NARROWING THE ROAD TO RECOVERY: A PROPOSAL TO TIGHTEN THE REINS ON THE DOCTRINE OF PIERCING THE CORPORATE VEIL

BY: LAUREN E. DOUGLAS*

I. INTRODUCTION

Limited liability is the pride and joy of the corporate form.[1] Most often, limited liability holds an investor's personal assets out of reach of an incorporated entity's creditors, thereby reducing the investor's personal exposure to corporate liability.[2] When applied to corporate groups (that is, a parent company and its subsidiaries "collectively conducting a business enterprise"), limited liability protects not only the investors from the debts of the enterprise, but also each of the subsidiaries within that enterprise.[3]

Situations may arise, however, where the limited liability enjoyed by corporate actors and subsidiaries is exploited for unfair or fraudulent business practices, thereby creating a judicial tension between recognizing a corporation's limited liability status and upholding fundamental notions of fairness. To resolve such tension, American courts developed the doctrine of piercing the corporate veil.[4] In essence, the piercing doctrine allows the court system to disregard a corporation's separate-entity status and hold equity investors and other related parties financially responsible for corporate debts in instances of fraud or misrepresentation by corporate actors.[5]

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* Wake Forest University School of Law, J.D. 2022; Finance, B.S. 2019, Endicott College. Managing Editor of the *Wake Forest Law Review*, Volume 56.3–57.2. Special thanks to Abigail Castaldi for her insightful suggestions on the initial draft, for Professor Alan Palmiter for introducing me to the world of corporate veil-piercing, and for the editors of the *Stetson Business Law Review*.

1. Christopher W. Peterson, *Piercing the Corporate Veil by Tort Creditors*, 13 J. BUS. & TECH. L. 63, 63 (2017).
2. *Id.* at 63-64.
3. Philip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573, 575 (1986).
4. Jonathan A. Marcantel, *Because Judges are Not Angels Either: Limiting Judicial Discretion by Introducing Objectivity into Piercing Doctrine*, 59 KAN. L. REV. 191, 195 (2010).
5. *Id.*

While piercing the corporate veil is among the most litigated issues in corporate law, it also remains one of the least understood.[6] The doctrine itself is cloaked in "misperception and confusion," and is a concept that American courts have grappled with for decades.[7] Despite this, the piercing doctrine remains the primary exception to limited liability and is a staple of corporate law that impacts virtually all aspects of business planning.[8]

State courts currently employ a wide range of murky tests to determine whether a case warrants piercing of the corporate veil.[9] Unfortunately, these tests, and their troubling lack of explanation, lead to confusion among legal scholars and inconsistency among state courts.[10] Even more troubling is the fact that courts consistently fail to distinguish between types of plaintiffs–specifically, between a plaintiff who is a voluntary contract creditor as opposed to an involuntary tort creditor (that is, a plaintiff that intentionally forms a relationship with the business versus a plaintiff who engages with the business purely by accident or happenstance, respectively).[11] Drawing a clear distinction between categories of victims is an important and often undervalued element of the analysis that, if considered, could provide an ounce of clarity to the piercing doctrine.[12] This Article aims to offer such clarity.

Part II provides an overview of the theory of limited liability, along with its benefits and drawbacks. Part III discusses the history and development of the piercing doctrine and offers insight into Delaware's view on the subject. Part IV analyzes the distinction between involuntary tort creditors and voluntary

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6. Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1058 (1990-1991).

7. Jonathan Macey & Joshua Mitts, *Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil*, 100 CORNELL L. REV. 99, 100 (2014).

8. Peter B. Oh, *Veil-Piercing*, 89 TEX. L. REV. 81, 90–91 (2010).

9. Speer, Denise L., Comment, *"Piercing the Corporate Veil" in Maryland: An Analysis and Suggested Approach*, 14 U. BALT. L. REV. 311, 311 (1985).

10. *Id*. Scholarly discussion also exists regarding the doctrine of piercing the corporate veil with regard to federal question litigation. However, this Comment focuses solely on piercing the corporate veil as it relates to state courts, and the term "courts" refers solely to state courts from this point forward. Piercing the corporate veil in the federal context is outside the scope of this Comment and will not be discussed further.

11. *See* Peterson, *supra* note 1, at 67 (recognizing that most courts apply the same veil piercing test in both tort and contract cases).

12. *See* David Millon, *Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability*, 56 EMORY L. J. 1305, 1317 (2007) (discussing a distinction between contract creditors and tort creditors). *See generally* Peterson, *supra* note 1 (same).

contract creditors and proposes that forming two groups of voluntary creditors–referred to hereinafter as "ordinary creditors" and "sophisticated creditors"–would pave a way for courts to solidify numerous aspects of the piercing doctrine once and for all. Ultimately, Part IV, and this Article as a whole, argues that sophisticated contract creditors should not be able to reap the benefits of piercing the corporate veil because they nearly always have a sufficient opportunity to protect themselves against risk of loss prior to contracting with the corporate actor. Part V furthers this argument by suggesting that courts should instead utilize the Uniform Fraudulent Transfer Act or equivalent to govern the recovery of sophisticated creditors. Part VI offers a brief conclusion.

II. THE THEORY OF LIMITED LIABILITY: A PRIMER

A fundamental principle of corporate law in the United States is that a business operating as an incorporated entity is legally recognized as being separate and distinct from its "creditors, shareholders, directors, and other constituencies."[13] The general result of such separateness is twofold. First, the corporation enjoys many rights similar to individuals, such as the ability to "enter into contracts; sue and be sued; be responsible for paying taxes[,] and complying with laws and regulations[.]"[14] In essence, the law tends to view the corporation as its own person.[15]

Second, the separateness between a corporation and its constituents exempts corporate shareholders from facing personal liability for debts incurred or torts committed by the corporation–a concept known as "limited liability."[16] Under the doctrine of limited liability, absent a personal breach of duty either in contract or tort, investors in a corporation, LLC, or other separate entity[17] are only liable for the amount of money they invest into the venture and are not liable for any other business obligation taken on by the

13. Macey & Mitts, *supra* note 7, at 104.
14. *Id.*
15. *Id.*
16. Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479, 480 (2001).
17. *Id.* It should be noted that this Article is limited in scope to limited liability and piercing the corporate veil as it relates to the corporate form. While the general concepts presented ring true for limited liability entities outside of the corporation, non-corporate entities, such as LLCs, LLPs, and LPs are bound by state laws that may have nuanced differences that those discussed here.

entity.[18] In other words, if a corporation fails, limited liability caps a shareholder's loss at the amount of money they invested—the investor does not lose *more* money; rather, he simply does not receive any *return* on his already-invested .funds.[19] This makes sense. If the law recognizes the corporation as its own person, it logically follows that the corporation itself is almost exclusively responsible for its own wrongdoing. Such limited liability is perhaps the most sought-after aspect of the corporate form and has been deemed the "hallmark" of corporate status.[20]

A. The History and Evolution of Limited Liability

Although the global origins of limited liability are not entirely clear, it is certain that limited liability in the United States began as a feature solely for "infrastructural projects" such as railroad development.[21] This narrow use expanded throughout the Industrial Revolution and, by the 1840s, most United States jurisdictions had adopted limited liability in some form.[22] Such adoption occurred enthusiastically, as states embraced the theory that limited liability would encourage investment and increase economic competition.[23]

Today, limited liability is a default rule and applies absent an agreement otherwise.[24] The Model Business Corporation Act ("MBCA")[25] provides that shareholders are not personally liable for corporate debts or actions unless the articles of incorporation expressly provide otherwise or if the shareholder becomes personally liable "by reason of [his] own conduct or acts."[26] This

18. Peterson, *supra* note 1, at 66.
19. Bainbridge, *supra* note 16, at 480–81.
20. *See* Peterson, *supra* note 1, at 63.
21. Marcantel, *supra* note 4, at 194.
22. *Id.*
23. *Id.*
24. Bainbridge, *supra* note 16, at 501. *See, e.g.*, MODEL BUS. CORP. ACT § 6.22(b) (2002) (providing for shareholder limited liability unless liability might be warranted by virtue of the shareholder's own conduct).
25. MODEL BUS. CORP. ACT (2002). The MBCA is a body of laws designed to regulate corporate affairs uniformly across different states. The majority of states have adopted the full MBCA as the basis of their own laws, though each state has modified the provisions to some extent. *See A Map of Model Business Corporation Act States*, PROFESSORBAINBRIDGE.COM (Nov. 04, 2013, 1:03 PM), https://www.professorbainbridge.com/professorbainbridgecom/2013/11/a-map-of-model-business-corporation-act-states.html.
26. Thompson, *supra* note 6, at 1042 (citing MODEL BUS. CORP. ACT § 6.22(b) (1985)).

means that "outsiders," such as banks and other lenders, can demand that corporate "insiders," such as shareholders, assume contractual responsibility for corporate obligations.[27] For example, commercial lenders often require that corporate contractors sign a personal guarantee before extending credit to closely held corporations.[28] However, absent such an agreement, the rule is that corporate participants are not personally liable for corporate obligations; in this case, the bank enters into a "nonrecourse relationship" with the insiders, limiting each shareholder's liability to the amount of investment.[29]

An argument can be made, however, that companies regularly stretch limited liability far beyond its original objective. For instance, in modern-day America, it is very common for companies to organize themselves in the form of a parent corporation with dozens of subsidiary corporations. In fact, multinational corporations with this structure conduct most of the world's business.[30] Corporations that employ this tiered structure have essentially manipulated limited liability to shield each tier of the corporate group, thus achieving layers upon layers of insulation for the parent corporation and opening the door for possible abuse of limited liability.[31]

B. The Benefits of Limited Liability

Limited liability has been "compared to that of a steam engine, and likened to the discovery of electricity" due to the laundry list of benefits that it presents to incorporated entities.[32] Limited

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27. *See* Merle F. Wilberding, *Tax Consequences of Shareholder Guarantees: There's Still Hay in Tulia Feedlot*, 6 WYO. L. REV. 165, 166 (2006) (indicating that personal shareholder guarantees of corporate obligations are "a way of life" for most privately-owned corporations).

28. ALAN R. PALMITER, CORPORATIONS 608 (8th ed. 2015). For readers not well-versed in commercial lending, a "personal guarantee" is "a legal contract requiring an individual – typically an officer or owner of the business borrowing money – to personally repay the loan in the event the business is unable to do so . . . ." Rebecca Lake, *Should You Sign a Personal Guarantee for a Business Loan?*, U.S. NEWS (June 3, 2019), https://loans.usnews.com/articles/should-you-sign-a-personal-guarantee-for-a-business-loan.

29. *Id.*

30. Blumberg, *supra* note 3, at 575.

31. *Id.*

32. Ron Harris, *A New Understanding of the History of Limited Liability: An Invitation for Theoretical Reframing* (March 28, 2020) (manuscript at 2), https://ssrn.com/abstract=3441083.

liability generally shields all investors equally, regardless of the amount of money invested, and regardless of whether the entity consists of one individual or millions of shareholders.[33] Perhaps one of the greatest benefits of limited liability is that it allows entities to aggregate large amounts of capital from numerous investors of all sizes, many of whom would be reluctant to risk their personal wealth if they might be held liable for corporate missteps.[34] As such, investors of all statures are enticed to invest in desirable yet risky businesses because their other assets remain protected.[35] Limited liability also allows recreational and sophisticated investors alike to build diversified wealth portfolios in a vast array of companies, thereby reducing their exposure to potential financial ruin.[36] Such protection therefore facilitates and encourages investments that would otherwise not occur, and acts as an extremely important driver of economic growth.[37]

Limited liability, specifically with regard to a shareholder's ability to diversify her portfolio, also facilitates management risk-taking.[38] Without limited liability, risk-averse or risk-neutral shareholders who throw all of their financial eggs into one corporate basket might discourage managers from undertaking projects that carry higher-than-average risk, even if the project ensures net positive returns.[39] As such, limited liability gives managers the green light to make risky business decisions in an effort to yield higher returns–a benefit to both the investor and the company itself.

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33. *See* Nellie Akalp, *Party of One: Setting Up Your Single-Person Corporation*, ENTREPRENEUR (Dec. 14, 2016), https://www.entrepreneur.com/article/283918 (discussing how a corporation can consist of a "board of directors [that] hold shareholder meetings" or "just one owner").

34. Peterson, *supra* note 1, at 63–64. *See also* Dane Shikman, Note, *A Risk-Based Approach to Limited Liability for Individuals and Corporate Parents*, 84 GEO. WASH. L. REV. 1104, 1105 (2016) ("[A corporation's] willingness to take investment risks often exceeds that of an individual, who might be loath to gamble his personal retirement account on a new business venture.").

35. PALMITER, *supra* note 28, at 608.

36. Peterson, *supra* note 1, at 64.

37. *Id.*

38. *See generally* Marcantel, *supra* note 4.

39. PALMITER, *supra* note 28, at 608.

C. The Drawbacks of Limited Liability

As no rose comes without its thorns, there are inevitable downsides to limited liability hidden beneath the attractive benefits discussed above. One substantial risk of limited liability is that creditors are often discouraged from extending credit to seemingly-unstable corporations.[40] A well-established principle of debt-versus-equity financing is that, in the event of corporate insolvency, debt creditors (i.e., banks and other financial institutions) receive repayment of their outstanding loans before equity investors can recover anything.[41] However, if a company has insufficient assets to repay a creditor in full, limited liability bars that creditor from recovering more than the corporation has to offer.[42] Since creditors must bear the loss if a corporation cannot fulfill its obligations, they might not feel comfortable investing in the corporation at all.[43]

Another significant, albeit intangible, drawback of limited liability is the risk of creating a "moral hazard";[44] that is, since management does not face the same scrutiny by shareholders as do managers in unincorporated entities, and since such shareholders themselves do not bear losses beyond initial investment, corporate individuals might comfortably pursue overly-risky business ventures or become disconnected with their moral compass in an effort to line their own pockets with gold.[45] For example, an investor in a cigarette corporation that does not bear the loss of individuals who die as a result of smoking might not care that he supports a company that sells deadly and addictive products so long as he receives a positive return on his investment.[46] In this sense, limited liability arguably allocates part

40. ALAN PALMITER ET AL., BUSINESS ORGANIZATIONS: A CONTEMPORARY APPROACH 337 (3d ed. 2019).

41. *See* Andrew Gellert, *Who Has Priority: a Shareholder or a Creditor?*, CHRON., https://smallbusiness.chron.com/priority-shareholder-creditor-75052.html (last updated Oct. 19, 2018) (explaining that "[t]he pecking order dictates that the debt owners, or creditors, will be paid back before the equity holders, or shareholders").

42. PALMITER ET AL., *supra* note 40, at 337.

43. *Id*. This result of limited liability seems to run counter to the states' goal of economic growth, but I digress.

44. Peterson, *supra* note 1, at 65.

45. *See* David L. Cohen, *Theories of the Corporation and the Limited Liability Company: How Should Courts and Legislatures Articulate Rules for Piercing the Veil, Fiduciary Responsibility and Securities Regulation for the Limited Liability Company?*, 51 OKLA. L. REV. 427, 439–40 (1998); Thompson, *supra* note 6, at 1040.

46. *See* Cohen, *supra* note 45, at 439–40.

of its risk to those outside the corporation, such as tort victims, small uninformed creditors, or innocent consumers, thus shifting the cost of doing business "away from the corporation and to other parts of society."[47]

The practice of reallocating risk can severely impact a number of outsiders. When a company invokes the principle of limited liability and engages in what is called "risk externalization," some other entity typically bears the costs on the other side.[48] Such costs impact parties that voluntarily contract with the business (such as suppliers, employees, and customers) as well as individuals who involuntarily become creditors of the entity (such as tort victims and uninformed consumers). Because risk externalization occurs in the case of "every transaction where parties are not in a practical position to negotiate credit terms,"[49] the term *involuntary creditors* often encompass many small trade creditors, consumers, and workers as well as tort creditors.[50] As such, corporations who unnecessarily externalize risks onto involuntary creditors (especially tort creditors) are acting outside the scope of behavior that limited liability exists to protect. Perhaps the biggest risk that stems from this is that corporate actors might use their limited liability shield to conduct shady or illegal behavior, and as a result, injure innocent outsiders along the way.[51]

In sum, limited liability aims to shield individual actors or investors from liability for the corporation's losses and to achieve certain social and public policy goals. However, when the costs of limited liability heavily outweigh its benefits–such as when it is used as a device to extract value deliberately or recklessly from or escape liability from third parties without consent or compensation[52]–the U.S. legal system owes it to creditors of all types to analyze whether to set aside the benefits of limited liability to allow for recovery beyond the corporate borders. Enter the doctrine of piercing the corporate veil.

47. Thompson, *supra* note 6, 1040.

48. Peterson, *supra* note 1, at 64. *See also* Blumberg, *supra* note 3, at 576 (recognizing that limited liability "raises serious problems" by allowing corporations to "externalize [their] costs").

49. Blumberg, supra note 3, at 576.

50. Thompson, *supra* note 6, 1040.

51. Millon, *supra* note 12, at 1307.

52. Millon, *supra* note 12, at 1307–08.

III. AN OVERVIEW OF CORPORATE VEIL PIERCING

While most often accepted as being separate and distinct from its shareholders, the corporation does not always shield shareholders from personal liability.[53] Though often not discussed in detail during the incorporation process, the risk of personal liability still looms in the shadows via the doctrine of piercing the corporate veil.[54] The piercing doctrine is thus a fundamental concept for any businessperson to understand.

Piercing the corporate veil is a judicially-created equitable doctrine that allows a creditor to disregard the separate corporate identity and forces shareholders to satisfy the entity's debts if the entity is unable to do so independently.[55] Notably, the doctrine itself is not a separate cause of action; a plaintiff generally cannot seek to pierce the corporate veil until the court finds the corporation liable for wrongdoing and cannot satisfy the judgment against it while maintaining its limited liability status.[56] The piercing doctrine aims to prevent corporate fraud and achieve justice in situations where allowing corporate actors to hide behind a shield of limited liability would be immoral.[57] As an equitable remedy, the doctrine has the power to do justice "by exercising discretion to mitigate the rigidity of strict legal rules" vis-à-vis the exclusion of limited liability protection when it would be grossly unfair not to.[58]

The judicial system's desire to ensure an equitable remedy in suspicious cases is in inevitable tension with the fundamental understanding that the corporation is an entity legally recognized as its own person.[59] As such, courts in all jurisdictions acknowledge that, in order for investors to feel comfortable relying on limited

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53. Speer, *supra* note 9, at 312.

54. *See* Douglas C. Michael, *To Know a Veil*, 26 J. CORP. L. 41, 42 (2001) ("What counsel does not wince when telling her client that liability is limited except in certain unspecified and unpredictable situations?").

55. Marcantel, *supra* note 4, at 195.

56. T. Richmond McPherson & Nader Raja, *Corporate Justice: An Empirical Study of Piercing Rates and Factors Courts Consider When Piercing the Corporate Veil*, 934 WAKE FOREST L. REV. 931, 934 (2013).

57. Peterson, *supra* note 1, at 68.

58. *Id.*

59. Thompson, *supra* note 6, at 1036.

liability when choosing how to allocate their money, piercing the corporate veil must be conducted reluctantly and cautiously.[60]

A. Development of the Equitable Doctrine of Piercing the Corporate Veil

As mentioned in Part II(A), jurisdictions across the nation enthusiastically adopted the concept of limited liability during the Industrial Revolution.[61] Over time, however, courts began facing situations where limited liability yielded inequitable results in cases where, morally, the corporation's liability shield should have been disregarded.[62] To combat inequities in judicial results, courts developed (or attempted to develop) the doctrine of piercing the corporate veil.[63] Veil-piercing law began as an application of equitable maxims but has subsequently diverged into messy state-specific tests.[64] Unfortunately, no reliable concrete analysis or general consensus has emerged over time; rather, veil-piercing law remains a murky free-for-all across jurisdictions. While courts uniformly agree on the doctrine's intended effect, a concrete pathway to victory has yet to be articulated.

In 1926, Justice Cardozo described the piercing doctrine as being "enveloped in the mists of metaphor."[65] Courts have enjoyed little progress since then, and commentators continue to criticize the doctrine's unruly process, describing judicial decisions calling for corporate veil piercing as "irreconcilable," "not entirely comprehensible," and "defy[ing] any attempt at rational explanation."[66] It is no surprise, then, that judges, lawyers, law students, and law professors have a complicated love-hate relationship with this doctrine.[67]

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60. *See* Maurice Wormser, *Piercing the Veil of the Corporate Entity*, 12 COLUM. L. REV. 496, 496 (1912) (emphasizing that piercing the corporate veil is not an "open sesame" concept that will always warrant disregarding the corporate form).

61. *See supra* Part II(A).

62. Marcantel, *supra* note 4, at 194–95.

63. *Id.* at 195.

64. *See generally* Sam F. Halbi, *Veil-Piercing's Procedure*, 67 RUTGERS U. L. REV. 1001 (2015) (discussing the various veil piercing procedures used by courts across the United States).

65. Thompson, *supra* note 6, at 1036.

66. *Id.* at 1037.

67. *See* Michael, *supra* note 54, at 41 (describing the complex relationship between the piercing doctrine and the legal profession).

B. Judicial Morals of the Piercing Process

While courts never disregard the corporate form lightly, cases do arise where the only equitable solution is to pierce the veil and impose individual shareholder liability. Since courts readily recognize that "the corporate veil exists for a reason," [68] conflicting policy considerations exist that make judges hesitant to pierce.[69] In this sense, the angel and the devil are hard at work on the courts' shoulders, narrating a serious judicial struggle between making a harmed plaintiff whole and upholding the hallmark of the corporate form.[70] On one hand, there is a strong policy argument for maintaining shareholder limited liability in order to promote capital growth and investment.[71] On the other hand, there is a competing judicial interest in serving justice in a situation where upholding the theory of limited liability would be inequitable.[72] Because of this tension, courts have yet to announce a black-and-white piercing test and instead rely heavily on the specific facts of each case.[73] In essence, the courts have merely outlined a gray, or even invisible, test left up to scholars to decode.[74]

C. The Muddle of Modern Veil-Piercing Analyses

While piercing the corporate veil is perhaps the most litigated issue in corporate law, it remains one of the least understood and often results in court decisions that appear confusing and incoherent.[75] In piercing cases, courts typically base their decisions on nothing more than "conclusory references to criteria of doubtful relevance."[76] Rather than concrete legal principles, judges hang

68. Cascade Energy and Metals Corp. v. Banks, 896 F.2d 1557, 1576 (10th Cir.1990).

69. Speer, *supra* note 9, at 313.

70. Ryan Bottegal, Comment, *Liberalizing Maryland's Approach to Piercing the Corporate Veil*, 42 U. BALT. L. REV. 821, 824–25 (2013) ("Since piercing the corporate veil is an exception to a primary reason for incorporating a business, 'courts addressing the issue are often caught between the conflicting goals of preserving the corporate entity and affording relief to the victim.'").

71. Speer, *supra* note 9, at 313.

72. *Id.*

73. Millon, *supra* note 12, at 1327.

74. *See* Speer, *supra* note 9, at 313 ("[C]ourts are often inconsistent in which factors are dispositive when confronted with a veil piercing case.")

75. *See* ROBERT C. CLARK, CORPORATE LAW 38 (1986) (describing veil piercing as "intellectually disturbing").

76. Millon, *supra* note 12, at 1307.

their hats on the uber-specific fact patterns of each case and on their own feelings of right and wrong.[77] Such practices result in caselaw that is largely reflective of the judges' personal opinions as opposed to their interpretation of the law.[78] Results are thus unpredictable, so much so that critics have emphasized unpredictability as a reason to abolish the doctrine altogether.[79] However, despite the fact that many critics turn up their noses at the courts' decision-making processes, there is a general consensus that judges deciding piercing cases nearly always reach the "correct" conclusion.[80]

Part of the headache surrounding the piercing doctrine is that each jurisdiction employs its own convoluted analysis of each case.[81] Courts take several approaches when describing a respective state's approach to piercing the corporate veil.[82] Some jurisdictions, including but not limited to, Illinois, Kansas, Maine, Massachusetts, and New York, have attempted to articulate the relevant factors that may be considered in piercing cases.[83] For example, Massachusetts courts have expressly articulated the laundry list of relevant factors that must be considered before applying the piercing doctrine.[84] In contrast, courts in other jurisdictions, such as Delaware, have merely recognized that piercing the corporate veil is "appropriate under some circumstances" but have not expressly defined what those circumstances are.[85] Nonetheless, cases in most instances seem to

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77. *See* Marcantel, *supra* note 4, at 198 (noting that most states permit trial courts to "consider, ignore, and weigh" different piercing factors as necessitated by case facts).

78. *Id.*

79. Oh, *supra* note 8, at 85 (citing, generally, Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479 (2001)). *See also* Douglas C. Michael, *To Know a Veil*, 26 J. CORP. L. 41 (2000).

80. *See, e.g.*, Macey & Mitts, *supra* note 7, at 103 ("[I]n our view, judges generally reach the correct results in the cases they decide.").

81. Marcantel, *supra* note 4, at 195.

82. Fredric J. Bendremer, *Delaware LLCs and Veil Piercing: Limited Liability Has its Limitations*, 10 FORDHAM J. CORP. & FIN. L. 385, 390–91 (2005).

83. *Id.* at 390–91.

84. *Id.* at 390. As interpreted by the First Circuit, under Massachusetts law, courts may consider many specific factors in a veil piercing analysis, including, among other things:

(i) common ownership; (ii) pervasive control; (iii) confused intermingling of business activity; (iv) insufficient capitalization; (v) nonobservance of corporate formalities; (vi) nonpayment of dividends; (vii) insolvency of the corporation at the time of transaction; (viii) siphoning of corporate funds by the dominant shareholders; (ix) nonfunctioning of officers and directors other than the shareholders; (x) absence of corporate records; (xi) use of the corporation for transactions of the dominant shareholders; and (xii) use of the corporation in promoting fraud. *Id.*

85. *Id.* at 391.

turn on whether the court sees the corporate defendants as "good" or "bad," and the fact-dependent question often appears to be whether the defendants abused the "privilege" of limited liability.[86] For a coherent analysis, it is helpful to break the unruly, tangled mess into more bite-sized pieces.

i. The First Prong: "Formalities"

To begin the veil-piercing analysis, courts typically look first at factors involving the defendant's compliance with corporate formalities–known by some as the "formalities prong" of the judicial analysis.[87] The formalities prong, which is also referred to as the control[88] or alter ego[89] prong, essentially requires the plaintiff to prove that a parent corporation and its subsidiary or shareholders have such a strong unity of interest and ownership that their "separate personalities" no longer exist.[90] The formalities prong is often analyzed using a number of factors that aim to determine whether a sufficient "unity of interest" exists between the actors, such that the business or shareholder has *no separate mind or will of its own* and is merely the *alter ego* of its parent.[91] Regardless of the language chosen by the court, a bright-line standard does not lie below.[92] A judge may consider as many as twenty factors, but is not limited to an exclusive or definitive list.[93]

Although the outcome from a piercing the corporate veil inquiry depend on the facts of each case, courts are more likely to pierce in cases that involve the following six situations: (1) closely-held corporations; (2) defendants that actively participated in the

86. PALMITER ET AL., *supra* note 40, at 334.

87. Peterson, *supra* note 1, at 71.

88. *See, e.g.*, Dombroski v. WellPoint, Inc., 895 N.E. 2d 538, 543 (Ohio 2008) (referencing Ohio's test as the "control" test).

89. *See, e.g.*, Perpetual Real Estate Servs., Inc. v. Michaelson Props., Inc., 974 F.2d 545, 548 (4th Cir. 1992) (applying a test referred to by the court as an "alter ego" analysis).

90. Peterson, *supra* note 1, at 71.

91. *See* United States *ex rel.* Landis v. Tailwind Sports Corp., 51 F. Supp. 3d 9, 62 (D.D.C. 2014).

92. *See* Bainbridge, *supra* note 16, at 506–07 (recognizing that language such as "alter ego" and "corporate dummy" yield no clarity in the analysis used by the court).

93. *See, e.g.* Assoc. Vendors, Inc. v. Oakland Meat Co., 26 Cal. Rptr. 828, 838–39 (Cal. Ct. App. 1962) (noting twenty potential factors); Laya v. Erin Homes, Inc., 352 S.E.2d 93, 98–99 (W.Va. 1986) (noting nineteen factors considered amid the totality of the circumstances).

business; (3) insiders that disregarded corporate formalities; (4) insiders that commingled business and personal assets for noncorporate use; (5) insiders that did not adequately capitalize the business; and (6) a company that deceived or misrepresented information to its creditors.[94] Unfortunately, little, if anything, is said about the weight given to each factor or about which ones are "necessary or sufficient" on their own to support a piercing result.[95]

Notably, courts *do not* pierce the corporate veil solely because a corporation is undercapitalized.[96] This finding is consistent with the fact that legislatures permit thinly capitalized firms to engage in business and generally do not hold adequate capitalization as a requisite to formation.[97] It is also significant to clarify that, even though closely held corporations have their veils pierced significantly more often than public corporations, being a closely held corporation, without more, is *not* sufficient for courts to disregard the corporate form.[98] This is because a public corporation typically has a high number of shareholders, which prevents the level of individual control required to justify a court's piercing of the corporate veil. In contrast, a shareholder in a closely held corporation is more likely to be actively involved with management and decision-making, thus giving them a greater opportunity at "pierceable" corporate control.[99]

ii. The Second Prong: "Fairness"

In the event a plaintiff is able to establish under the formalities prong that the defendant-shareholder had complete control over the corporation and that the entity was the mere "alter

94. PALMITER ET AL., *supra* note 40, at 354–55.
95. Millon, *supra* note 12, at 1327.
96. Macey & Mitts, *supra* note 7, at 103.
97. *Id.* Similarly, particularly in the LLC context, courts may be reluctant to use the failure to follow corporate formalities as a piercing factor for small corporations or LLCs because they typically do not have the organizational structure of an established corporation with meetings of directors and shareholders. *See, e.g.*, REVISED UNIF. LTD. LIAB. CO. ACT § 304(b) (2006) ("[T]he failure of a limited liability company to observe formalities relating to the exercise of its powers or management of its activities and affairs is not a ground for imposing liability on the member or manager for a debt, obligation, or other liability of the company.").
98. *See* Bottegal, *supra* note 70, at 825–26 (noting that, in theory, the limited liability doctrine "extends with equal force to all variations on the corporate form," but in practice, closely held corporations are exponentially more likely than publicly held corporations to have their veils pierced).
99. Millon, *supra* note 12, at 1315.

ego" of the shareholder, the court will then try to determine what is blameworthy about the defendant's use of that control–this is the "fairness" prong of the piercing analysis.[100] To do so, the judge combs through the particular facts of the case with an overarching theme of fairness in mind and asks whether it would be inequitable to the plaintiff to keep corporate limited liability intact.[101] In essence, the fairness prong reflects the idea that investors should not be allowed to "hide from the normal consequences of *carefree* entrepreneuring by doing so through a corporate shell."[102] As such, this prong most often requires a general determination of fraud, illegality, inequity, injustice, or some other wrongdoing by the corporate entity.[103] "Fraud," in the context of piercing the corporate veil, is used generally to mean bad faith or unfairness rather than strictly "deliberate dishonesty" intended to induce reliance.[104]

Despite a thorough analysis of both the formalities and the fairness prongs, it is still possible for a court to reach an unanticipated, seemingly convoluted result. This is because courts look heavily to the totality of the circumstances rather than to whether a certain number of boxes are checked on the veil-piercing scorecard.[105] Totality of the circumstances tests, unlike strict factor tests, allow judges to weigh all "known and relevant" information in light of all "known and conceivable circumstances."[106] Part of the murkiness surrounding the piercing doctrine is that the weight given to each factor remains a mystery.[107] Thus, while courts must at least review the various factors set forth in prior caselaw, judges are awarded significant discretion to consider any other "known and conceivable circumstances" relevant to the case at bar.[108] It follows that such significant discretion often results in caselaw rooted in personal opinion than in legal principle.

100. *See id.* at 1332–34; Peterson, *supra* note 1, at 71–72.

101. Peterson, *supra* note 1, at 72.

102. Labadie Coal Co. v. Black, 672 F.2d 92, 100 (D.C. Cir. 1982).

103. *See* Dombroski v. WellPoint, Inc., 895 N.E.2d 538, 543-44 (Ohio 2008) (discussing fraud, illegality, and injustice requirements); Nat'l Labor Relations Bd. v. Greater Kan. City Roofing, 2 F.3d 1047, 1052 (10th Cir. 1993).

104. Peterson, *supra* note 1, at 72–73.

105. Bottegal, *supra* note 70, at 825.

106. Peterson, *supra* note 1, at 74. A factor-based test, on the other hand, restricts the judge's discretion to only "consideration and balancing of a certain closed set of factors." *Id.* at 73.

107. Millon, *supra* note 12, at 1327; *see supra* Part III(C)(1).

108. Peterson, *supra* note 1, at 73-74.

D. Delaware's Take on the Piercing Doctrine

Because the state of Delaware is a powerhouse for corporate formation, this Article would be incomplete without analyzing how its courts apply the equitable doctrine of piercing the corporate veil. As a whole, Delaware is the state with the most robust collection of general corporate caselaw, which can be largely credited to the state legislature's efforts to create a flexible system that favors both managers and shareholders alike.[109] However, to the surprise of many, Delaware's caselaw surrounding piercing the corporate veil remains largely underdeveloped compared to that of other states.[110] In fact, Delaware's caselaw is so scant that some sources actually suggest looking outside of Delaware to best understand the piercing doctrine.[111]

To give credit where credit is due, Delaware has clearly recognized piercing the corporate veil as an appropriate equitable remedy.[112] Further, presumably because of the inherent complexity that accompanies piercing cases, Delaware requires all piercing suits to be brought "only in a court of chancery."[113] It has not, however, been transparent in defining the circumstances in which it will invoke the doctrine, though it is understood that piercing "may be effected only in the interest of justice."[114]

While robust caselaw touching all corners of corporate law is empowering, the reasoning behind Delaware's choice to hide its cards about the piercing doctrine might be simple. As mentioned, Delaware is a powerhouse for corporate formation. "More than 65 percent of all Fortune 500 companies and more than half of U.S. publicly-traded companies are incorporated in Delaware."[115] Delaware's laws are optimal for corporations in large part because of their "predictability and dependability" in both the judicial and

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109. STEPHEN B. PRESSER, PIERCING THE CORPORATE VEIL § 2.8 (2020–2021 ed. 2020).

110. *See* Bendremer, *supra* note 82, at 389.

111. *Id.* at 390-91

112. *Id.* at 391.

113. *See, e.g.*, Sonne v. Sacks, 314 A.2d 194, 197 (Del. 1973) (ordering the case to be transferred from Delaware's supreme court to its Court of Chancery); Hanna v. Baier, No. CV S12J-03-058 RFS, 2020 WL 391924, at *3 (Del. Super. Ct. Jan. 22, 2020) (same).

114. Bendremer, *supra* note 82, at 391.

115. Harvard Business Services, Inc., *Why Incorporate in Delaware?*, DELAWARE INC.COM, https://www.delawareinc.com/before-forming-your-company/benefits-of-incorporating-in-delaware/ (last visited Feb. 21, 2022).

legislative context.[116] In significant contrast, the piercing doctrine is the *furthest* thing in corporate law from predictable and dependable.[117] Delaware thus has an interest in leaving the waters of the piercing doctrine as uncharted as possible to maintain its seemingly pristine oasis of corporate paradise and to uphold the promise of limited liability as best it can.

I. TORT CREDITORS, CONTRACT CREDITORS, AND THE NEED FOR JUDICIAL REFORM

A muddled legal doctrine filled with ill-defined and boundless tests might be part of why so many plaintiffs try to pierce the corporate veil. The first step courts can take to uncoil the knots of the piercing doctrine is to uncross the paths of involuntary tort victims and voluntary contract creditors and provide each group with its own unique path to recovery. For clarity's sake, the most important distinction between these two groups is that contract creditors have an opportunity to evaluate the risks of interacting with the corporation and can subsequently protect themselves from potential harm before engaging with the corporation, while tort creditors do not.[118] Such differently situated plaintiffs require legal doctrines tailored to their specific condition, not a blanket approach resulting in a haphazard, often inappropriate application.

A. The Empirical Landscape of Piercing the Corporate Veil

In the early 1990s, Professor Robert Thompson analyzed roughly 1,600 Westlaw cases through the year 1985 involving the veil piercing issue in an attempt to give the piercing doctrine some shape.[119] Despite Thompson's reservations on judicial use of the information, courts and scholars regularly cite his findings, and attorneys use them to advise corporate clients.[120] Among Thompson's most important conclusion was that

116. *Id.*
117. *See* Michael, *supra* note 54, at 41 (describing the complex relationship between the piercing doctrine and the legal profession).
118. Oh, *supra* note 8, at 87.
119. Thompson, *supra* note 6, at 1044.
120. Oh, *supra* note 8, at 88.

misrepresentation, illegality, and fraud are the most predictive factors of when courts will allow parties to pierce the corporate veil.[121] Specifically, the corporate veil was pierced in 91.6 percent of cases where corporate misrepresentation was found, and in 85.3 percent of instances where parties comingled personal and corporate assets.[122]

Another one of Thompson's most valuable findings was that piercing occurred more often in contract cases (roughly 42.0 percent of the time) than in tort cases (roughly 31.0 percent of the time).[123] These results indicated that, contrary to the assumption that courts in piercing cases are more sympathetic to tort victims who cannot contract around their potential injury, courts actually decide to award tort creditors less often than contract creditors.[124]

Nearly two decades after Thompson published his study, no explanation for the "dominance" of veil-piercing for contract creditors versus tort creditors had emerged.[125] Some commentators opined that contract claims may simply be a stronger channel for getting piercing cases in front of a judge, while others viewed the findings as evidence of how poorly courts were handling the piercing doctrine.[126] In a search for clarity, Professor Peter Oh conducted a follow-up study in the late 2000s to determine exactly what the relationship is between voluntary creditors, involuntary tort victims, and the piercing doctrine. Professor Oh's study involved a wider timeframe than Thompson's and analyzed a total of 2,908 piercing cases.[127] His results confirmed many of Thompson's findings, including that the most successful veil piercing claims are rooted in fraud or misrepresentation and are supported by specific evidence of such conduct.[128] This helps solidify the argument that limited liability should not (and apparently does not) allow shareholders to behave opportunistically toward third parties, whether they be contract creditors or tort creditors.[129]

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121. PALMITER ET AL., *supra* note 40, at 335. This source articulates Thompson's results much more succinctly than his original study does and will thus be referenced for Thompson's additional findings.

122. *Id.*

123. *Id.*

124. Thompson, *supra* note 6, at 1059.

125. Oh, *supra* note 8, at 88.

126. *Id.*

127. *Id.* at 89.

128. *Id.* at 90.

129. Millon, *supra* note 12, at 1307.

However, in stark contrast to Thompson's findings, Oh's results indicated that tort creditors prevail more often than contract creditors–47.8 percent and 46.2 percent of all piercing cases, respectively–thus placing results back in line with intuitive thinking.[130] These figures raise the question of why piercing happens as often in contract law as in tort law. Some commentators suggest that commercial litigators realize that businesses often fail for reasons other than those that warrant piercing and are thus more selective of when to bring piercing cases, whereas a personal injury lawyer may bring a piercing claim as often as possible to satisfy his search for a deep pocket.[131]

B. A Closer Look at Tort Creditors (aka Involuntary Creditors)

Oh's findings indicate that involuntary tort creditors have an easier path to recovery under the piercing doctrine because of their inability to protect themselves from potential injury ahead of time.[132] While courts weigh equities in favor of piercing the veil for injured tort victims more often than ever before, courts have been slow to recognize the distinction between creditor types; most courts have only done so within the last thirty years.[133] Of course, the ability for involuntary tort creditors to recover under the veil piercing doctrine embodies the equitable principles of American law. Like tort claims against any type of defendant, judgments against corporations for tortious conduct can be very large and can very easily exceed the amount of assets a corporation can offer for recovery. Because of this, justifications for allowing tort plaintiffs to pierce the corporate veil are "found in the desire" to incentivize corporations to avoid injury-causing behavior or to allocate risks to those more able to bear them.[134] Moreover, since there is no element of consensual dealing between the plaintiff and the corporation, investors should not "be able to transfer a risk of loss or injury to members of the general public."[135]

130. Oh, *supra* note 8, at 90; PALMITER ET AL., *supra* note 40, at 358.
131. *See* PALMITER ET AL., *supra* note 40, at 358.
132. *See* Oh, *supra* note 8, at 90 (concluding that tort creditors recover via the piercing doctrine more often than contract creditors).
133. Peterson, *supra* note 1, at 66.
134. Michael, *supra* note 54, at 49.
135. Peterson, *supra* note 1, at 80.

Perhaps the biggest factor behind the courts' new treatment of tort piercing cases is the severe disconnect between the piercing doctrine and the definition of tort. As discussed throughout, and as proven by Oh, the most significant factor driving a decision to pierce the corporate veil is a showing of fraud, misrepresentation, or illegality.[136] However, "by definition, there can be no misrepresentation to, or reliance by, involuntary [tort] plaintiffs" in any setting.[137] As such, discussions of fraud, misrepresentation, and (arguably) undercapitalization should have no bearing on the analysis of recovery in piercing cases with tort victims because tort victims are completely disconnected from the corporation until an accident occurs.[138] Thus, inclusion of such factors in the analysis demonstrates just how dissociated the doctrine is from the circumstances surrounding its use and emphasizes its need for a judicial face lift.[139]

C. A Closer Look at Contract Creditors (aka Voluntary Creditors)

In contrast to tort creditors, contract creditors are parties who voluntarily contract for a relationship with the corporation.[140] The biggest distinction between a contract creditor and a tort creditor is that, unlike a tort creditor, many contract creditors often have ample opportunity to evaluate the credit risks and contract around potential injury with the corporation before forming a relationship with the enterprise.[141] This opportunity is arguably the single-most important advantage that voluntary creditors have over involuntary creditors. The overwhelming motivator behind the piercing doctrine was to protect contract creditors.[142] When a corporation engaged in fraud or misrepresentation, voluntary creditors were subsequently misled into believing a risk of default was lower than it truly was and thus unwillingly and unknowingly

136. *See supra* Part III(C)(1) and accompanying text.
137. Michael, *supra* note 54, at 49.
138. *See* W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 105 (5th ed. 1984) (noting that reliance is a quintessential element of an actionable misrepresentation).
139. As mentioned, as much as a lengthy argument about how a new piercing analysis is necessary for tort creditors, the scope of this Article is limited to why the argument for piercing in favor of sophisticated contract creditors is weak.
140. Marcantel, *supra* note 4, at 199.
141. Millon, *supra* note 12, at 1316.
142. Peterson, *supra* note 1, at 78.

carried such risk.[143] Piercing the corporate veil became an equitable way to reallocate the risk back to the corporation's shareholders in events of fraud or misrepresentation.[144] However, not all contract creditors are created equal, and the judicial system has reached a point where the piercing doctrine would benefit from recognizing some distinctions.

i. The Distinction Between "Ordinary Creditors" and "Sophisticated Creditors"

Because limited liability is designed to externalize the risk of corporate insolvency that shareholders would otherwise bear themselves,[145] the piercing doctrine exists to reimburse creditors (tort and contract alike) for the costs incurred from the unjust allocation of risk.[146] One category of such costs stems from the often imperfect information available to parties like banks and suppliers when deciding whether to pursue a contractual relationship with a corporate entity.[147] Contract creditors might inaccurately gauge the risks of transacting business with a corporation, either due to misrepresentations made by the company or because the creditor lacks access to information found in credit reports or other documents.[148] Additionally, a significant imbalance in bargaining power might preclude the contracting party from obtaining valuable information and from negotiating things like shareholder guarantees or security interests before signing on the dotted line.[149] For these reasons, it is equitable to allow such creditors to recover under the piercing doctrine if things go awry.

Some commentators argue that contract creditors should not be able to pierce the corporate veil at all, based on the theory that

143. Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 112 (1985).

144. Peterson, *supra* note 1, at 78.

145. Millon, *supra* note 12, at 1316.

146. Easterbrook & Fischel, *supra* note 144, at 112.

147. *See* Alan Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630, 632–33 (1979) (explaining that one justification for legal intervention is that consumers cannot contract in their own interest without the necessary information to make the best decisions).

148. Elizabeth S. Fenton, *Trends in Piercing the Corporate Veil*, 20 BUS. TORTS LITIG. 10, 10 (2013).

149. Robert B. Thompson, *Piercing the Veil: Is the Common Law the Problem?*, 37 CONN. L. REV. 619, 631 (2005).

they can always obtain a personal guarantee ahead of time.[150] While logical at its roots, this statement is overbroad because not all contract creditors are created equal.[151] Voluntary creditors can range in size and sophistication from an individual citizen who buys concert tickets at a corporation's venue to an enormous international banking firm. Of course, larger, more sophisticated contract creditors have greater resources available than individual contractors do for a pre-signing risk analysis.[152] Because of this, it is illogical to make an all-or-nothing determination about whether *all* contract creditors *as a group* should be able to pierce the corporate veil. Rather, it is appropriate to make an initial distinction between what this Article refers to as "ordinary creditors" and "sophisticated contract creditors."

For purposes of this Article, an "ordinary creditor" is a contract creditor that lacks adequate resources to limit its contractual risk and is thus vulnerable to being victimized by corporate fraud or misrepresentation (like the consumer who buys concert tickets from a corporation's venue). Because of this, ordinary creditors deserve the power to pierce the corporate veil if necessary. In contrast, a "sophisticated creditor" is a contract creditor that has ample opportunity and resources to protect itself from risk ahead of time via steps like a credit check or personal guarantee. Examples of sophisticated creditors include banks, commercial real estate companies, and large suppliers. In essence, for purposes of this Article, sophisticated creditors are ones who, frankly, should have known better than to contract with a corporation absent sufficient protection and thus do not deserve the ability to recover under the piercing doctrine.

It is important to address a potential counterargument to the distinction between ordinary creditors and sophisticated creditors. While it is technically possible for an ordinary creditor to require a personal guarantee or adequately research the company to avoid potential losses, it is simply not a viable requirement to impose on ordinary creditors. The biggest reason for this is the incredibly

150. PALMITER ET AL., *supra* note 40, at 358.

151. *See* Michael, *supra* note 54, at 47. (referencing a commentator's view that "[t]he sheer breadth of this [veil-piercing doctrine] renders it almost totally useless").

152. *See generally, e.g.*, WILLIAM A. KLEIN & JOHN C. COFFEE, JR., BUSINESS ORGANIZATION AND FINANCE 142 (8th ed. 2002) (describing large entities such as banks, lenders, and large suppliers as capable of analyzing corporate risk and obtaining personal guarantees but making no mention of this ability with regard to smaller creditors).

unequal bargaining power between the corporation and the ordinary creditor,[153] such as someone who buys a concert ticket at a venue that subsequently shutters its doors. While the individual is technically a voluntary creditor, her ability to obtain a personal guarantee on her concert ticket is an infeasible expectation that would just result in the corporation making an "if you don't like the contract, don't sign it" ultimatum—and the corporation would win every time.[154]

Additionally, the fact that piercing occurs exclusively against closely held corporations makes it completely impracticable to require ordinary creditors to obtain credit reports and other corporate documents.[155] Unlike public companies, private companies are not required to file financial statements or other formal documents with the Securities and Exchange Commission ("SEC"), so the type of information accessible on public companies is not necessarily available for private companies absent some serious, potentially expensive digging.[156] As such, it is impracticable to expect an ordinary creditor to conduct such extensive, lengthy, and tedious research every single time she buys concert tickets or orders an item from Amazon.[157]

It is largely for the foregoing reasons that recognizing a distinction between ordinary creditors and sophisticated creditors makes great sense when navigating the choppy waters of the piercing doctrine. While the storm still roars regarding how to clarify the doctrine for involuntary tort victims, adopting separate standards for ordinary and sophisticated creditors would part the clouds in the voluntary creditor context. Therefore, the nuanced

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153. *See* Thompson, *supra* note 152, at 628 (discussing how unequal bargaining power can significantly disadvantage a weaker party from obtaining information necessary to fully eliminate contractual risk).

154. In contrast, instead of a "take it or leave it" ultimatum, a sophisticated creditor, such as a large supplier of goods, could simply raise its prices to reflect the increased risk of contracting with the company or demand a security interest on the contract. *See* Roger E. Meiners et al., *Piercing the Veil of Limited Liability*, 4 DEL. J. CORP. L. 351, 361 (1979) (recognizing that "market conditions force [an individual or other type of contract creditor] to pay a price for limited liability").

155. *See* Oh, *supra* note 8, at 86 ("[Robert] Thompson found that veil-piercing claims succeed[] 40.18 percent of the time, and exclusively against close corporations.").

156. *Doing Company Research: U.S. Private Companies*, LIBRARY OF CONGRESS, https://guides.loc.gov/company-research/private (last visited Dec. 14, 2020).

157. In addition, separating creditors into groups based on incorporation status is equally as impracticable because, as noted, corporations can be thousands of people large or one person small. *See* Akalp, *supra* note 33 (discussing how a corporation can consist of "a board of directors [that] hold shareholder meetings" or "just one owner").

argument asserted herein is that *sophisticated* contract creditors, such as commercial lenders, real estate companies, and large suppliers, should be barred from recovery under the doctrine of piercing the corporate veil absent incredibly rare circumstances.

ii. The Argument Against Piercing the Corporate Veil through Sophisticated Creditors

After distinguishing ordinary creditors from sophisticated creditors, the argument that sophisticated creditors should be barred from recovery via the piercing doctrine emerges clearly from the shadows. The argument itself is quite simple: sophisticated creditors have the ability, "through [requiring] personal guarantees, security agreements, diversification, or similar mechanisms," to protect themselves from potential losses or misrepresentation when contracting with a limited liability entity.[158] More specifically, sophisticated creditors who knowingly contract with limited liability entities can factor the limited liability status into their analysis of things like appropriate interest rates, personal guarantees, security interests in assets or company stock, or contractual provisions that limit the corporations' freedom to "engage in conduct that would increase the risk of default" on their contracts.[159] Because of this ability, sophisticated contract creditors can better gauge the risk of loss than ordinary creditors and tort creditors can.[160]

Since the sophisticated creditor is almost always able to adequately protect itself, it follows that it should not be entitled to recover under the doctrine of piercing the corporate veil. Allowing such recovery provides the sophisticated creditors with a do-over at their botched transactional effort—a concept that goes entirely against the fundamental purpose of a contract.[161] In essence, this is a type of "you made your bed, now lie in it" approach: to the extent a sophisticated creditor passes up its chance to protect its

158. Cascade Energy & Metals Corp. v. Banks, 896 F.2d 1557, 1557 (10th Cir. 1990).

159. Millon, *supra* note 12, at 1316.

160. *See* Easterbrook & Fischel, *supra* note 146, at 112.

161. *See* Stephanie Faris, *What is the Importance of Contract to a Business?*, CHRON (March 25, 2019), https://smallbusiness.chron.com/importance-contracts-business-906.html (stating that a contract is intended to be a binding recording of party expectations and consists of various protections put in place by each party to mitigate risk).

own interests before executing a contract, it assumes the risks of dealing with a limited liability entity.[162]

A case demonstrating such treatment of sophisticated creditors is *Theberge v. Darbro, Inc*.[163] This case was decided in 1996 by the Maine Supreme Judicial Court and still reflects the state's approach to piercing cases with regard to well-situated contract creditors. In relevant part, Plaintiff-creditors alleged that defendant-businessmen were guarantors of notes payable on a sale of real property, and sought to pierce the corporate veil to collect the debt from the corporate officers.[164] Plaintiffs contended, and the trial court determined, that the corporate veil should be pierced because one of the defendants falsely represented that he was "a person of financial substance" who would stand behind the obligations of the contract.[165] However, the Supreme Judicial Court ultimately reversed, finding that defendants did not act "illegally or fraudulently," but rather conducted themselves "shrewdly" and "employed sharp business practices."[166] Importantly, the Court dubbed the plaintiffs as "sophisticated real estate professionals who understood the significance of a personal guarantee" and determined that, since plaintiffs were fully aware that the documents neither released them from liability for, nor personally obligated the defendants on, the payment of the mortgage, there was no basis for piercing.[167] In other words, the plaintiff-creditor should have been more careful and taken adequate steps to protect its financial interests.

Despite the logical approach outlined above, a predictable counterargument against barring sophisticated creditors from invoking the piercing doctrine is that they should still be able to pierce the veil in instances of fraud, illegality, or misrepresentation. However, this argument holds little water. As discussed in Part V below, even without piercing the corporate veil, sophisticated creditors have numerous other doctrines and statutes to utilize if they wish to bring a claim for fraud or misrepresentation and thus are not harmed if the confusing,

162. *See* Bainbridge, *supra* note 16, at 501 ("[T]he creditor ought to lose because it assumed the risk of doing business with an individual who chose incorporation [and decided not to protect itself beforehand].").

163. Theberge v. Darbro, Inc., 684 A.2d 1298 (Me. 1996).

164. *Id.* at 1299–300.

165. *Id.* at 1301.

166. *Id.*

167. *Id.*

abstract piercing doctrine is removed from their arsenal of recovery.

II. THE UNIFORM FRAUDULENT TRANSFER ACT: AN ALTERNATIVE STATUTORY ROAD TO RECOVERY FOR SOPHISTICATED CONTRACT CREDITORS

The prohibition of creditors from using "sham transactions" to hide their assets from creditors is a concept "as old as Roman law" and was codified in England's Statute of Elizabeth in 1571.[168] Today, it is codified in America's Uniform Fraudulent Transfer Act ("UFTA").[169] Originally completed in 1918 and revised in 1984, the UFTA is a model code that provides a creditor "with the means to reach assets that a debtor has transferred to another person to keep them from being used to satisfy a debt."[170] In other words, it is a remedy by which voluntary contract creditors can recover against corporate debtors that participate in fraudulent business practices without invoking the common law piercing doctrine. All but seven states have adopted the UFTA in some form.[171]

While completely disconnected from the piercing doctrine, the UFTA helps explain many of the piercing factors, as well as whether they are (or are not) relevant to a particular case.[172] The UFTA defines certain debtor transactions as "fraudulent" and

168. PALMITER, *supra* note 28, at 684.

169. UNIF. FRAUDULENT TRANSFER ACT (UNIF. L. COMM'N 1984). While other doctrines, such as the doctrine of fraudulent conveyance and the doctrine of equitable subordination, also exist to protect the interests of creditors, they are more applicable to the bankruptcy context and are therefore outside the scope of discussion for this Article.

170. *Fraudulent Transfer Act*, UNIFORM LAW COMM'N, https://www.uniformlaws.org/committees/community-home?CommunityKey=4226ae7c-91c0-4ce9-b488-8520dbc39ea3#:~:text=The%20Uniform%20Fraudulent%20Transfer%20Act,the%20Uniform%20Voidable%20Transaction%20Act (last visited Dec. 15, 2020). In 2014, the UFTA was revised to include a few "narrowly-defined issues" and was renamed the Uniform Voidable Transfer Act. *Voidable Transactions Act Amendments – Formerly Fraudulent Transfer Act*, UNIFORM LAW COMM'N, https://www.uniformlaws.org/committees/community-home?CommunityKey=64ee1ccc-a3ae-4a5e-a18f-a5ba8206bf49 (last visited Dec. 15, 2020). Because these changes have only been adopted by a handful of states, this Article will base its analysis on the 1984 version of the UFTA. *See id.*

171. UNIFORM LAW COMM'N, *supra* note 173. The seven states who have not yet adopted the UFTA are Alaska, Louisiana, Maryland, New York, South Carolina, Vermont, and Virginia. *Id.*

172. *See* PALMITER, *supra* note 28, at 686 ("In [light of the UFTA] it is easier to see the relevance of corporate formalities and the intermingling of corporate and personal assets or affairs in deciding piercing cases. Disregarded formalities provide indirect evidence of fraudulent transfers and intermingling may provide direct evidence.").

allows creditors with viable claims to void such transactions or seize the property fraudulently conveyed by the debtor.[173] The UFTA and the piercing doctrine both consider some of the same factors to find fraud.[174] Notably, when it cannot be shown that the debtor is purposefully avoiding its creditors, the UFTA deems transfers by the creditor as "constructively" fraudulent if they are for amounts of questionable value or threaten the debtor's ability to pay its other debts as they become due.[175] Both doctrines also create implicit duties for corporate participants (similar to fiduciary duties[176]) that require them to place a creditor's expectations ahead of their own interests.[177]

Due to the stark similarities between the UFTA and the piercing doctrine, a reasonable question lingers: why have courts not replaced the incoherent, ambiguous piercing doctrine with the UFTA or state equivalent?[178] The answer, while acceptable to some, leaves something to be desired. Supposedly, there are many difficulties involved in invoking the UFTA, such as the fact that fraudulent transfer law relies on a creditor's ability to identify specific transactions conducted by the debtor that give rise to fraudulent activity, rather than just arguing fraud as the outcome.[179] Specifically, under the UFTA, a creditor must demonstrate that a particular transaction falls into at least one of three categories of fraudulent transfers: (1) any transfer the debtor made with the "actual intent to hinder, delay, or defraud" present or future creditors; (2) any transfer for which the debtor does not receive "reasonably equivalent value" in return; and (3) any transfer that leaves the debtor with "unreasonably small" assets in relation to its actual or expected business needs, or that the debtor knew or should have known would result in insolvency.[180]

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173. UNIF. FRAUDULENT TRANSFER ACT §§ 4, 7 (UNIF. L. COMM'N 1984).

174. *Id.* § 4. *See also* Bendremer *supra* note 82, at 390.

175. PALMITER, *supra* note 28, at 685.

176. *See* Kat Tretina & Benjamin Curry, *How Fiduciary Duty Impacts Financial Advisors*, FORBES ADVISOR, https://www.forbes.com/advisor/investing/what-is-fiduciary-duty/ (last updated May 14, 2021, 11:37 AM) (describing a fiduciary duty as the requirement of certain professionals to act solely in the beneficiary's best interest, mainly through the duties of care and loyalty).

177. PALMITER, *supra* note 28, at 686.

178. Since there are seven states that have not adopted the UFTA, the state equivalent takes the place of the UFTA in this analysis. UNIFORM LAW COMM'N, *supra* note 173.

179. *See* UNIF. FRAUDULENT TRANSFER ACT § 4(a) (UNIF. L. COMM'N 1984) (requiring a creditor indicate where a transaction leaves a corporation with "unreasonably small" capital or that lack "reasonably equivalent value.").

180. *Id.*

Concededly, it could be difficult for a creditor to pinpoint all transactions that defrauded her or left the debtor's business with unreasonably small capital if, for example, corporate records are sketchy, sloppy, or not kept at all. The broader piercing doctrine avoids such problems of proof and has greater "deterrent and compensatory force."[181] However, limited liability is such a cornerstone of the corporate form that a creditor–a sophisticated creditor, at least–seeking to hold shareholders personally liable should be required to prove its case in some particular form rather than allowing judges to rule based on emotion and opinion. Thus, prohibiting sophisticated creditors from recovering under the fluid piercing doctrine and instead requiring them to jump over the UFTA's hurdles is a fair solution that welcomes a structured and transparent court analysis. The solution also provides a balance between the prestige of limited liability, a sophisticated creditor's ability to protect itself *ex ante* (or failure to do so), and the court's ability to set limited liability aside in a constricted set of tangible circumstances.

Another purported shortfall of applying the UFTA in piercing cases is that fraudulent transfer law focuses on the "shady" actions of corporate participants rather than on the creditor's understanding of the transaction.[182] In particular, the UFTA focuses on the actions of business insiders rather than on the issues of "confusion" and "deception" as perceived by creditors, and thus might not detect some cases where the debtor's deception led the creditor to contract with the debtor with limited or faulty information.[183] However, this argument is nullified by implementing the proposed distinction between ordinary creditors and sophisticated creditors.[184] Per the distinction, sophisticated contract creditors all have an ample opportunity to conduct pre-relationship research, require personal guarantees or security interests, and add contractual provisions to best protect themselves from the risk of loss. Thus, the argument that the UFTA is inadequate because it focuses less on less-powerful creditors is irrelevant and moot.

In short, adopting the distinction between ordinary and sophisticated creditors invalidates the arguments against limiting

181. PALMITER, *supra* note 28, at 686.
182. *Id.*
183. *Id.*
184. *See supra* Part IV(C)(1).

sophisticated creditors to recovery under the UFTA. While there are a number of supposed difficulties intertwined with the UFTA—many of which are applicable with regard to ordinary creditors—the UFTA nonetheless provides sophisticated creditors with a fair and concrete road to recovery as opposed to the abstract, insubstantial doctrine of piercing the corporate veil.

III. CONCLUSION

Since its inception, the American judicial system prides itself on the ability to ensure the predictable and consistent administration of justice.[185] The doctrine of piercing the corporate veil embodies the exact opposite characteristics, resulting in a completely unpredictable analysis that is often not rooted in law regardless of the test or language used by the courts. While a general distinction exists between involuntary tort victims and voluntary contract creditors, courts almost always implement the same so-called "analysis," regardless of who the plaintiff is. Not only is this approach outdated, but it just adds fuel to the unruly fire that is the piercing doctrine.

Ultimately, the doctrine of piercing the corporate veil needs some serious modernization and stabilization. To provide clarity to the murky doctrine, courts must recognize two different subsections of contract creditors: ordinary and sophisticated. Because ordinary creditors lack the ability to adequately gather information and add contractual provisions protecting themselves from potential losses, this group should retain the legal ability to invoke the piercing doctrine if necessary. In contrast, sophisticated contractors have sufficient resources to contract around risk, require a personal guarantee, and obtain information about the corporation, so they should be barred from recovery under the piercing doctrine and should instead be limited to the more concrete system of the UFTA—a clear, unbiased, emotionless route of recovery. While not explicitly stated, this distinction appears to already be recognized in Maine via its decision in *Theberge v. Darbro, Inc.* in 1996.[186] More states should follow this lead to provide some stability in the doctrine and provide another layer of

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185. *See The Judicial Branch*, THE WHITE HOUSE, https://www.whitehouse.gov/about-the-white-house/the-judicial-branch/ (last visited Dec. 10, 2020).
186. *See* Theberge v. Darbro, Inc., 684 A.2d 1298 (Me. 1996).

safety to the corporate construct that is limited liability. Only then can we untangle the unruly web of judicial veil-piercing.