when faced with the future potential of legal liability? Initially, a legitimate corporation would probably attempt to discern whether legal liability exists, the extent of the legal liability, and what funds, if any, exist to pay a potential judgment. If a legitimate corporation then believed liability existed, a legitimate corporation would begin holding reserves, either through its income in the ordinary course or by sheltering existing retained earnings to ultimately pay what could become the judgment. Thus, by the time a legitimate corporation could become exposed to a

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148. Courts have routinely analyzed undercapitalization at the moment of the entity’s inception. Campbell, *supra* note 14, at 41 (“One problem in undercapitalization cases that has troubled both commentators and judges is the determination of the point in time at which undercapitalization is measured. Language from cases generally indicates that the critical time is that of incorporation.”); Gevurtz, *supra* note 32, at 889; Mendelson, *supra* note 105, at 1262, 1264; Presser, *supra* note 4, at 413–14 (“Some courts have expanded this requirement of initial adequate capitalization into an obligation to continue to finance the corporation such that its capital remains adequate to meet anticipated obligations. The wiser jurisdictions maintain that the ‘undercapitalization’ question should be asked only for the time of incorporation.”). *Contra* DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co., 540 F.2d 681, 688 (4th Cir. 1976) (supporting the notion that the obligation to adequately capitalize is a continuing obligation that exists after formation); Gelb, *supra* note 140, at 4 (“Courts cannot focus solely on initial corporate capital or assets, as some are prone to do, in deciding whether inadequacy of assets warrants a decision to pierce because subsequent changes, such as increased hazards or reduced assets, may render a determination as to initial inadequacy irrelevant.”). Analyzing undercapitalization only at the time of formation is myopic. For example, imagine corporation *A* forms for the purpose of selling widgets with initial capitalization of one million dollars. Presumably, at this point, *A* would be solvent for any claims arising from its formation. However, imagine further that *A* subsequently retains no earnings and, after several years, commits some action giving rise to tort liability. While the corporation followed the theoretical law in this instance, the theoretical law was insufficient to serve the goal—to create some mechanism for payment of liabilities when the entity is otherwise insolvent. Rather, the proposal would only necessarily serve the goal at the moment of formation, a moment that would only capture liabilities arising from formation.

149. See *supra* note 19 and accompanying text.

judgment, at the latest, a legitimate corporation would have sufficient funds to pay the judgment.<sup>150</sup>

Scholars and practitioners alike may criticize this notion—what if the corporation has gross assets per fiscal year of one million dollars, net assets of \$500,000, and potential exposure in a particular piece of litigation up to \$700,000? Obviously, this corporation could not raise sufficient funds through retaining earnings to pay the judgment, assuming the judgment was issued in less than two years. The response here is easier than one might think—the corporation should already have retained earnings sheltered for the *potential* of this type of event. This statement leads to the final inquiry—how much should a legitimate corporation retain as capitalization?<sup>151</sup>

This has proven to be the most difficult of questions to answer because each company's answer will be different. That is, a plumbing company might retain less than a chemical manufacturer. A chemical manufacturer might retain less than an explosives manufacturer. An explosives manufacturer might retain less than a nuclear facility. Furthermore, one chemical manufacturer might retain more than another on the basis of business. Thus, a large chemical manufacturer with thousands of clients might retain more than a small chemical manufacturer with three clients. A nuclear facility might retain less because it is located in a rural community as opposed to a metropolitan area.

And so, analytically, retention creates other problems. With too much capitalization, the corporation will unnecessarily limit liquidity. With too little capitalization, the corporation could expose itself to a piercing claim. In the midst of this prospective dilemma is another specter—how can a court decide retrospectively whether a corporation made a legitimate choice? The answer is custom.

Custom, in the context of tort law, is generally defined as the usual manner in which an industry conducts an activity.<sup>152</sup> Or, stated another

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150. Of course, this method necessarily reduces liquidity of the corporation by encumbering funds. Nonetheless, when faced with potential legal exposure, that is exactly what legitimate corporations should do.

151. “Professor Lattin has perhaps accurately described ‘adequate capitalization’ as the amount a ‘reasonably prudent man with a general knowledge of the particular type of business and its hazards would determine was reasonable . . . in light of any special circumstances at the time of incorporation . . . .’” Campbell, *supra* note 14, at 40 (quoting NORMAN D. LATTIN, *THE LAW OF CORPORATIONS* 77–78 (2d ed. 1971)).

152. WILLIAM L. PROSSER, *HANDBOOK OF THE LAW OF TORTS* § 33 (4th ed. 1971); David G. Owen, *Proving Negligence in Modern Products Liability Litigation*, 36 *ARIZ. ST. L.J.* 1003, 1017 (2004) (“Custom, how a community addresses particular situations according to prevailing social norms, is one of the most rudimentary and powerful sources of law.”). Custom has been defined a

way, it is “what is customary and usual in the profession”<sup>153</sup> and is considered by some as “one of the most rudimentary and powerful sources of law.”<sup>154</sup> Although custom plays a limited role in a typical negligence case—it is only one of several factors used to determine breach<sup>155</sup>—it swallowed the standard of care for purposes of medical malpractice actions.<sup>156</sup> Thus, in medical malpractice cases, juries determine the positive—what the custom is or what physicians normally do—instead of the normative—what the custom should be or what physicians should do.<sup>157</sup> Furthermore, the determination of what the custom is, in combination with examining whether the practitioner in question complied with the custom, ends the inquiry.<sup>158</sup>

Courts should incorporate this doctrine as a means to determine whether a corporation sufficiently capitalized itself. Accordingly, when reviewing this element of the test, judges and juries would only review whether the corporation had capitalized in a manner consistent with other corporations of the same industry, size, and general locale. If adopted, the primary benefit of the doctrine is that it eliminates the retrospective guessing of what a corporation should have done—the normative—and thereby eliminates the subjectivity, inconsistency, and lack of predictability that necessarily follow it.<sup>159</sup> Furthermore, because this proposal seeks to adopt a well-worn body of law, the potential of unforeseen ripple effects is at least less likely. Finally, the doctrine

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number of different ways in a number of different contexts. See Jennifer E. Rothman, *The Questionable Use of Custom in Intellectual Property*, 93 VA. L. REV. 1899, 1900–01 n.1 (2007). For more information regarding the development of custom in tort law, see generally Richard A. Epstein, *The Path to The T. J. Hooper: The Theory and History of Custom in the Law of Tort*, 21 J. LEGAL STUD. 1 (1992).

153. PROSSER, *supra* note 152, § 32.

154. Owen, *supra* note 152, at 1017.

155. RESTATEMENT (SECOND) OF TORTS § 295A (1965).

156. Tim Cramm et al., *Ascertaining Customary Care in Malpractice Cases: Asking Those Who Know*, 37 WAKE FOREST L. REV. 699, 702 (2002) (“While in most negligence cases adherence to custom is not conclusive proof that no negligence occurred, in the medical malpractice realm different rules apply.”).

157. Carter L. Williams, Note, *Evidence-Based Medicine in the Law Beyond Clinical Practice Guidelines: What Effect Will EBM Have on the Standard of Care?*, 61 WASH. & LEE L. REV. 479, 500 (2004) (“Under a custom-based standard, practicing in accordance with accepted practice generally precludes liability. Medical malpractice law is unique in this regard because in other areas of negligence law, defendants are subject to a standard of reasonable care under the circumstances.”).

158. *Id.* at 500–01.

159. See Michelle M. Mello, *Of Swords and Shields: The Role of Clinical Practice Guidelines in Medical Malpractice Litigation*, 149 U. PA. L. REV. 645, 684 (2001) (“[T]he use of custom serves an important signaling role in tort law: It reduces the uncertainty facing actors about what level of precaution is legally required of them.”); Jeffrey J. Rachlinski, *A Positive Psychological Theory of Judging in Hindsight*, 65 U. CHI. L. REV. 571, 609 (1998) (stating the doctrine of custom reduces hindsight bias).

eliminates the need for judges, or juries, to become experts in any particular field to determine whether a corporation reasonably capitalized. Rather, judges and juries would need only look to how other similar corporations capitalized.

The remaining problems are those inherent in the doctrine of custom itself. These problems are both practical and theoretical. As to practical, the doctrine raises a number of questions. For example, how does a corporation prove the custom? Will the custom be national, regional, or local? There is necessarily some fluidity here, but a lawyer could prove the custom by proving that a number of other corporations of the same industry, the same comparable size, and the same general locale maintained similar amounts of liquid capital on a day-to-day basis. The ideal scenario would keep the comparative information as close to the locale of the defendant corporation as possible to maintain consistency. Or, if an industry lacks comparable corporations locally or regionally, similar comparisons could be made nationally.<sup>160</sup>

Theoretically, the customs doctrine also carries some baggage. Thus, for instance, the most common criticism of custom in the medical malpractice context is that it permits doctors to frame their own exposure to liability.<sup>161</sup> Accordingly, to limit their liability, the customs doctrine could encourage physicians to work in a manner less uniform to other doctors in their field, even when safety would argue for the opposite.<sup>162</sup> In the corporate context, the argument would presumably be that corporations would benefit from the same defect—corporations would uniformly set the standard lower than public policy should require.

While this potential remains, it is unlikely for two reasons. First, it presumes that no corporation would be willing to do more than is required by custom as a means to add greater protection from piercing or as a means to encourage conservative, long-term investment. Second, it presumes that members of any given industry within any given area would come together, conspiratorially, to not only discuss their current level of capitalization but also to discuss where to set the benchmark as a means to defeat piercing claims. This seems chimerical at best.

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160. I am admittedly uncomfortable with opening the evidentiary door to a national comparison for the obvious problems some such comparisons can muster. Nevertheless, for some industries, this particular problem is unavoidable. For instance, it will be difficult for lawyers in most areas to find a suitable number of local or regional nuclear power plants. It is simply the nature of that industry.

161. *Cf.* *The T. J. Hooper*, 60 F.2d 737, 740 (2d Cir. 1932) (asserting that industries should never set their own standards).

162. *See id.*

*B. Piercing Should Maintain an Element of Unity*

The unity element of the test is simultaneously the most controversial and the most dangerous from a predictability and consistency perspective.<sup>163</sup> This controversy arises because the majority of the factors in a factors test seek to discern the existence or absence of sufficient unity or control.<sup>164</sup> This has led scholars, in hopes of creating consistency and predictability, to disavow the element altogether.<sup>165</sup> Nevertheless, the unity test is indispensable.<sup>166</sup> Furthermore, courts can revamp the unity test itself to increase predictability and consistency.

The unity test is indispensable because it contains the factors that target specific controlling shareholders and leave passive shareholders safe from the reaches of piercing.<sup>167</sup> For instance, imagine a corporation, *A*, has three shareholders, *B*, *C*, and *D*, and *C* and *D* are true passive investors—capital contributors who have no role in the management or day-to-day operations of the corporation. *B* is both a shareholder and serves in every officer role for the corporation. If a plaintiff sues *A* and seeks to pierce *A*'s corporate veil, the suit should not expose *C* and *D* to personal liability under any circumstances for they are true passive investors.<sup>168</sup> Nevertheless, if no unity requirement exists, nothing would separate *B* from *C* and *D*.

Once we accept that the unity requirement must exist in some form to maintain any level of fairness within the piercing doctrine, the remaining analysis is whether a formula can be generated that effectively measures unity while promoting predictability and consistency.

At its fundamental base, the unity requirement seeks to determine whether the shareholders use the entity as an extension of self—making decisions or taking actions that are inherently beneficial to the shareholders and not necessarily beneficial to the entity. This is fundamentally another way of asking who controls the entity.<sup>169</sup>

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163. Millon, *supra* note 8, at 1330–34.

164. See Cane & Burnett, *supra* note 23, at 666–67.

165. See, e.g., Matheson & Eby, *supra* note 8, at 181–82 (proposing a test that does not include unity or control as an independent factor in the codified law).

166. Gevurtz, *supra* note 32, at 865–66.

167. *Id.*

168. Shaun M. Klein, Comment, *Piercing the Veil of the Limited Liability Company, from Sure Bet to Long Shot: Gallinger v. North Star Hospital Mutual Assurance, Ltd.*, 22 J. CORP. L. 131, 136–37 (1996) (“When a court disregards the corporate form, only those shareholders responsible for the acts justifying the pierce are personally liable for the debts of the corporation. Passive shareholders are not liable.”).

169. See Bainbridge, *supra* note 7, at 507 (“Control is the common (if sometimes implicit) feature of all the concepts used to describe cases in which veil piercing is appropriate. . . . Hence, it

Traditional piercing analysis uses the factors test to determine control, reviewing facts such as the treatment by an individual of the assets of the corporation as his or her own, the failure to maintain minutes or adequate corporate records, disregard of legal formalities, the failure to maintain arm's length relationships, and many others.<sup>170</sup> While these factors initially appear relevant and easily operationalized, their application is much more complicated in common examples.

For instance, imagine corporation *A* has four shareholders, *B*, *C*, *D*, and *E*. Imagine further that *B* possesses all officer positions for *A*, maintains separate personal and corporate monetary accounts, does not maintain proper minutes or corporate records, and has, on several occasions several years ago, engaged in non-arm's-length transactions between himself and the corporation. Finally, imagine *C*, *D*, and *E* are truly passive shareholders. One day, *F*, the plaintiff, is injured by one of *A*'s products. Reviewing the factors above and assuming piercing was otherwise appropriate, who would have sufficient unity for piercing? Suddenly, the factors stated above seem largely irrelevant. The first factor—whether the shareholders treat the assets of the corporation as their own—isn't really relevant here because even *B* maintains separate monetary accounts. The second factor—the failure to maintain minutes or corporate records—is certainly present here and thus would presumably provide at least some support for piercing. But against whom would the court pierce? All of the shareholders meet that factor. Does it serve the goal of piercing to expose them all to liability? The third factor—the disregard of legal formalities—has the same problem. It potentially affects all of the shareholders, including the passive ones because it attaches the analysis to actions of the entire entity instead of actions by the individual shareholders. Finally, the fourth factor—the failure to maintain arm's length transactions—seems irrelevant here because it is only potentially applicable to *B*, but *B* has not engaged in the conduct in several years. More importantly, the temporally removed conduct is presumably unrelated to *F*'s injuries.

If the touchstone of unity is, or should be, control, then the factors test is untailed for the purpose for it, at most, determines whether *an*

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seems clear that control is an essential prerequisite for holding a shareholder liable.”); Gevurtz, *supra* note 32, at 862–63 (describing “two multi-part tests” used to determine “defendant’s domination or control over the corporation”); *see also* Thompson, *supra* note 3, at 1056 (“The role that the individual plays within a corporation also has an effect on the outcome. . . . [I]n the few cases that characterized potential defendants as passive shareholders rather than active in the business as directors, officers, or otherwise, the courts almost always found no liability.”).

170. *See* Gevurtz, *supra* note 32, at 856–57 (describing other factors courts use to determine control of an entity).

*entity* is ripe for piercing without analyzing whether any *individual shareholder* is ripe for piercing. Courts should reform the test to analyze whether the shareholder, shareholders, or entity that the plaintiff seeks to pierce individually possesses the ability through percentage of voting shares to make the decision that gave rise to the injustice of undercapitalization. The unity thus becomes tied to the decision as opposed to the corporation.

For instance, imagine a corporation, *A*, possesses four shareholders, *B*, *C*, *D*, and *E*. Furthermore, imagine *A* sells a widget to a third party, *F*. *F* is subsequently injured by the widget and sues *A*. Of course, *F* thereafter learns that *A* is insolvent and seeks to pierce *A*. Which of *B*, *C*, *D*, and *E* are sufficiently unified to justify piercing? Using traditional analysis, the court would review a number of factors in hopes of determining which of *B*, *C*, and *D* controlled the corporation in general. Of course, the court would also weigh those factors as it saw fit.<sup>171</sup> Under the proposed analysis, only one inquiry would be necessary—who controlled the decision giving rise to the injustice? That, of course, begs the question, which decision? The answer to that question is inherently reliant upon the type of underlying injustice. Thus, for example, if the underlying suit is premised upon fraud, then the decision giving rise to unity would be the decision to misrepresent material facts. The same would be true for misrepresentation. In terms of undercapitalization, the relevant decision would be one to pay dividends or retain earnings in an uncustomary manner.

This formulation has three positives. First, it resolves the need for a complicated factors test to determine a shareholder's unity with the corporation. While determining the unity may require detailed review, determining the control of a decision requires much less. Thus, of course, it encourages the stated goal of limiting discretion and thereby increasing predictability and consistency. Second, this formulation links the conduct giving rise to the liability directly with the plaintiff's claim, which, as discussed below,<sup>172</sup> is preferable from a policy perspective. Finally, this formulation bears sufficient flexibility to be generally applicable to various types of piercing cases.<sup>173</sup>

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171. See *supra* note 30 and accompanying text.

172. See *infra* Part V.C.

173. Admittedly, this formulation bears its own flaw. Specifically, there is some discretion for a judge to determine which decision gave rise to liability and which shareholders had control, through their shares, to reach the decision. Thus, in terms of predictability and consistency, the possibility of asymmetric results certainly exists. While admittedly this makes the proposal short of perfect, an ideal state of objectivity in this regard is not possible. Instead, the goal should be to limit judicial discretion as much as possible to enhance the goals of predictability and consistency while not

*C. Piercing Should Require Causation*

While causation—the requirement that the plaintiff’s harm stem from the wrongful conduct of the defendant—is a necessary element to most causes of action, it is not frequently adhered to in piercing cases.<sup>174</sup> In part, this stems from the doctrine’s historical roots. That is, the piercing doctrine is not a true sword in the same manner that a cause of action is a sword. Instead, it is only viable upon a plaintiff’s showing of breach of an underlying duty, the insolvency of the entity, and the other elements of the doctrine.<sup>175</sup> This has led many courts to view the elements of injustice and unity as entirely separate elements as opposed to elements that must bear a causal relationship.<sup>176</sup>

The lack of this requirement goes to the very heart of the philosophical inconsistency with the piercing doctrine. That is, the piercing doctrine is premised upon the idea that it would be unfair to permit a shareholder to hide behind limited liability.<sup>177</sup> Without the causation requirement, though, no unfairness could possibly exist. If the corporation is an empty shell used solely for the purpose of doing the shareholders’ bidding, but the harm suffered by the plaintiff bears no relationship to the unity, then the harm, assuming it exists, is unrelated to the manner in which the shareholders conduct the business of the entity. Accordingly, that conduct should not compromise the entity’s limited liability shield.

For instance, imagine that corporation *A* has five shareholders, *B*, *C*, *D*, *E*, and *F*. Imagine further that *B* controls *A* in every sense of the word and meets all unity requirements. However, *C*, *D*, *E*, and *F* are true passive investors. Subsequently, *B* engaged in fraudulent conduct using *A* as a vehicle for the fraud. Thereafter, *A* produces a product that harms *G*, a purchaser of a product. Assume *G*’s harm is wholly unrelated to *B*’s fraudulent activity. Additionally, assume *B* has not engaged in any

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compromising the purpose of the test. Any further objectivity by narrowing the specific type of decision would limit the test such that it could not generally apply.

174. This element still exists in many instrumentality formulations. *See* Caudill, *supra* note 23, at 465–66. Nevertheless, many courts ignore the requirement. *See* Gevurtz, *supra* note 32, at 862 (“The notion that there ought to be some causal relationship between the fraud or wrong of the defendant, and harm to the plaintiff, is sound, yet, as we have seen above, often forgotten by the courts in piercing cases.”).

175. *See* 18 AM. JUR. 2D *Corporations* § 47 (2004) (“[Piercing] is a means of assessing liability for the acts of a corporation against an equity holder in the corporation. It is not itself an action but is merely a procedural means of allowing liability on a substantive claim.”).

176. *See* Gevurtz, *supra* note 32, at 862.

177. *See supra* notes 17–19 and accompanying text.

actual wrongdoing in terms of the control of the corporation that has led to *G*'s injuries.

Under existing jurisprudence, at least in some jurisdictions, this circumstance is sufficient to pierce.<sup>178</sup> This result is logically inconsistent and is the functional equivalent of “holding a driver liable for an accident that occurred in broad daylight because the headlights were not in proper working condition.”<sup>179</sup> The causation prong would solve this problem, ensuring that the behavior by the entity, shareholder, or shareholders is the same behavior that gave rise to the plaintiff's harm. On that basis, piercing should require a plaintiff to prove that the injustice complained of is in fact the actual and proximate cause of the plaintiff's harm.<sup>180</sup>

This proposal has two positives. First, it solves the logical inconsistency associated with permitting plaintiffs to pierce without demonstrating that the corporation actually engaged in inappropriate conduct related to the plaintiff's harm. Second, it encourages predictable and consistent application of the causation prong by using jurisprudence that is already sufficiently well-worn—standards for actual and proximate cause.

#### *D. Piercing Should Maintain the Element of Insolvency*

The existence of an insolvency requirement is not an actual alteration to the law.<sup>181</sup> Rather, it would simply solidify the element within the test. Nevertheless, the element is a necessary component of the test because it prevents compromising an entity's limited liability shield except where necessary to serve the dictates of equity.

Although limited liability exists statutorily for incorporated entities in every jurisdiction in the United States,<sup>182</sup> the piercing doctrine is not a legislative exception to most of those statutes.<sup>183</sup> Furthermore, the

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178. See Gevurtz, *supra* note 32, at 862.

179. Matheson & Eby, *supra* note 8, at 176 (referring to failure to follow corporate formalities as a basis for piercing).

180. While it may seem repugnant to introduce tort concepts into the corporate arena, I am not the only one who has suggested that this problem is perhaps one more akin to tort. See Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 *YALE L.J.* 1879, 1916–23 (1991).

181. Cf. Douglas Laycock, *The Death of the Irreparable Injury Rule*, 103 *HARV. L. REV.* 687, 689 (1990) (stating a plaintiff may not seek equitable remedies until the plaintiff exhausts legal remedies).

182. See sources cited *supra* note 16.

183. See Morrissey, *supra* note 5, at 542 (“State statutes typically provide limited liability for shareholders unqualified by any reference to [the piercing doctrine.]”); Thompson, *supra* note 3, at

piercing doctrine is not an independent statutory cause of action in most jurisdictions.<sup>184</sup> Instead, the piercing doctrine is a judicial exception created through the court's equity powers.<sup>185</sup>

Equity is arguably the oldest type of jurisdiction, as it derives from the king.<sup>186</sup> Before the existence of courts in England, the king was the original and final arbiter of all disputes.<sup>187</sup> Thus, the king's jurisdiction was unlimited and completely subject to his own sense of fairness.<sup>188</sup> As the number of disputes grew, however, the king was increasingly incapable of hearing them all.<sup>189</sup> Thus, the king began slowly divesting judicial responsibilities to others who were charged with carrying out his will.<sup>190</sup> His position, then, became solely one of ratification or appellate review—again, accordingly to his own sense of fairness.<sup>191</sup>

As the number of petitions continued to grow, the king began delegating authority to Parliament to hear the petitions; Parliament, at least at the time, sat as a sessional body called only for specific purposes.<sup>192</sup> Thereafter, Parliament began delegating authority to hear the petitions to various bodies, ultimately leading to the dichotomy between courts of equity and courts of law.<sup>193</sup> Following the split of law and equity, the common law courts and equity courts reached a compromise on their jurisdictions.<sup>194</sup> Specifically, jurisdiction in the equity courts would not exist unless and until a plaintiff had exhausted all legal remedies in the common law courts.<sup>195</sup> The insolvency requirement is simply a corollary to this basic compromise. Thus, plaintiffs are required to seek recompense at law prior to seeking recompense in equity.<sup>196</sup>

Maintaining this element is both practically and theoretically sound. Practically, there is no reason to pierce a corporation's liability shield if the corporation is solvent. For instance, imagine *A*, a corporation,

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1041 ("Almost all state corporations statutes simply ignore the whole idea of piercing the corporate veil.").

184. Morrissey, *supra* note 5, at 542.

185. *See supra* note 18 and accompanying text.

186. JOSEPH PARKES, A HISTORY OF THE COURT OF CHANCERY 27–29 (1828).

187. *Id.* at 9–10.

188. *Id.* at 10.

189. *Id.* at 11–13.

190. *Id.* at 13.

191. *Id.* at 14–15.

192. *Id.* at 29.

193. For a more detailed discussion of the history of equity jurisdiction, see generally *id.*

194. Laycock, *supra* note 181, at 699.

195. *See id.* at 689.

196. *See id.*

engages in fraud against *B*, and *B* sues, seeking piercing as a remedy. Assuming *A* is solvent for the debts and for the liability, if any, arising from the litigation, courts will not permit *B* to pierce. Rather, *B* will be required to seek recompense only from *A*. This makes sense because none of the shareholders were parties to the contract and *A* is, in fact, solvent.

Theoretically, this requirement is consistent with traditional equity jurisprudence because it limits piercing actions to only those situations where no remedy at law exists—situations where the corporation is judgment-proof.

## VI. CONCLUSION

For all of the criticisms levied at the piercing doctrine, it is unequivocal that it serves a valid goal—to protect plaintiffs against true inequity. Nevertheless, as currently constructed, the piercing doctrine is the archetype of mechanisms permitting unwieldy judicial discretion and thus inconsistency and a lack of predictability in judgments. As a result, the move towards a conjunctive, objective test is necessary for the doctrine to continue holding an analytically legitimate place in the fabric of the law. Without some cabining, however, the doctrine is exposed to seemingly credible attacks to its very existence.