WASHINGTON AND LEE
UNIVERSITY
SCHOOL OF LAW
Sydney Lewis Hall
Lexington, VA 24450

**Washington & Lee Public
Legal Studies Research Paper Series**

**Accepted Paper No. 2010-12
November 18, 2010**

"The Still-Elusive Quest to Make Sense of Veil-Piercing"

David Millon

Accepted Paper
(89 Texas Law Review *See Also* 15 (2010))

Texas Law Review
See Also

Response

The Still-Elusive Quest to Make Sense of Veil-Piercing

David Millon*

I. Introduction

Professor Peter Oh's article *Veil-Piercing*[1] is an important supplement to Professor Robert Thompson's landmark empirical analysis of hundreds of federal and state cases.[2] Thompson's original study examined nearly 1,600 cases in which parties attempted to hold shareholders (individual or corporate) or affiliated corporations[3] liable for corporate obligations on the ground that the debtor corporation's separate-entity status ought to be disregarded. Thompson reported several important findings. On the whole courts pierced the corporate veil in about 40% of the cases.[4] Piercing did not occur in publicly held entities; it was deployed successfully solely against shareholders or corporate affiliates of closely held firms.[5] Courts disregarded the corporation's statutory limited liability more often to reach the assets of shareholders than they did of affiliated corporations.[6] As between contract and tort cases in which veil-piercing claims were asserted, courts found

---

* J.B. Stombock Professor of Law, Washington and Lee University. The author is grateful to Adam Scales for sharing his knowledge of the mysteries of insurance.

1. Peter B. Oh, *Veil-Piercing*, 89 TEXAS L. REV. 81 (2010).

2. Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036 (1991).

3. The distinction here is between corporations as shareholders of other corporations on the one hand and, on the other, groups of two or more separate corporations that are owned by common shareholders. One might usefully think in terms of vertical- versus horizontal-piercing claims. Only the former involve efforts to hold shareholders directly liable for corporate obligations.

4. Thompson, *supra* note 2, at 1048.

5. *Id.* at 1055 tbl.7.

6. *Id.* at 1056.

shareholder liability much more often in the former category than in the latter and also pierced the veil at a higher rate of frequency.[7] These findings Thompson found surprising, "more than any other in the project, go[ing] against the conventional wisdom."[8] Thompson's subsequent study, conducted a decade later, added another 2,200 cases and concluded that the results "fit within the pattern of the original study."[9]

In addition to these findings, Thompson also analyzed the reasons courts have given to justify their decisions to pierce the corporate veil. He identified the frequency with which courts cited any of eighty-five possible factors. These factors he described as falling into several categories:

> undercapitalization; failure to follow corporate formalities; overlap of corporate records, functions or personnel; misrepresentation; shareholder domination; intertwining and lack of substantive separation; use of the conclusory terms "alter ego" and "instrumentality"; the general ground of fairness; assumption of risk; refusal to let a corporation pierce itself; and statutory policy.[10]

This aspect of Thompson's study was especially interesting because commentators have long insisted that veil-piercing is an ill-defined and unpredictable area of the law.[11] The promise of Thompson's work was that it might be possible to have a firmer sense of what considerations courts actually think warrant disregard of the limited liability shield.

Using broader search criteria and extending the temporal scope to 2006, Oh ends up with a dataset of 2,908 cases.[12] Oh determines that courts disregard the corporate entity somewhat more often than Thompson found, 49% rather than 40% of the time.[13] Like Thompson, Oh sees no evidence of veil-piercing in cases brought against shareholders of public corporations and finds that it is more likely to occur in claims against shareholders than against affiliated entities that are part of corporate groups.[14] Oh also collected data on the rationales cited by courts to justify piercing, grouping the various factors into fifteen categories.[15] His findings as to the most popular rationales—fraud or misrepresentation, injustice or unfairness, domination, commingling of assets, and undercapitalization—are broadly

7. *Id.* at 1058 tbl.9.

8. *Id.* at 1058.

9. Robert B. Thompson, *Piercing the Corporate Veil Within Corporate Groups: Corporate Shareholders as Mere Investors*, 13 CONN. J. INT'L L. 379, 385 (1999).

10. Thompson, *supra* note 2, at 1044–45 (citations omitted).

11. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 89 (1985) ("'Piercing' seems to happen freakishly. Like lightning, it is rare, severe, and unprincipled.").

12. Oh, *supra* note 1, at 89.

13. *Id.* at 107.

14. *Id.* at 110, 112 & tbls.4 & 5.

15. *Id.* at 133 tbl.12.

consistent with Thompson's results, although certain differences in relative frequency are observed.[16]

While supplementing and revising Thompson's results, the especially novel contribution of Oh's study is to include fraud cases as a distinct analytical category. That is, in addition to breach of contract and tort claims, Oh studies fraud—which can sometimes be characterized as contract or tort—as a separate substantive claim in order to yield "a more fine-grained analysis" of the frequency of veil-piecing.[17] The category is important because of the potentially different approaches that courts might take depending on whether voluntary creditors extended credit with full knowledge of the relevant risk or instead were misled by material misrepresentation as to either the debtor's separate-entity status or the value of its assets or revenues. Tort claims might also be divided between claims arising out of voluntary versus involuntary interactions and, perhaps, treated differently as a result.

It turns out, Oh finds, that veil-piercing is more likely in fraud cases than in nonfraudulent contract or tort cases.[18] Further, fraud or misrepresentation is the most commonly relied on justification for piercing.[19] Most importantly, Oh overturns Thompson's conclusions that piercing occurs at a higher rate in contract than in tort cases. Thompson found 327 successful piercing cases based on contract claims compared to 70 based on tort claims; courts pierced the corporate veil in about 42% of contract cases and about 31% of tort cases.[20] In contrast, while Oh also found significantly more contract-based than tort-based piercing cases (not including cases based on claims of fraud), the rate of piercing in these cases was roughly similar whether cases were brought by contract or tort creditors.[21] However, when fraud cases were recharacterized as either contract or tort and added to the nonfraudulent contract and tort cases, a roughly 54% piercing rate in tort cases emerged, in comparison to a rate of about 47% in contract cases.[22]

In this Response, I first observe that Oh's analysis of the factors cited by courts to justify disregard of statutory limited liability (like Thompson's before it), while useful and interesting, does not actually tell us much about what is going on in the piercing cases. For various reasons, the factors

16. *Compare* Oh, *supra* note 1, at 133 tbl.12 (reporting that fraud/misrepresentation, injustice/unfairness, domination, commingling of assets, and undercapitalization are the most popular rationales for veil-piercing), *with* Thompson, *supra* note 2, at 1063 tbl.11 (reporting that misrepresentation, domination and control, intertwining, and undercapitalization were among more popular rationales for veil-piercing).

17. Oh, *supra* note 1, at 97.

18. *Id.* at 125 & tbl.8.

19. *Id.* at 133 tbl.12.

20. Thompson, *supra* note 2, at 1058 tbl.9.

21. Oh, *supra* note 1, at 124 tbl.7.

22. *Id.* at 127.

themselves cannot really explain the results. Instead, imperfectly understood and poorly articulated considerations of fairness and policy drive decision making in this area. The law will continue to be obscure and results therefore unpredictable until courts develop a better sense of the appropriate limits of limited liability. I also, in Part III, comment on the different approaches courts apparently take to piercing in contract and tort cases. I suggest that the frequently asserted assumption, repeated by Oh, that piercing is harder to justify in the former situation than in the latter (because of the opportunity for ex ante bargaining about risk) may be mistaken. Instead, a proper understanding of when veil-piercing is appropriate may well result in a significant number of judgments for contract creditors. Likewise, there may be good reasons for the relative infrequency of piercing in tort cases. The courts may be getting it right, even if the factors they cite typically do not tell us what their real reasons are.

II. The Asserted Reasons for Veil-Piercing

Like Thompson before him, Oh conducts a thorough study of the frequency with which the most commonly cited factors appear in veil-piercing cases.[23] This research is important because, before we had it, there was a general sense that the law in this area consisted of little more than a list of factors often adverted to by courts but in unsystematic and unpredictable ways.[24] Some cases might refer to "alter ego," undercapitalization, or fraud, for example, but to what extent were such references typical or standard elements of piercing analysis? One could not be sure. Other cases, even within the same jurisdiction, might refer to other factors.[25] Or a factor might be said to be present, but the court might decline to pierce anyway.[26] In some states, the cases tell us that several factors are relevant but say nothing about their relative weight or whether any of them is necessary or sufficient

23. *Id.* at 133 & tbl.12.

24. *See supra* note 11 and accompanying text.

25. *Compare* Keffer v. H.K. Porter Co., Inc., 872 F.2d 60, 65 (4th Cir. 1989) (listing factors relevant to the decision to pierce the corporate veil as including "gross undercapitalization of the subservient corporation; failure to observe corporate formalities; nonpayment of dividends; siphoning of the corporation's funds by the dominant corporation; non-functioning of officers and directors; absence of corporate records; and the fact that the corporation is merely a facade for the operation of the dominant stockholder or stockholders"), *with* Cancun Adventure Tours, Inc. v. Underwater Designer Co., 862 F.2d 1044, 1047–48 (4th Cir. 1988) ("[W]hen substantial ownership is combined with other factors, such as commingling of corporate and personal assets and diversion of corporate funds to the dominant shareholder, a court may peer behind the corporate veil . . . .").

26. *Cf.* Stephen M. Bainbridge & Aaron H. Cole, *The Bishop's Alter Ego: Enterprise Liability and the Catholic Priest Sex Abuse Scandal* 30 (Univ. of Cal. L.A. Sch. of Law Pub. Law & Legal Theory Research Paper Series, Research Paper No. 06-23, 2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=901663 (stating that "courts pierce the corporate veil in over 73% of cases in which they conclude that the corporation was undercapitalized," and therefore implying that in approximately 27% of cases in which a corporation is undercapitalized, its corporate veil is not pierced).

to justify piercing.[27] So it is helpful to learn from Oh that courts tend to find fraud, injustice, domination, and commingling of assets to be especially good reasons for veil-piercing.[28] Undercapitalization and nonobservance of corporate formalities are important too, but less so, and some rationales—like alter ego, instrumentality, agency, and assumption of risk—are relatively unimportant.[29]

Valuable as this information is, we are still a long way from knowing when courts will pierce. Part of the reason is significant jurisdiction-specific variation. According to Oh's data, piercing appears to be frequent in some states—such as Hawaii, Montana, and the Dakotas, all showing a rate of 75% or higher (but with small *n*s in each case)—but very rare in others, like Maryland (26%) and Virginia (29%).[30] In states with relatively large numbers of cases (over one hundred), the veil-piercing rate varies from 39% to 56%.[31] Oh does not give us a factor-by-factor frequency analysis for each state, but it seems safe to presume that there would be at least a fair measure of variation here as well. So, at the end of the day, Oh's study (like Thompson's before it) is not going to be much help to the lawyer in, say, Florida or Pennsylvania trying to figure out how best to prosecute or defend against an action seeking to hold a corporation's shareholders liable for its debts. He or she is still going to have to sit down and read that jurisdiction's cases just as before.

Of course, Oh never claims that his study is designed to have that kind of intensely practical utility. It is an essentially academic exercise designed to shed light on veil-piercing as a single, cross-jurisdictional phenomenon. And so we learn what courts as a group tend to think is relatively important and unimportant. This is interesting to know, but I think we are still a long way from understanding veil-piercing even on those terms. When one takes a look at the factors courts cite, it is quickly apparent that they cannot really be determinative. Some of the factors are opaque, others are reasonably clear but make no sense, and still others are so general as to amount to nothing more than conclusory proxies for the largely unarticulated considerations that actually drive judicial decision making.

---

27. *See, e.g.*, Baatz v. Arrow Bar, 452 N.W.2d 138, 141 (S.D. 1990) (marshaling factors that "indicate injustices and inequitable consequences" and allow a court to pierce the corporate veil: "1) fraudulent representation by corporation directors; 2) undercapitalization; 3) failure to observe corporate formalities; 4) absence of corporate records; 5) payment by the corporation of individual obligations; or 6) use of the corporation to promote fraud, injustice, or illegalities").

28. *See* Oh, *supra* note 1, at 133 tbl.12 (reporting fraud, injustice, domination, and commingling of assets as the most popular rationales in veil-piercing decisions).

29. *See id.* (reporting that alter ego, instrumentality, agency, and assumption of risk are less popular rationales in veil-piercing decisions than undercapitalization and informality).

30. *Id.* at 115 tbl.6.

31. *Id.* at 115 tbl.6.

The metaphorical factors are notoriously uninformative.[32] Thus, for example, some cases say that if a corporation is a mere "alter ego" of its shareholder, it is a basis for piercing.[33] There is talk of the corporation lacking an identity or existence of its own separate from that of its shareholder.[34] In a similar vein, we sometimes read that piercing is appropriate if a corporation is no more than the "agent" or "instrumentality" of its shareholder.[35] Here the idea is supposed to be that the corporation lacks a distinctive "will" of its own.[36] According to some cases, "domination" or "control" by a shareholder is also relevant.[37]

Two ideas lurk in the shadows cast by these metaphors. If those in charge have failed to attend to statutory formalities—such as annual shareholders' meetings, appointment of officers by the directors, or action by means of board resolution—it may be a basis for denying the corporation's separate existence as a legal entity. If that is the problem, though, lack of attention to corporate formalities can itself be cited as a reason to pierce the corporate veil and metaphor adds nothing but a pejorative characterization. Alternatively, courts sometimes state that excessive shareholder control, such that the corporation lacks any independent volition, is problematic. This is obviously absurd, because a closely held corporation will always be run by and in the interests of its controlling shareholders. Business people form corporations for various reasons, but in all events they do so as a vehicle for

---

32. Recall Justice Cardozo's cautionary remark about the analysis of the relations between parent and subsidiary corporations being "enveloped in the mists of metaphor." Berkey v. Third Ave. Ry. Co., 155 N.E. 58, 61 (N.Y. 1926).

33. *See, e.g.*, Galgay v. Gangloff, 677 F. Supp. 295, 298 (M.D. Pa. 1987) (noting that an exception to the rule against personal liability for corporate actions is the alter ego doctrine); Cheatle v. Rudd's Swimming Pool Supply Co., Inc., 360 S.E.2d 828, 831 (Va. 1987) (stating that the corporate fiction may be disregarded if the plaintiff shows that the corporation was the alter ego of the individual shareholders).

34. Some courts offer guidance on specific facts that may indicate lack of separate identity. *See, e.g.*, *Galgay*, 677 F. Supp. at 299–300 (listing "relevant factors in determining the applicability of the alter ego doctrine"). Other courts supplement the alter ego metaphor with additional pejorative characterizations. *See, e.g.*, *Cheatle*, 360 S.E.2d at 831 (requiring a plaintiff to prove that "the corporate entity was the *alter ego*, alias, stooge, or dummy of the individuals sought to be charged personally and that the corporation was a device or sham used to disguise wrongs, obscure fraud, or conceal crime").

35. Some decisions seem to view the alter ego and instrumentality theories as interchangeable. *See, e.g.*, DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co., 540 F.2d 681, 685 (4th Cir. 1976) (noting that, in appropriate cases, courts "have shown no hesitancy in applying what is described as the 'alter ego' or 'instrumentality' theory"); Woods v. Commercial Contractors, Inc., 384 So. 2d 1076, 1079 (Ala. 1980) ("'[S]eparate corporate existence will not be recognized where a corporation is so organized and controlled and its business conducted in such a manner as to make it a mere instrumentality of another . . . .'" (quoting Forest Hill Corp. v. Latter & Blum, 29 So. 2d 298, 302 (Ala. 1947))).

36. *See, e.g.*, Zaist v. Olson, 227 A.2d 552, 557 (Conn. 1967) (requiring that the corporation have "no separate mind, will or existence of its own").

37. *See, e.g.*, Davis v. Alexander, 269 U.S. 114, 117 (1925) ("Where one railroad company actually controls another and operates both as single system, the dominant company will be liable for injuries due to the negligence of the subsidiary company.").

the pursuit of their own economic interests. It could not be otherwise, so the notion that the corporation lacks a will of its own cannot possibly be a legitimate basis for disregarding limited liability.

Other factors cited by courts as justifying piercing are not metaphors; they are reasonably concrete and potentially determinate. These include failure to attend to corporate formalities and commingling of corporate and shareholder assets, which is actually a subset of the formalities factor.[38] The problem here is that often the punishment does not fit the crime. It is not uncommon for shareholders of a small, closely held firm to resist the play-acting involved in convening an annual meeting at which, as shareholders, they elect themselves directors and then, having adjourned the shareholders' meeting, immediately reconvene as the board of directors, which by formal resolution recorded in the corporation's minutes, then appoints the same people the officers of the corporation. Failure to enact this costly charade should not itself be a reason to hold the shareholders personally liable for a corporate obligation unless the creditor has been misled into thinking that it was dealing with the shareholders as individuals rather than with a corporation for which they were acting. But in that case we may have a claim against the shareholders for garden-variety fraud and there is no need for veil-piercing.

Another factor often cited by courts—undercapitalization—could also provide a reasonably determinate criterion for veil-piercing.[39] Here the problem is that corporate law does not require a particular minimum amount of capital, either at the time of formation or once the corporation is up and running. Withdrawal of capital to the deliberate prejudice of existing creditors is another problem, but it can often be dealt with through the law of fraudulent conveyances without recourse to piercing the corporate veil. Thus, some of the reasonably determinative factors cited by courts cannot be criticized as mere metaphors. Rather, the problem is that they do not make sense.

The final category of veil-piercing rationales consists neither of metaphors nor of reasonably determinate but irrelevant criteria. Courts often state that piercing is appropriate in cases of fraud or unfairness, also using

38. *See, e.g.*, My Bread Baking Co. v. Cumberland Farms, Inc., 233 N.E.2d 748, 751–52 (Mass. 1968) (noting that separate identities of affiliated corporations may be disregarded when "there is a confused intermingling of activity of two or more corporations engaged in a common enterprise with substantial disregard of the separate nature of the corporate entities, or serious ambiguity about the manner and capacity in which the various corporations and their respective representatives are acting").

39. *See, e.g.*, Minton v. Cavaney, 364 P.2d 473, 475 (Cal. 1961) (noting that owners may be held liable for a corporate obligation "when they provide inadequate capitalization and actively participate in the conduct of corporate affairs").

words like injustice or inequity.[40] As used in the piercing cases, fraud can mean one of two things. It can be used in its technical sense as misrepresentation of fact intended to induce reliance. For example, the shareholders of a corporation may behave as if they are dealing in their own, individual capacity when in fact they are acting on behalf of a corporation enjoying limited liability. Or they may misrepresent the corporation's financial soundness in order to persuade a third party to extend credit. Actual cases of fraud do not require veil-piercing because the creditor can simply sue the responsible shareholders directly in tort.[41] More typically, the term fraud is used in piercing cases as a synonym for unfairness or injustice. These terms are not metaphors but they are too indeterminate by themselves to tell us much of anything about when courts will disregard the corporate entity. Rather, they are intended to express the idea that certain kinds of misconduct or wrongdoing justify forfeiture of limited liability. That is an important idea but the terms themselves are used in a conclusory manner and do not necessarily tell us anything about what kinds of misconduct or wrongdoing might have that effect.

What we have, then, is a fairly long list of factors that courts point to as justifying veil-piercing.[42] And we know, thanks to Oh (and Thompson), the frequency with which U.S. courts as a group claim to rely on them. But how much do we really know about the circumstances that are likely to give rise to a successful claim? Some of the factors are mere metaphors, standing in for factors that either have their own place on the list (e.g., failure to observe corporate formalities) or else make no sense (e.g., excessive shareholder domination). Others are reasonably determinate but either do not seem sufficient to justify shareholder liability (formalities again) or else refer to nonexistent legal requirements (undercapitalization). And then there is fraud, in the general sense of unfairness or injustice. Fraud in this nontechnical sense together with unfairness or injustice is especially important because it may actually express an idea that has relevance to the problem. Deployment of these factors may reflect the idea or at least the intuition that limited

40. *See, e.g.*, Co-Ex Plastics, Inc. v. AlaPak, Inc., 536 So. 2d 37, 38 (Ala. 1988) ("[T]he corporate form can be set aside, . . . even in the absence of fraud, as a means of preventing injustice or inequitable consequences."); Bartle v. Home Owners Coop., 127 N.E.2d 832, 833 (N.Y. 1955) ("[T]he doctrine of 'piercing the corporate veil' is invoked 'to prevent fraud or achieve equity.'" (quoting Int'l Aircraft Trading Co. v. Mfrs. Trust Co., 79 N.E.2d 249, 252 (N.Y. 1948))).

41. *Cf.* Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479, 517–19 (2001) (contrasting the tort of fraud or misrepresentation with corporate veil-piercing to argue that "[t]he questions veil piercing asks are the wrong ones, encouraging decisionmakers to focus on side issues," whereas "a standard of direct liability premised on fraud and misrepresentation asks the right questions and seems far more likely to lead to correct outcomes").

42. Some tests combine two or more factors. *See, e.g.*, Automotriz Del Golfo De Cal. S.A. De C.V. v. Resnick, 306 P.2d 1, 3 (Cal. 1957) ("[T]he two requirements . . . are (1) that there be such unity of interest and ownership that the separate personalities of the corporation and the individual [shareholder] no longer exist and (2) that, if the acts are treated as those of the corporation alone, an inequitable result will follow.").

liability can be abused in ways that justify its forfeiture. We still do not know, though, when that might be the case, unless courts actually tell us what the particular acts of unfairness or injustice are.

If the asserted rationales are actually uninformative, the real challenge is to figure out what kinds of facts really motivate courts to pierce the corporate veil. This would require a case-by-case reading of the facts of each piercing decision in order to discern just what it is that triggers the court's belief (or perhaps just intuition) that the corporation's shareholders have acted improperly. In another article I have tried to develop a theory that would justify veil-piercing in particular, definable instances of shareholder misconduct.[43] Reference is made to some of these ideas below.[44] Perhaps courts are relying on considerations like these in veil-piercing cases but leaving them unarticulated and citing standard doctrinal tags instead. Occasionally one finds an opinion in which a particularly thoughtful judge speaks about the limits of limited liability as I would, in terms of whether those in control of the corporation exercised their authority in a financially responsible manner, that is, with appropriate regard for future creditor claims; if the company ended up insolvent anyway, its shareholders should not be held personally liable.[45] Perhaps other cases are based on vaguer intuitions of a similar kind. Until we know what is really driving these decisions, however, we are not going to be able to predict when courts will pierce. Simply looking at the asserted rationales is not enough.

III. Veil-Piercing in Contract and Tort Cases

Perhaps the most widely noted of Thompson's findings was that courts were more likely to pierce in contract cases than in tort ones and that they did so much more often in contract cases.[46] Recasting the data in terms of voluntary versus involuntary creditors yielded similar results.[47] Oh also analyzes his dataset by distinguishing between cases brought by voluntary versus involuntary creditors.[48] He finds that courts pierce at a somewhat higher rate in cases involving involuntary creditors than in cases in which the

43. David Millon, *Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability*, 56 EMORY L.J. 1305 (2007).

44. *See infra* text accompanying notes 58–60.

45. In *Radaszweski v. Telecom Corp.*, the Eighth Circuit rejected a veil-piercing claim where the corporation's balance sheet was "anemic" but it nevertheless had purchased sufficient liability insurance (in excess of the federally mandated minimum) to pay the plaintiffs' claim. 981 F.2d 305, 308–09 (8th Cir. 1992). The court pointed out that liability insurance can support financial responsibility "just as well, perhaps even better, than a healthy balance sheet." *Id.* at 309. The fact that the insurance carrier was insolvent was deemed to be irrelevant because, at the time of the plaintiffs' accident, those in control of the corporation had no reason to anticipate that problem. *Id.* at 310.

46. Thompson, *supra* note 2, at 1058 tbl.9.

47. *Id.* at 1058 n.117.

48. Oh, *supra* note 1, at 139–44.

plaintiff's claim was based on a voluntary transaction (about 53% to about 48%).[49] To this extent, Oh revises Thompson's conclusions. Like Thompson, though, Oh also finds many more successful cases of piercing brought by voluntary creditors than involuntary ones (1933.5 to 627.5).[50]

The frequency with which voluntary creditors succeed in veil-piercing cases has troubled numerous commentators, especially when compared to the much smaller number of judgments in favor of involuntary creditors. Oh's finding of over three times as many cases of piercing by voluntary creditors presents the same challenge. Some simple assumptions underlie these misgivings. Persons who choose voluntarily to extend credit to a corporation know, because they are dealing with an incorporated entity, that their claims will have to be satisfied out of the corporation's assets. If those assets are insufficient, the shareholders' limited liability will shield them from personal responsibility for obligations that the corporation itself cannot satisfy. Because these transactions are voluntary, however, there is an opportunity for potential contract claimants to bargain ex ante about the risk of corporate insolvency. A lender, for example, can insist on compensation for this risk in the form of a higher interest rate. Or it can require that the corporation's shareholders personally guarantee its obligation. Suppliers of inventory can protect themselves with security interests. According to this view of the matter, there may be no reason for veil-piercing in contract cases in the absence of fraud. Creditors have already been compensated for the risk of corporate insolvency and piercing the corporate veil in effect gives them the benefit of a personal guarantee that they chose not to bargain and pay for.[51]

In contrast, tort victims, whose interactions with corporations are typically involuntary, have no ex ante opportunity to bargain with the corporation for protection from the risk of insolvency. Furthermore, limited liability for corporate torts creates a moral-hazard problem. Owners of incorporated businesses are encouraged to engage in risky behavior even where social costs exceed private benefits because limited liability protects them from having to internalize those costs fully; those that cannot be paid out of corporate assets are shifted to accident victims. These considerations

49. *Id.* at 141.

50. *Id.* at 141 tbl.14.

51. *See, e.g.*, David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1584 (1991) (noting that for debtholders "risk and potential loss have been simply transferred from the equity holder to the debtholder" such that "[t]he debtholder will correspondingly reduce the expected value of his investment, and demand a greater expected return"); Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 503 (1976) (highlighting that "the lender is fully compensated by the higher interest rate that the corporation must pay by virtue of enjoying limited liability").

have led scholars to argue that limited liability for corporate torts is inappropriate.[52]

Prior to Thompson's surprising findings, the apparent weakness of the case for veil-piercing in contract cases, combined with the problematic policy implications of limited liability for corporate torts, led commentators to assume that veil-piercing occurred less frequently in cases involving voluntary creditors.[53] The empirical data have proved these assumptions to be wrong. Critics have therefore pointed to the relative frequency of veil-piercing in contract cases as a strong reason for condemning the doctrine.[54]

Despite the conventional wisdom, why might courts pierce the corporate veil much more frequently in contract than in tort cases? And why might this actually make sense? One reason for the relative infrequency of veil-piercing in tort cases probably has to do with the relative infrequency of claims by tort as opposed to contract creditors. Small businesses typically enter into voluntary credit arrangements with an array of counterparties, including banks, suppliers of materials or inventory, employees, and private investors. Any of these creditors is a potential veil-piercing plaintiff if the corporation ends up insolvent. In contrast, even if most business activities involve at least some degree of risk that someone will be injured, such claims are probably still infrequent. So the universe of potential creditor claims based on tort very likely is significantly smaller than that consisting of voluntary creditors.

Veil-piercing claims may also be less frequent in tort because liability insurance facilitates payment of claims, even large ones, that the corporation would otherwise be unable to satisfy out of its own assets. Standard Businessowners Policies (so-called BOPs) include liability protection as well as property and business-interruption insurance.[55] In contrast, of course, contract liability ordinarily is not insurable. Insurance thus provides additional funds for tort creditors that are not available when a contract-based claim exceeds the corporation's financial ability to pay. Even if under-

52. *See, e.g.*, Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879 (1991). *See generally* Leebron, *supra* note 51.

53. *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 58 (1991) ("Courts are more willing to disregard the corporate veil in tort than in contract cases.").

54. *E.g.*, Bainbridge, *supra* note 41, at 512 n.159; 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, 859 (1997).

55. INSURANCE INFORMATION INSTITUTE, *What Does a Businessowners Policy (BOP) Cover?*, http://www.iii.org/articles/what-does-a-businessowners-policy-cover.html. Data on the frequency with which small businesses actually purchase BOPs and the typical limits of coverage are apparently not available. It seems likely, however, that advisors (such as lawyers and accountants) would encourage businesses to buy liability insurance, as would certain lenders. Even if veil-piercing is infrequent enough not to cause business owners to insure for that reason, the fear that a large tort judgment or settlement could render the corporation insolvent would still seem to provide a sufficient incentive.

insurance and coverage limits mean that insurance is not necessarily sufficient to pay all claims, tort creditors as a class would still appear to enjoy stronger protection vis-à-vis contract claimants and for that reason may be less likely to pursue veil-piercing claims.

Insurance is also important for another reason. Businesses that incur contract-based obligations must do so with an eye toward their ability to pay those debts in the future. This involves complex projections of revenue and expense in a business environment that is always inherently unpredictable. Getting it wrong may mean insolvency and default, a frequent phenomenon reflected in the high rate of small business failure.[56] In contrast, the availability of liability insurance makes planning for potential future tort claims much easier. Although judgments must be made about the amount of coverage, providing for the ability to pay future contract claims is still technologically more difficult than planning for potential tort claims. As to contract-based obligations, business owners are therefore more likely to make a mistake even if acting in good faith and therefore more likely to find themselves the target of a veil-piercing claim.

Once a veil-piercing claim based on a corporate tort has been filed, the presence of liability insurance may increase the likelihood that the court will refuse to pierce even if the policy turns out to be inadequate. This is because the purchase of liability insurance may be seen as an effort by the owners of the business to manage it responsibly, that is, with due regard for the costs of foreseeable accidents. Even if it turns out that the policy is insufficient to pay the claim, if, at the time coverage was purchased, the amount of the policy seemed reasonable in light of the likely risk, a court should still refuse to pierce. This is a case where limited liability serves a legitimate purpose, to protect business owners from the costs of corporate insolvency where they have attempted to manage the business in a financially responsible manner but are undone by unforeseeable events.[57]

In short, the likely smaller number of plaintiffs coupled with the availability of liability insurance could explain why veil-piercing is infrequent in tort-based cases in comparison to contract-based ones. The fact that limited liability for corporate torts is hard to justify from an economic perspective, because of the obvious moral-hazard problem, is of no relevance

---

56. *See* BRIAN HEADD, U.S. SMALL BUSINESS ADMINISTRATION, REDEFINING BUSINESS SUCCESS: DISTINGUISHING BETWEEN CLOSURE AND FAILURE 54 (2003) (reporting that approximately one-third of small businesses survive two years or more and only one-half survive four or more), http://www.sba.gov/advo/stats/bh_sbe03.pdf.

57. *See* Millon, *supra* note 43, at 1356–58 ("Without the limited liability shield, the possibility of a massive tort judgment—however remote—would lead prudent people either to overinsure or to decide against engaging in an otherwise profitable business venture."). In the well-known *Walkovszky* case, the court mistakenly concluded that purchase of the statutorily mandated minimum amount of liability was sufficient to defeat a piercing claim, even though the value of the policy was woefully inadequate to meet the foreseeable costs of operating a taxi cab business. Walkovszky v. Carlton, 223 N.E.2d 6 (N.Y. 1966).

here because the legislative judgment has been made that the social benefits—presumably in the form of business investment—exceed the social costs of uncompensated or undercompensated accidents. Instead, courts must look harder at the facts of each case and wrestle with the difficult question of the limits of limited liability for corporate torts. This should turn on the question of whether the business has been managed in a financially responsible manner, and the presence or absence of liability insurance will, I suspect, often be an important factor, even though it is not to be found on the standard laundry list of supposedly relevant considerations.

As explained above, the possibility of ex ante bargaining has led some to argue that veil-piercing is inappropriate in cases involving contract creditors. Leaving aside cases of deceit or misrepresentation, in which the creditor lacked relevant knowledge of risk, voluntary creditors can insist ex ante on compensation for the risks involved in dealing with a limited liability counterparty. Yet Oh has found over 1,700 cases in which courts have disregarded the corporate entity for the benefit of a contract creditor.[58] This number does not include claims based on fraud. How are we to make sense of this?

I have argued that piercing in favor of contract creditors is appropriate in cases in which the controlling shareholder has behaved opportunistically.[59] Opportunistic abuse of limited liability in the contract setting involves deliberate or reckless management of the corporation in a way that results in defeat of a creditor's legitimate expectation of reasonable provisions for payment of its claim.[60] The managers of the business may cause the corporation to assume indebtedness either with knowledge that repayment is unlikely or without having worked hard enough to determine whether repayment is likely to be possible. Or, they might borrow money to fund a project with expected value lower than cost because they know that, if the project fails, the lender's claim will be limited to corporate assets. Even if business owners have acted in good faith in assuming a credit obligation, they may thereafter take actions that have the effect of increasing the likelihood of corporate default. Asset distributions to shareholders or additional indebtedness reduce the corporation's equity and thereby put greater pressure on cash flows. If such actions increase unreasonably the risk of default on existing obligations, veil-piercing may be appropriate if the corporation ends up unable to pay those obligations.

Without limited liability, business owners would be unwilling to expose their personal wealth to creditor claims unless they were confident about the business's creditworthiness. They would be scrupulous in managing the

---

58. Oh, *supra* note 1, at 126 tbl.9.
59. For this discussion, see Millon, *supra* note 43, at 1342–46.
60. *Id.* at 1343.

business so as to minimize the possibility that they would have to reach into their own pockets to pay claims arising out of business activities. By shifting some of the cost of business insolvency to creditors, limited liability encourages owners to take greater risks, including risks that would otherwise appear to be excessive.[61] Limited liability should be limited to protection of shareholders whose corporations fail despite their reasonable efforts to manage the business in a financially responsible manner. It should not extend to those who use the limited liability shield deliberately or recklessly to impose costs on creditors that they have not agreed to bear.

Potential creditors have the opportunity ex ante to bargain for compensation for assuming the risk of corporate insolvency. Requiring them for that reason to bear fully the costs of corporate insolvency in all cases assumes that they either knew or should have ascertained the full magnitude of the risk they were taking on. Even if there is no deceit or misrepresentation, lenders might reasonably fail to investigate fully the borrower's ability to repay. For example, the business's track record of success may result in the lender overlooking potential future problems that would be hard to detect in any event. Furthermore, even if credit is priced appropriately at origination, corporate borrowers may thereafter engage in opportunism that lenders had no reason to foresee. An ironclad rule against piercing could lead lenders, aware of the risk presented by limited liability but uncertain as to its magnitude, to insist on excessive compensation. Moreover, the difficulty of determining ex ante whether a particular borrower is trustworthy or not may result in demands for compensation even from borrowers who intend in good faith to manage the business in a financially responsible manner. In other words, refusal to pierce even in cases of opportunistic abuse is likely to result in higher credit costs for all borrowers.[62]

The suggestion I am offering here is that piercing cases based on contract claims could reflect legitimate concerns about shareholder opportunism. In effect, the availability of veil-piercing puts courts in the position of having to distinguish between cases involving businesses that have been managed in a financially responsible manner and those in which shareholders have used the limited liability shield abusively. The factors pointed to by the courts—and analyzed by Thompson and Oh—do not reflect these concerns, or any other thoughtful effort to demarcate the appropriate limits of limited liability. To determine what is really driving the results in the piercing cases, it would be necessary to study carefully the facts of each

---

61. *See id.* at 1317 ("Limited liability is an important incentive because individuals will willingly take on the risk of business failure if their exposure to loss is limited to their actual investment.")

62. *See id.* at 1349–55 (explaining that refusal to pierce in such cases forces creditors to "factor the risk of opportunism into all of their credit pricing decisions").

case in order to identify the considerations that actually explain the result. Metaphors like "alter ego," conclusory references to injustice or unfairness, or irrelevant considerations like failure to observe corporate formalities serve as little more than window dressing for fairness or policy considerations that are rarely articulated clearly. That is the real reason for the general sense of dissatisfaction with the jurisprudence of veil-piercing. The courts may actually be getting it right at least some of the time, but we still do not know.

IV. Conclusion

Despite Oh's impressive contribution, we are still a long way from understanding what is really going on in the veil-piercing cases. Until courts develop a better sense of the policy basis for limited liability and its appropriate limits and begin to articulate those considerations forthrightly, we will continue to read decisions to pierce that are based on factors that are obscure or irrelevant. And we will continue to read commentary that mistakenly assumes the invalidity of veil-piercing in all cases based on contract claims.